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STABILIZATION AND FOREIGN ECONOMIC POLICY IN HUNGARY

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The set-back in the Soviet-Hungarian trade in 1991 can be attributed to the switch-over to US dollar settlement, the political chaos, the collapsing economy, the currency problems and the fall in supply in the SU. Therefore, Hungarian economy cannot rely on the Soviet trade as a stabilizing factor. The authors take their stand on export orientation and system of tools and means of liberalization in foreign economy, they reject shock therapy and urge a gradual development of convertibility. They deem reasonable that the government wants to fully meet its dept service. Yet, stabilization of domestic economy cannot happen without Western undertaking of obligations to a larger extent, and stopping withdrawal of net resources.

As can be seen from the Hungarian government's economic programme published last April and the ensuing debates, a consensus has been reached in Hungary. This consensus, ostensibly or actually, concerns the trends of the external economic strategy the country must follow. The major political trends and the economic schools equally underline the need to open towards the world economy and they emphasize that, as part of this opening, the geographical reorentation and liberalization of the external economy must also be accomplished. Similar views have also been voiced with regard to the strategic aims of the country's joining the European Community and the need to support the influx of foreign direct investment. Finally, save some extremist political and economic views, nobody has questioned the fact that if the country wants to stay afloat, it must continue to honour its debt service obligations. As a consequence, it has been agreed in general, although varying in firmness, that the country must follow an export-oriented (or "export-led") economic policy.

However, from the different economic programme conceptions and from the various debates, it can also be seen that while on the surface there seems to be a consensus over the above issues of the external economy (and over its other issues as well—especially over those that concern the tasks of the near future) the existing views conceal a high degree of divergence. Below, we expound our views and proposals concerning some of these issues. Although we believe that the long-term foreign economic strategy cannot be separated from the short-term tasks, our point of departure will be the situation in the spring of 1991 and in the major part, we are going to discuss the short-term tasks. First, we analyze the most critical point in this context—i.e. the situation and prospects of the Hungarian–Soviet economic relations. This is followed by an analysis of the problems in Hungary's cooperation with those smaller Eastern European countries that have also started out towards a market economy. Next, we discuss general external economic policy issues, in first place the "philosophy" of the foreign economic opening. We examine what type of therapy is necessitated by the current problems,—is it "shock therapy" or a gradual therapy that promises to be the best cure? In this context, we discuss import liberalization and export-orientation and the role of foreign direct investment. Finally, we touch upon the much-debated issue of debt management.

Reorientation and the Hungarian–Soviet economic relations

The changeover to dollar accounting *had been preceded* by significant structural realignment in the Hungarian external economy. In 1990, parallel with the forced decline of the rouble exports, there was a dynamic increase in the dollar exports in the manufacturing industries. This greatly contributed to achieving a record surplus in dollar trade. At the same time, however, it also resulted in a decline of rouble exports, that dropped to 30 percent of total exports. Within this, exports to the Soviet Union fell below 20 percent. Although at this stage we do not yet know each of the components of this process, it can clearly be seen that the originally Soviet export-oriented Hungarian companies turned out to be much more capable of reorienting their trade than had been expected.

In 1990, the Hungarian government policy toward Soviet–Hungarian trade was rather ambiguous. It wavered greatly over the question of priorities: i.e. whether to give priority to balancing trade or preserving of the market (reducing the decline to the minimum). In the final months of 1990, the latter concept became prevalent, and as a result, a several hundred million roubles surplus on Hungary's balance sheet was accumulated. Although this amount can be converted into dollars, it is not a claim that can be redeemed in the short term. This is a warning signal in spite of the fact that, as has been claimed by the government—apparently not without justification—stricter limitation on exports might have resulted in bankruptcy for many Hungarian companies which had already been struggling with difficulties. Independently of the January 1991 changeover, the current situation is a clear warning. In other words, we have to realize that the Hungarian economy will not be able to escape from the trap-situation of its turnover with the Sovier Union unless, instead of steps taken in the bilateral trade, it creates and supports conditions for a reorientation of trade relations. The developments that characterized Hungarian foreign trade in 1990 and in early 1991 clearly indicate that this solution is not illusory.

The developments that have been taking place since the beginning of 1991—characterized by the emergence of the several-year-old dilemma (albeit in a new form)—make this warning especially timely. As is well known, the changeover to dollar settlement in Hungary—just as in the rest of the former Comecon countries—

has not been a smooth process at all. Since the Soviet partner does not open letters of credit (L/C), the Hungarian exporters are unable to deliver their goods. This affects them seriously—all the more so because the goods in question were produced under earlier civil law contracts. On the other hand, the governments repeatedly held out the prospects of an improvement in Soviet solvency (the opening of letters of credit and the lifting of restrictions on trade. On the other hand, it has been giving accounts for initiating such financial constructions that would bridge over the liquidity problems of the Soviet Union. In addition, the government took measures to give temporary assistance to Hungarian export companies whose existence looked likely to be threatened by the present situation.

Insofar as the current problems in Hungarian-Soviet relations can be traced back to short-term financing difficulties (more exactly to a delay in the introduction of a new financing system in the Soviet Union due to technical reasons) there is a justification for short-term financial constructions that help the exporter to overcome temporary financing problems. The government should, however, continue to refrain from making any promises or hints that might induce the companies to make an open choice in the belief that their eventual losses would be reimbursed by the government.

We must emphatically state this because the *underlying problems of the Soviet attitude are not primarily related to short-term difficulties of the changeover.* The problems are much more fundamental. In the short-term (and probably also in the medium-term) one must, at any rate, reckon with total political and economic uncertainty in the Soviet Union. This means, among other things, that the question of authority in the Soviet external economy is as yet unsettled (e.g. among central organs, republics, companies). Moreover, there is no guarantee that the Soviet side will actually fulfil its trade or financial contracts, no matter at what level these contracts were concluded, and no matter when they were concluded. On the basis of the grim experiences of the last months we should not take the alternatives raised on the discussion at their face value. Among the real economic conditions that have been directly affecting Soviet–Hungarian trade, we must single out first of all the decline of the energy production and the deterioration of the transportation infrastructure. It must also be taken into account that in 1991, the insolvency of the Soviet Union raises an acute danger. The danger of the collapse of the Soviet economy is further aggravated by the Soviet Union's complicated political relations with the West and by the dwindling willingness of the West to grant the Soviet Union aids or credits. Consequently, the Hungarian government's *priority should be to encourage market reorientation* and, as a priority field of export orientation, it should work out credit constructions in order to promote reorientation. The exporter (and importer) must be made to realize that, due to the current and perspective situation in the Soviet Union, their position can be secure only if they manage to make efficient sales (purchases) in the international market. The government must realize that *any concept that* in the years to come *wants to base the*

stability (revitalization) of the Hungarian economy on the expected stabilization and increase of Hungary's trade with the Soviet Union, is doomed to failure from the start. Therefore, in connection with Hungarian activities in the Soviet market, the government should refrain from giving any kind of encouragement, political support or promise for those who intend to conduct export (or import) business with the Soviet Union. Special care should also be taken to avoid a situation in which the potential exporters mistake something as a protective shield when in fact it is not. Statements by government officials in November and December 1990 gave the impression that the inter-state agreements that were established at that time could serve ***as a guarantee*** for bilateral trade in 1991 and that an entry on the Soviet indicative list would mean that the Soviets were going to pay.[1]

However, the government should make it possible for all those who want to trade with the Soviet side at their own responsibility and risks, and who undertake to shoulder all the burdens and risks of collecting their exports incomes, to do it at their own discretion without being hindered by any superfluous limitations.

The above interrelations must also be taken into consideration when assessing the relevance of such solutions which plan to solve the Soviet partner's liquidity problems with some kind of *clearing scheme*—perhaps financed by a third party.

Following the changeover to dollar accounting, the Soviet Union concluded convertible currency payment agreements with some of the Eastern European countries, while with others, it introduced bilateral dollar clearing accounting. Poland, which belongs to the convertible currency group, has been struggling with the same difficulties as Hungary: the lack of solvency of the Soviet Union. Moreover, to indicate that the existing problem affects a much wider circle than the former Comecon countries, we can mention that Finland which changed over from clearing to convertible currency accounting with the Soviet Union, is expecting a 50 percent decline in its trade with the Soviet Union. (ETLA, 1991) In the cases of Czechoslovakia and Bulgaria, which changed over to some kind of clearing accounting with the Soviet Union, the problems are caused by the fact that the system is not working "because of the lack of interest of the Soviet companies".[2]

On the basis of the above, at least two conclusions can be drawn. Firstly, no one should think that the existing problem is a specific one, characterizing Soviet–Hungarian relations only. Therefore, it would be illusory to expect that, lacking a general solution of the problem, one can find specific ways of external financing that might cure the liquidity problems of the Soviet–Hungarian trade *separately*. If there is any chance of external financing at all and if the potential participants

[1] The indicative list includes products whose delivery is guaranteed by the governments of the two countries using their own means. (*M. Zs.* 1990)

[2] *Szalontay* 1991. As the author points out: "Of course, the Soviet producers are trying to hide from the clearing those of their products that can be sold for free currency. Also, if they are not delivering their goods, there is nothing to collate on the bank accounts."

show any interest, even then the only solution that can be thought of is some kind of multilateral solution. However, we consider such conceptions neither properly funded nor desirable—among other things because a system like this would tend to restore the long-outworn elements of Comecon and, under such circumstances, when the collapse of the Soviet economy *ab ovo* pulled the ground from under the feet of the old structures.[3]

Secondly, the clearing solution would change the problems on the surface only, while in essence, the problems would remain the same. In the case of establishing a clearing system, the direct limitation to Hungarian exports would not be the Soviet partner's failure to open letters of credit, but its failure to deliver goods. Under such circumtances, it would be the Hungarian government that would be forced to limit the exports. This would entail essentially the same macro-economic effects that Hungary has to face in the present situation. On the basis of press reports, it has become unambiguously clear that the Soviet side has so far refused (in its talks with Poland and Hungary) solutions which provide a framework for the settling of the clearing balances in convertible currency in the foreseeable future. This makes us to realize that an eventual clearing solution—presuming a sound economic policy—would be no solution to the current problems (the collapse of exports). From Hungary's point of view, the only alternative to the limitation of exports would be the continuous increase of the clearing trade surplus.

Clearly, the main lesson of the Hungarian–Soviet economic negotiations of 1991 is that nearly two billion dollars of Hungary's short-term claims cannot be collected for some time to come. The economy is simply not in a situation to endure any further increase in this figure. Consequently, Hungary's backing down on the convertible currency accounting would be a mistake. Instead, it would disorient the economy.

In stating this, we do not mean of course, that we should not seek, in the *framework* of the free-dollar payment systems such means of transaction that might spare us paying cash. However, we must realize that this is not an easy task because, among other things, the barter trade is, for the time being, restricted by the Soviet side (despite countless promises to lift the ban on it).

Therefore, schemes where no cash is involved can be used only in a very narrow field of trade. Besides, it is also clear that these schemes can hardly offset the unfavourable effects of the changeover on Hungary's balance of payments, because in the future the Soviet Union is going to supply energy and raw materials only for actual hard currency payment.

Since the Hungarian government has only a limited scope for maneouvre in shaping the trade, its tasks include, first of all, to prevent disorientation and to assist the reorientation of the Hungarian companies.

[3]With regard to problems of the Eastern European Financial Union-type schemes see Köves (1991) *Csaba* (1991).

Towards a post-Comecon integration?

We assume that it can be clearly seen from the above facts that any external economic policy that intends to continue preferential treatment of the former Comecon countries, including *also* the Soviet Union, must be avoided. The facts listed above also explain that Hungary's economic policies, declared or implicit, are in conflict with plans of a "new type" of Eastern-European integration that would include the Soviet Union as well.

Cooperation with the smaller former Comecon countries that have already taken significant steps towards the change of their economic systems is a different case.[4] In this context, the Budapest–Visegrád summit involving Hungary, Czechoslovakia and Poland might have signalled the start of welcome political progress after earlier reluctance. This is beneficial even if no concrete economic agreement of any significance emerged from the summit. Economic cooperation among the above-mentioned countries (and open to other countries as well) must be encouraged both for political and economic reasons, in two fields: *on one hand*, the free trade (duty-free trade) among the three countries may somewhat lessen the decline in their trade in the wake of the changeover to dollar accounting and, later on, it may become a factor of economic development by way of promoting economies on scale. *On the other hand* it may help institutionalize joint government-level policies. This would widen the possibilities for external economic diplomacy when it comes to enforcing national interests.

However, we also call attention to the fact that this cooperation has limitations as well. This includes—beside the known economic situation of the three countries and the limited success by the three in introducing market economies—the fact that they have comparatively little weight in foreign economic relations of each other. Trade among the three countries makes up for less than 10 percent of their total foreign trade. Consequently, their cooperation is *not strategic* in nature: their most important markets, external financing and technological development sources are *outside* the tripartite cooperation. The small share in each other's trade can, of course, be traced back to historical reasons as well. However, the primary reason is the past cooperation within the Comecon, which was radial in nature, i.e. the smaller countries developed their relations mainly with the Soviet Union. Many barriers have already been dismantled and are still being dismantled. Yet it must also be taken into consideration in the future that *integration among countries* at a level of medium-stage development, as is the case with the three countries, has many limitations: the primary interest of these countries is to develop relations with the most advanced region (regions) and, as a consequence,

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[4] This question is discussed in detail by the already mentioned works of Köves (1991) and Csaba (1991). See also: *Illés and Szegvári* (1991).

they will subordinate their relations between each other in order to further this interest.

Foreign economic policy and regulation

With regard to the *general* course of foreign economic policy, we think it should have two major objectives.[5]

The policy of opening towards the world economy and liberalization of exports and imports must be continued. This policy should set the goal of achieving the convertibility of the forint (in relation with the items on current account). This cannot be achieved immediately, but it should not be delayed to the distant future either (i.e. it should be planned for 1993–94).

On the other hand, the export orientation should be given basic priority in economic policy. This means that both the *strategic* and the shorter term macroeconomic decisions should be judged on the basis of whether or not they benefit the growth of exports.

Objectives and limitations

Concerning the first goal, our reason for calling this a decisive point of departure for economic opening is that in the case of a small and structurally open economy like Hungary's, *no viable* market economy can exist if this openness is not accompanied by an open trade policy and by opening also in the institutional sense. The foreign goods, market conditions and their changes must be allowed to exert direct influence on domestic production. This is inevitable in order that the participants in the economy be able to act or to make decisions with a view to strengthening the country's foreign economic position. The steps taken in the direction of external economic opening and the introduction of convertibility may serve the establishment of these very conditions.

In this context, we must also draw attention to the fact, however, that these steps might involve serious dangers for both the macro- and the micro-economy in the short term. Steps taken hastily or without the proper weighing of all the factors involved, or without creating the means and institutions for the protection of the economy during the transition, may lead to a situation in which the extensive liberalization of the economy involves heavy costs to the country: higher inflation

[5] The more the external conditions and framework of Eastern trade approach the conditions in the trade with the West, the more sense it will make to talk about general foreign economic policy.

and/or a greater economic decline than otherwise would be the case. Moreover, it may involve the danger that steps taken in the direction of external liberalization thus far will have to be withdrawn at a later stage. If the participants of the economy were cheated by withdrawing the steps toward liberalization, it will be very difficult to rebuild the confidence necessary for liberalization of the economy. Without this, no policy of opening can be conducted and convertibility cannot be achieved.[6]

The other point of departure is the export *orientation*. In the years to come, Hungary can expect economic growth only if it increases exports, and this entails multiplying effects. Those conceptions that want to revitalize the economy by increasing domestic demand (tax reduction or large-scale investment programmes) are inevitably inflationary and/or would worsen the country's external balance. It is only an expansion of exports that can revitalize the economy and put a brake on the decline in the short-term. However, accelerating inflation and the increase of inflationary expectations entail serious limitation for the policy of export expansion and, especially, for its instruments.. One of the internationally accepted means of stimulating export is the devaluation in real terms of the currency, a method that has proved efficient in many cases.[7] Devaluation, however, is a strongly inflationary method and its efficiency depends on the success of other instruments of macroeconomic policy, e.g. those of monetary and fiscal policies. As long as the latter do not work efficiently and inflationary expectations strengthen, the devaluation of the national currency may have very short term real effects, while strongly contributing to inflation.

Shock-therapy or a gradual approach?

Speaking about the limitations to be coped with in the realization of the dual goal, one cannot circumvent a basic question. This question is treated as a fundamental issue and is also dealt with in the international literature on economic transformation in Central Europe: would it be better to overcome the difficulties of external economic opening and export orientation with a once and for all, single big leap (package of measures)? The package would include a big devaluation of the currency, stringent measures in the monetary and fiscal policy and a strong and centrally-controlled wage policy. This is what is usually called "shock-therapy".

[6] Despite considerations of diplomacy, it is advisable to declare the convertibility of the forint only after the conditions have been established for the liberalization of currency purchase by households. In this regard there is no consensus thus far. For different arguments, see the answers given to a poll conducted by *Külgazdaság*. (January 1991)

[7] Real devaluation means devaluation that surpasses the difference between domestic and external inflation. Henceforth, by "devaluation", we mean real-devaluation.

According to many experts, as a result of these steps the country's currency could become convertible at once, the export orientation of the economy could be achieved practically overnight and, at the cost of considerable price hikes—often called the "ultimate price hikes"—the spirale feeding inflation would be broken and price stability would be created.[8] However, it is highly questionable whether these latter expectations are well-grounded, partly because of theoretical considerations and partly because of pratical experience, e.g. the Yugoslav and Polish examples. (*Kolodko* 1991) Without doubt, the quick introduction of convertibility, immediately followed by export expansion, is not an impossible task, as can be seen in the case of Poland. Similarly, it is also true that technically this is a very simple task: economic policy makers have nothing to do but introduce some harsh measures as part of the package and then wait for the outcome.

We, however, consider this conception dangerous and illusory. Although this is far from being widely accepted in Hungary, yet it re-emerges again and again in newer forms, claiming that with a single, well-designed package of measures, the past can be wiped out, a new leaf can be turned and the country can get rid of the economic burdens and structural ills it has inherited. According to this concept, convertible currency, stable prices and vigorous export incentives will create the conditions for the country's economy to be revitalized and for economic growth to start. This conception promises that, instead of "fussing" with things—i.e. instead of a gradual process that is uncertain in its outcome and has several barriers—it can extricate the country from the mud with a couple of firm moves. There is no doubt that this conception has a certain intellectual appeal. Moreover, it can easily become a political slogan if it is presented in the proper wrapping. In fact however, by enforcing a conception like this, immediate and heavy burdens would be placed on society. At the same time, there are no guarantees, either in theory or practice, that the "big leap" would bring along *permanent* results. Even if such guarantees existed, the basic question would remain: are the dangers, burdens and costs (including the danger of political destabilization) proportionate with the expected benefits? The answer is a definite no. Any hasty opening towards the world economy (i.e. the quick introduction of convertibility) could be achieved only at the cost of a larger than necessary economic decline and a significant increase in

[8] The "shock-therapy" conception, related to the current transformation in Eastern Europe, is attached first of all to the name of Jeffrey *Sachs* (1991). Despite considerable disagreement over the details, several authors, belonging to the mainstream of western economic thinking, consider shock-therapy justified concerning the change of the economic system in Eastern Europe. (See, e.g. *Dornbush* 1990.) In his work *Kornai* (1990) proposes a single operation in Hungary to put a brake on inflation. The immediate introduction of convertibility was proposed by Ferenc *Rabár* (see, e.g. his answers in *Külgazdaság* poll, referred to above.) Shock therapy can equally refer both to the stabilization and liberalization of the foreign economy, although the former does not necessarily imply in the latter. Since, however, in Poland the objective was to solve both at one time, literature does not always distinguish clearly the two interpretations of shock-therapy.

the number of unemployed. A big devaluation would lead to general price increases and, at the same time, the wage controls, aimed at preventing an inflationary spiral might lead to a considerable decrease in real wages. Therefore, in our view, the Hungarian economy and society does not need more shocks, because shocks come even when uninvited—for example in the wake of the introduction of the dollar accounting among the former Comecon countries and in the wake of the economic collapse of our Eastern partners. Instead of shocks, Hungarian society needs new economic institutions, wider possibilities and, last but not least, time in order to be able to adopt to the new circumstances.

Therefore, in our view, Hungarian economic policy should choose a more reasonable and politically more acceptable way to open towards the world economy. This is a more difficult, more circumstantial process than the shock-therapy. It would, however, progress firmly and, in the meantime, it would weigh up the chances for success without foregoing the complicated tasks of regulation.[9]

The conditions and means of opening up

The concept of "gradual progress" rests on the assertion that one cannot change overnight the system of institutions, the operation of institutions or the attitude of the participants of the economy; this can be done by a gradual approach only.

The gradual approach in the field of *import liberalization* first of all means that the short-term goals should include: maintenance of the level of import liberalization reached so far. This year, however, we must reckon with serious problems in import liberalization. The introduction of dollar accounting among the former Comecon countries is expected to pose serious dangers for import liberalization from the aspects of the macro-economy and the external balance. However, beyond the macro-economic effects, the fact that the share of liberalized imports increased from 65 percent last year to 80 percent (or from 30–40 percent to over 70 percent as compared to industrial production), involves serious risks for the micro-economy as well. This is because the participants of the Hungarian economy have been exposed to the competition of foreign products on a wide scale and within a short period of time. This possibly places a great number of Hungarian producers in an extremely difficult situation when competing with foreign rivals. The consequences of this situation will surely raise demands for restoring administrative methods for controlling imports. It is very important, however, that the Hungarian economic policy should avoid any attempts to counter-balance the difficulties emerging in the micro-economy in the wake of the import liberalization by way of restoring the

[9] From among writings supporting the gradual approach, we see F. *Levcik* (1991) and *Bokros* (1991).

system of permits and licences. Instead, the economy should use means that conform with market forces, and should take protective measures pre-set for a period of time, and should declare, right at the introduction of these measures, when they are expected to be eased. The most convenient from among these measures is the introduction of *temporary duties*. However, should this term conflict with internationally accepted usage, imports which threaten to hamstring the competitive, or at least potentially competitive, production should be regulated by gradually decreasing "surcharges". (Oblath 1991)

As a matter of fact, the administrative import restrictions were lifted in Hungary without being replaced with market means that could exert their influence through the price system. In this regard, the process used in Hungarian import liberalization is entirely different from the one used by the developing countries that have started out on the path of *external economic opening*. In the majority of these countries the initial stages of the opening to the outside world consisted of the "tariffication" of the former administrative restrictions. The actual liberalization process meant the gradual dismantling of these tariffs. In Hungary, the stage of "tariffication" has been entirely sidestepped. Therefore, the correct economic policy response to the problems emerging in the micro-economy in the wake of the import liberalization is not that the companies affected should individually and immediately find out how to adapt for themselves. In our view, a company in trouble must be given both the opportunity and time to adapt to the new conditions. A temporary increase of import tariffs to protect their production if needed, should serve this very purpose. Similar problems have surfaced in connection with *the handling of the exporters* as well. Although, in the course of the past few years, the economy has managed to eliminate nearly all subsidies that conflicted with international norms, this was done without introducing internationally accepted and widely used means to support the exports. As a consequence, Hungary's export conditions may turn out to be worse than the former situation and, what is even more worrying, the position of Hungarian exporters may weaken against their foreign competitors.

As mentioned above, in the current situation, it would be a mistake to introduce exchange rate policy which benefits the exporters alone, i.e. exchange rate policy directed at real devaluation. This is because it might have an all-out inflationary effect and, rather sooner than later, would create an unfavourable situation for the exporters themselves as well. Therefore, the correct target for the exchange rate policy is not to allow the real devaluation of the Hungarian currency, i.e. prevent the distribution of the domestic incomes in a way that would hit the exporters.[10]

[10] In his article Riecke *Werner* (1991) expounds an opposing standpoint, that puts into the foreground the anti-inflationary role of exchange rate policy.

However, this in itself is not enough. The exporters should be granted favourable treatment as regards both the conditions of exports credits and the support to current exports and export oriented investments. This should be done the same way as it is done by other countries to support their own exporters in their competition with us. Moreover, in the present critical situation, when structural changes and the acceleration of reorientation is especially important, there is good reason for using state resources to support the exporters. Although in supporting the exports, there is no solution that would be equally good and beyond all criticism, it is a fact that all countries encourage their exports, one way or another. Hungary, strongly in need of expanding its exports, has no reason to refuse its exporters the support that is internationally accepted.

Foreign direct investment

The effects of foreign direct investment (FDI) are, in part, micro-economic in nature and are linked with the healthy structural transformation of the economy. As is well known, FDI has a favourable influence on the infrastructure, the technological level, the quantity and composition of the domestic supply and, what is especially important, on the export capacity of the economy.

However, here we focus on its effects on the macro-economy.

In the years to come, Hungary will have to make annual foreign debt service payments between 3.5 to 4 billion dollars (which amount to 13–15 percent of the country's GDP in 1989). Out of this sum, the interest alone amounts to around 1,6 billion dollars (6 percent of the GDP of 1989). If interest payments were covered exclusively by the outflow of internal resources (from the commodity and service trade surplus) then this would place nearly unsurmountable obstacles for economic development. This is due to the fact that in 1991 the GDP is expected to decrease by at least as much as the proportion of the foreign interest payments. At the same time economic growth in the coming years will not, even in the most optimistic forecasts, approach the proportion of the interest expenses.

Under such circumstances, it would be a self-destructive policy to increase the net resource transfer abroad, but it would also be damaging to increase indebtedness abroad—not to speak about the external obstacles to such a policy.

Therefore, in the coming few years, the key question concerning the handling of the macro-economic process will be, whether Hungary will be able to increase the proportion of FDI to an extent that this item can cover at least a major part of the foreign interest payments of the country's debts. If Hungary manages to achieve this, then it will be able to handle the macro-economic process. If not, the country must face difficulties in managing its debt. Debt management problems will be discussed in some detail in the next section.

We must briefly refer to the concerns related to FDI. According to these, the influx of capital may lead to profit repatriation—that is, a large-scale withdrawal of income. For the time being, however, there are no facts to support these fears. In 1991, the repatriation of incomes from Hungary amounted to only 24 million dollars, while the influx of FDI totalled 500 million dollars. It is important to note that direct foreign investments have tremendeous advantages over financial credits. Namely, profits can be repatriated only if the investment is really profitable, while in the case of bank credits and bond issues interest must be paid even if these yield no profit. With regard to regulations concerning foreign direct investment, we call attention to three important points. Firstly, the decision upon sectoral preferences seems to be neither rational nor effective, as international experience has already shown. Any approach that wants to link the preferences to direct foreign exchange earnings of the FDI is mistaken. In Hungary, one of the biggest obstacles to widening exports is the underdeveloped state of the services, the trading and banking systems. Thus, foreign investments in Hungary into these branches may contribute to the expansion of exports through their secondary effects.

Secondly, the current irrational practice of providing tax allowances, in addition to reinvested profits also to the profits that are transferred to the home country will have to be modified. Thirdly, and most important of all, it is not specific regulations but the improvement of the general economic climate, the development of market institutions and of the infrastructure and the unhindered operation of these that can increase the influx of direct investment. From regulation, the only thing that can be expected is that it should not hinder this process.

Debt management

As mentioned in introduction, there is a general consensus in Hungary that in order that the economy stay afloat, it is imperative to continue to honour debt service obligations.

In essence, this policy rests on a *dual system of reasoning.* On the one hand, there are arguments according to which Hungary, due to external conditions, *has no chance* for debt relief. On the other hand it *must not* reach the situation when, parallel with an announcement of insolvency, its debts would have to be rescheduled.[11] The latter is supported by general economic considerations, and references can be

[11] By the term "debt relief" we understand such reductions by the creditor, declared or informal, that reduce the sum of the due debt repayment and/or postpone it to a later date; or, as part of such measures, the fulfilment of the debt repayment is eased with additional loans. As will be seen later, we asssume that in the case of Hungary today, it cannot be excluded—mainly because of international political reasons that such a situation emerges where the declaration of insolvency will not be an inevitable precondition for debt relief.

made to the grim experience of countries that have been forced to ask for rescheduling of their debts. The former statement is based on Hungary's experiences in the past eighteen months. It can be clearly seen that the hopes attached to western aid have proved to be illusory. After the political change, the western banks and governments did not become more generous than before. On the contrary, they became more tight-fisted. They have refused to listen not only to requests concerning debt relief, but they have made everything conditional on the IMF (on agreements with the IMF and their observance) including the support that had been promised in the framework of cooperation of the Group of 24.

On the other hand, this system of reasoning also suggests—explicitly or sometimes implicitly only—that as regards the domestic economy, there is *no need to ease the debts*. Without the disciplinary effects of the IMF, the country would be unable to conduct a restrictive monetary policy, the budget expenditures could not be cut back, inflation could not be kept under control and the economic restructuring would get struck.

Independently of such powerful arguments, the improvement of the trade balance that came along with the beneficial processes associated with the structural changes of 1990 (the overfulfilment of the agreements concluded with the IMF), as well as the fact that a surplus was also produced in early 1991, seem to testify that the Hungarian economy is manageable—at least for the time being—even amidst a net outflow of resources. This leads us to the conclusion that *this is not the moment to* raise the issue of debt relief.

This reasoning is supported, among other things, by the significant influx of FDI in 1990. If, in a way described in the previous section, Hungary could manage to avert the obstacles and to maintain the dynamics, the balance-of-payment targets could be achieved more easily than in the present situation. Also, the outflow of resources could be decreased. In this case (which, of course, depends on the development of several and, at this stage, highly uncertain economic and political factors) the main conditions for an "automatic" solution of the debt problem, or at least the main conditions for its manageability in the near future, would be created.

This leads us to the conclusion that the *main policy line* of the government and the central bank should be to continue managing the debt problem in such a way that debt relief is avoided. They must, however, prepare for a different kind of policy as well, because it could happen that this policy line cannot be pursued for some reason, or it may become evident that it is ineffective.

What kind of processes, what dangers are involved?

1. As is widely known, the Hungarian balance-of-payments situation has been unstable, at least since 1982. Since that time, the National Bank of Hungary has made tremendous efforts to produce the necessary resources for financing the balance. There is general uncertainty with regard to the question of whether the financing can go on without interruption in the future. In 1991, the uncertainties are bigger than before.

This, on the one hand, is due to the fact that in many respects the international conditions are unfavourable for Hungary's debt management. As is known, the entire Eastern European region has been struggling with serious financing difficulties and, despite the political developments in the past few years, the creditors are inclined to treat the whole region as a kind of a block. Last year, the insolvency of Bulgaria already made the creditors increasingly reserved towards all the East European countries. An eventual re-scheduling by the Soviet Union constitutes an even bigger danger for Hungary, because this would frighten away private creditors, who are very important for Hungary, more than for other countries of the region. New shocks in the world economy could also worsen the external financing situation of the country. At the same time, however, the forecasts for the current balance—at the time this article was written—did not appear to be too gloomy. Yet, there can be no guarantee that the situation will remain the same. The continuation of the economic processes depends, first of all, on how the balance of trade develops. The change-over from rouble to dollar accounting burdens the current account.

Thirdly, the ways of financing the balance of payments could also be threatened by further accumulation of internal economic and social tensions which cannot always be blamed on the hardships that accompany efforts to maintain the balance of payments. In this context, we must take into consideration not only the fact that the burden-bearing capacity of society is limited and that by overstepping these limits we risk destabilization, but also that, because of the nature of things, one cannot exactly tell where the limits are. (These limits could be found out only if government policy and the interest coordinating mechanisms would respond much more sensitively to social reactions, and if there was consensus between the political organizations and the social groups over questions how to handle the economic problems.) Therefore, it simply cannot be known in advance what size of price increases and in which field, how big unemployment or what measures will force the government to act contrary to its policy line and revise its balance-of-payments financing policy.

2. It is apparent from the facts above that one cannot exclude the possibility that Hungary might be forced to change its balance-of-payments financing policy. In the meantime, there are also indications that, from the point of view of the external political conditions, it would not be wise to shelve the issue of an eventual debt relief. True, the western decision-makers—under the present conditions—do not support the easing of Hungary's debts and this attitude cannot be seen as some kind of "mistake" or mistaken judgement of the situation. On the contrary, it can be traced back to powerful political and economic considerations. It is also obvious, however, that the more the affected party (i.e. the Hungarian government) refrains from urging a change in the Western attitude, the easier it is for the latter to continue its negative approach. It must also be taken into consideration that outside the circle of the actual decision-makers, there are highly influential circles on both sides of the Atlantic, that have been calling for easing of the debts of

Eastern Europe, and for the provision of more open-handed economic support for the region.[12]

The agreement between Poland and its official creditors (The Paris Club) to cancel part of Poland's debt is a new development. Although there is no direct relation between the management of the Polish and Hungarian debts, primarily because the Polish insolvency has a ten-years past and because the debts of the two countries differ in structure as well, and because the conditions and consequences of this agreement cannot yet be seen clearly—this development somewhat changes the conditions of the Hungarian debt management. This is mainly because it has become evident that the creditors are flexible and they are able to accept the consistently represented, specific positions of certain indebted Eastern European countries. Further, contrary to belief, they show willingness to cancel part of the debts of countries other than the famine-stricken African countries. Finally, it is also obvious that the West does not rule out support, also in this way, for the economic and political transformation of the region.

3. Considering the *international political* conditions today, it is an important development that since the end of 1990, Soviet developments have taken a further downward turn. In the light of the current developments, the most probable alternatives in the Soviet Union are: either a return of the conservative forces that enjoy the support of the army, the internal security forces and part of the party apparatus, or, desintegration. These two alternatives do not necessarily exclude one another for they can intertwine as well. The first version means that, contrary to the judgement of the situation prevailing in the past eighteen months, it is far from being certain that the changes in Central and Eastern Europe put an end to the Soviet–Western confrontation once and for all. The second version foreshadows the danger of unpredictable political developments and the possibility of the actual disintegration of the Soviet Union. This, in turn, could easily destabilize the situation in other regions of the continent. Although, in the short term, these prospects might make the commercial banks and business investors increasingly cautious towards the entire region, in the eyes of the western governments these prospects also increase the significance attached to the creation and maintenance of stability in Central and Eastern Europe. It would not be correct either if we excluded the possibility, right from the start, that in spite of the serious problems that accompany the change of the systems, in the end, this may positively influence the western position with regard to the financing of the Eastern European transformation.

In the light of what has been said above, we think it is right if in future, at its official negotiations, in statements and while working out short-term economic plans and projects the goverment does not leave the terrain of the complete fulfilment of debt obligations. We think, however, that in addition to this, other things

[12] See, e.g. *Mahll and Heynitz* (1990).

may become necessary as well. We must clearly see that no lasting stability can be created in Hungary without significant western commitment or at least without stopping the net outflow of resources. There is no reason to expect that this position cannot be represented in a credible way towards the western governments—without risking the loss of the confidence of creditors—whose *political decisions* have a significant influence on the business decisions and attitude of the creditors.

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СТАБИЛИЗАЦИЯ И ВНЕШНЕЭКОНОМИЧЕСКАЯ ПОЛИТИКА

А. КЕВЕШ–Г. ОБЛАТ

Статья посвящена важнейшим ближайшим дилеммам внешнеэкономической политики. Рассматривая вопросы советско-венгерской торговли, авторы констатируют, что наблюдаемый в этом году спад является не только следствием перехода к расчетам в конвертируемой валюте, но и политических неурядиц в Советском Союзе, краха советской экономики, трудностей в валютном хозяйстве и спада товарного предложения. Поэтому венгерская экономическая политика и в средней перспективе не может рассчитывать на торговлю с Советским Союзом как на стабилизирующий фактор. Условие развития в перспективе — переориентация внешнеэкономической деятельности. Авторы занимают позицию в связи с экспортной ориентацией и системой средств либерализации внешней экономики, отвергают шоковую терапию и поддерживают постепенное достижение конвертируемости. По их мнению, приток действующего иностранного капитала в настоящей ситуации может значительно облегчить проблемы страны, связанные с получением иностранных кредитов. Включаясь в проходящую в Венгрии дискуссию относительно менеджирования внешней задолженности, авторы считают обоснованным желание правительства полностью выполнять обязательства по погашению долга. При этом оно не должно упускать из внимания, что прочная стабилизация отечественной экономики невозможна без существенной поддержки Запада и без отказа от принудительного достижения позитивного сальдо во внешнеэкономической деятельности.

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FROM HIDDEN NATIONALIZATION TO COVERT PRIVATIZATION
LESSONS FROM THE PAST AND PRESENT IN THE INDUSTRIAL COOPERATIVES*

GY. TELLÉR

During the past thirty years a "privatization" process of a specific logic, intensifying the capital interests, has been going on in the earlier nearly nationalized industrial cooperatives. The informal inner relations of the cooperatives finally came to be imbued with elements of private ownership and private companies. The cooperative form and its actual contents got into a new sort of contradiction with one another. A large and increasing group of cooperative leaders is trying now to resolve it by assimilating the legal form of cooperative to that of joint-stock companies, or transforming it into a limited liability company, or other type of economic association.

1) In the Hungarian economy and society the industrial cooperatives play an important role. The total number of members and employees of the approximately 400 "traditional" and 3000 "small" cooperatives exceeds 250 thousand. The gross value of their fixed assets is more than 41 thousand million Ft and their turnover amounts to about 200 thousand million Ft. Their share in the summarized output of state companies and industrial cooperatives is about 8 percent, and they produce more than 6 percent of total Rbl exports and 5 percent of the whole of dollar exports. Within the industrial sector, from the total workforce employed by the state-owned and cooperative industries more than 15 percent (and within this figure the construction sector accounts for about 24 percent) work in cooperatives. Profitability of the cooperatives exceeds the average of industry and in certain subsectors their share in the total output and in the sales of consumption articles moves between one-sixth and half,[1] e.g. in the machine building industry, in precision engineering, in iron and metal mass production, in the leather, the fur and shoemaking industry, in the textile and garment industry.

The industrial cooperatives have reached their recent state and position outlined above as the result of a long and varied development. In the past six to eight years, and especially since their 9th Congress in 1986, decisively important changes have been taking place in their ownership- and power relations and with

*An abridged version of this study appeared in English under the title "Reminding lessons" in: *Hungarian Cooperation*, Nos 1-2. 1990; The notes were written to the Hungarian edition in February 1991.

[1] "Beszámoló..." 1990. The data refer to the year 1989.

regard to their cooperative particularities.[2] Of course, these changes have to be grasped primarily on the basis of the present processes. However, deeper reasons for the changes, and the principles of their genesis and the possible directions of their evolvement, cannot be understood without a short overview—from a certain aspect—of the cooperatives' history and their structural changes.

2) The "traditional" industrial cooperatives or their direct predecessors were established in the late 1940s and the early 1950s. The leadership of the Communist Party, at that time laying the foundations of the planned economy, was striving to take possession of the total mass of the means of production, in order to achieve integrated planning of the whole economy. Larger elements of property, operated by greater organizations, were taken over by simple expropriation (nationalization) and the elements of smaller size, more numerous and therefore more difficult to control, were organized into cooperatives; by using the cooperative form, they wished to group them into larger units and thus integrated them into the planned economy.[3]

As a reminder, it must be mentioned that from the late 1940s on the Communist Party—which had only just then come into power—had for several years been building up the organization system through which it was able to run the nationalized property. The decisions on production tasks, on the directions and proportions of extending property, on the allocation of resources among the participants of the economy and on the division of the national income between the targets of consumption and accumulation (i.e. in the final analysis on the future of the whole property taken under state management) were made at various points of this organization system. This rather complex system of operating state property, closely intertwined with the Party on all levels (including the Parliament, the Planning Office, functional and branch ministries, the National Bank, respective bodies of the council system, and those of medium-level and regional management) was a strongly hierarchic one. Within the system the centrally given impulses to production, along with orders intended to make the whole process dynamic, were forwarded to the particular participants (companies, leaders and workers) in the form of commands, instructions or directives; the same institutional channels were used for the allocation of resources needed for carrying out the production tasks (means of production, materials, wages etc.). (*Tardos* 1988a; 1988b; Tellér 1991) The new proprietary institutions soon produced the *bureaucratic élite* moving them, which may be considered a *new class of proprietors*. In relation to this class and to the power wielded by them, practically the *whole working society came into the position of employees or wage-workers.*[4]

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[2] The trend of these can clearly be seen from the minutes of the 9th Congress of the industrial cooperatives (October 11–12, 1986). An analysis of this has been made by Tellér (1987b).

[3] The activity of the author of the present study was partly aimed at the historical and theoretical exploration of these interconnections. (Tellér 1972; 1987a; 1989)

[4] The class-character of socialist redistributing bureaucracy has been exposed by many (see:

3) Since the original proprietary interests and decision-making mechanism of the cooperatives—among them also of the industrial cooperatives—were contradictory to the logic of the planned economy governed by mandatory instructions, the cooperative form was "made suitable", by using various means, for accepting the instructions coming from above. Thus, the cooperative was made suitable for being integrated into the uniform economic system controlled by mandatory plan instructions.

a) This was first achieved by introducing hierarchy into the cooperative movement. By an appropriate modification of their statutes, the cooperatives "voluntarily accepted" the instructions of OKISZ and of the KISZÖV-s, which acted as planning authorities.[5] The implementation of the instructions was the task of the president who was, up to 1957, elected by open vote, i.e. he got into his position by quasi-appointment. The president, by his power of external origin, could overcome the forums of self-government and could build up below himself the hierarchy that already existed above the cooperative.

b) Another means was the *local* or *regional* (county-, municipal, or communal) *property-operating system* created from cooperative, party and state administration bodies. These drew to themselves the right to make the most important decisions with regard to the cooperatives' operation (selection of "cadres", electing the president, definition of the spheres of activity, directions of development, selection of partners, mergers, opening of new departments or closing them etc.). Such decisions were made through continuous "reconciliation of interests"—with the guidance of the party organizations—within the system itself. Hence, the most important decisions were made outside of the cooperatives, or rather above them, and their implementation was carried out by the president, who was part of the hierarchy.

c) Such a means was the *institution of the indivisible cooperative fund* which, with its gradual growth, introduced more and more the characteristics of state ownership into the cooperatives. In this way it created and prepared the ground for accepting instructions coming from above. According to the intent of political management, this indivisible fund, increasing in both its volume and proportions, would have facilitated the "transition" of the "non-consistently socialist" cooperative property to a public property similar to the property of state enterprises ("*transitory property*"). Later on, at an appropriate moment, it might have become possible to detach the cooperative institutions—which became unnecessary and empty by losing their original contents—from property. This would have meant that nationalization of the cooperatives would have been completed.

Trotski: The revolution betrayed, *Milovan Djilas:* The new class etc.). On the employee-like position of the membership of productive-type cooperatives see: Tellér (1984; 1984–85).

[5] OKISZ: National Council of Industrial Cooperatives; KISZÖV: Vocational or Regional Association of Industrial Cooperatives (ed.note)

d) Last but not least, such means of integration—especially after 1957—were the mechanisms and related money funds brought about for a *redistribution on movementlevel*, and so on. (Tardos 1988a; 1988b; Tellér 1991; 1984; 1984–85)

There was an ideology closely connected with this integration of the industrial cooperatives into the planned economy. This ideology classified the cooperatives—i.e. the cooperative property—as a lower category of property than that of the state-owned enterprises, as a "non-consistently socialist property." This clearly expressed that the former owners of small businesses organized into cooperatives were not as close to socialism as the workers and poor peasants were.[6] The former owners included large number of artisans and their employees who entered into cooperatives because of political and economic pressure and, later on, women and other members of the middle strata who engaged themselves in work in great masses for the first time. This ideology was an effort to make the members of cooperatives, by degradation and intimidation, endure their discrimination in obtaining resources (buildings, machinery, materials, labour etc.) and tolerate the reserve-character of their production capacity and, eventually, the nationalization of it.[7]

The above outlined structure and operation of the cooperative institutions well indicate that in this period a cooperative in the hands of the party-state bureaucracy was not only a tool for centralizing and operating property—it was also a means of organizing society and exercising power. It was one of the institutions forming part of the redistributing and instruction-giving integration of society and economy. Also, it was considered "less socialist" or "more socialist", depending on how far it was appropriate for the above-mentioned objectives of macro-integration and for the ever changing aims of policy and economic policy. (A szövetkezetek... 1976) A cooperative was labelled according to its dimensions, its possibilities of being planned and controlled, and finally to the output it produced. In a somewhat simplified way one could say that *the ruling class, in the process of building up socialism, reorganized the large number of small private properties into its own collective property with the aid of the cooperative form.* On the basis of all this and in conformity with the particularities of the totality of economic integration, the members of the cooperatives *very soon came to face the effective owners as employees and wage-workers.* In addition, *the internal incentive system of the cooperatives was based on work, on work performance and on the income received for it.* These were linked to the means of production that had been turned into collec-

[6] The leaders of the HSWP declared only in the 1970s that those working in cooperatives are also members of the working class. However, even in this case the aim was the ideological foundation of the unity of cooperative and state-enterprise relations, rather than the elimination of the harmful discrimination of the cooperatives. Despite this declaration, the disadvantage suffered by the cooperatives regarding the distribution of resources did not cease to exist.

[7] This was the final objective, i.e. the fulfillment of the meaning of the so-called "transitory" form of cooperative property. In the Soviet Union the cooperatives were even nationalized. In addition see: *Biszku* 1975.

tive property and which were operated from outside and from above. (Kisipari ... pp. 16–22) In this respect there was no substantial difference between the president who appeared in the name of the real owner and who represented the hierarchy within the cooperative, and the members who slipped into the position of wage-workers. Actual cooperative relations, however, developed only where and only to the degree in which a particular cooperative, owing to its peripheral position, was unworthy of intervention for the hierarchy of economic management.

All this, in general, also determined the inner relations of the cooperatives. The absorption into the hierarchy, the monopoly of decision-making and the employer's role brought the presidents—selected on the basis of political trustworthiness, often from factory workers—and the narrow, politically reinforced managerial groups, into an independent power position confronting the membership of the cooperative. (Tellér 1972) This obviously entailed the rapid loss of power of the co-operative members. Eventually they found themselves in the position of employees and wage-workers. To a certain extent, independent of the effect of the economic integration that acted in this direction, the same process was strengthened by the later growth of the cooperatives' size, by the increasing complexity of their assets, operations and organization structures. The knowledge and information needed for making decisions, or even for merely understanding the problems also supported this process. [8] In other words, the managers had a monopoly of information and decision-making while all other actors in the process were marginalised.

The bodies of self-government that were subordinate in the hierarchy, instead of being proprietary decision-making forums, became in the best case *organs of wage- and performance-bargaining between the leaders (in the position of employers) and the working people (in the wage-workers' position).* Proprietary self-management, the operation of workshop democracy were not functions of the so-called self-governing organs. Hence, the internal relations of the cooperatives—despite the formal existence of the cooperative decision-making organization—became in their true content, similar to the internal relations of the state-owned enterprises. (Tellér 1984; 1984–85; 1987a)

During the 1950s and 1960s the industrial cooperatives built up significant production capacities and had important roles. On the one hand they played a significant part in the production of consumer goods and in foreign trade. On the other hand they were important suppliers of industry by manufacturing means of production or component parts. Still, a vast majority of them were increasingly prevented from adjusting themselves to the changing economic conditions. The reasons for this were their less developed means and conditions of production, increasing size accompanied by a loss of flexibility, and mass production based on semi-skilled work. By the mid-1960s only a small group of them had been able to hold onto the production of really high-level products of their own. In the

[8] This process has been described in several studies by the author (Tellér 1984; 1984–85; 1987a).

latter, they used the respective technology belonging to it and, together with that, achieved dynamic development and the acknowledged status of a small company. (Tellér 1989)

4) The conceptions of the 1968 economic reform promised vitally important changes to the industrial cooperative movement, too. According to these ideas, actions taken by the particular participants of the economy were no longer to be determined by instructions, but by artificially set regulators imitating the market. Decisions were to be made at company level, where the risks of such decisions were borne and where the information needed for decision-making was mostly available. Hence, in the case of the cooperatives, membership- and proprietary collectives were no longer to be hindered in making the company decisions assigned to them; these could be made by their self-governing bodies and in a democratic way. In this concept the president was no longer part of the hierarchy of economic management that extended into the cooperative, but a member (or employee) of the collective who, commissioned by the collective, was to activate and operate the common property for the interests of the collective. Accordingly, for the sake of protecting the interests of the cooperatives and their members, the hierarchy of the movement was also to be rebuilt from beneath. (A gazdasági... 1966, p.229)

A deeper theoretical basis for all this was produced by the new ideology of cooperatives, which acknowledged the cooperative property of the members and regarded the members as members of the proprietary collective—consequently, the members had the right to make proprietary decisions on their property and to benefit from its returns. (A gazdasági... 1966, p.229)

In this cooperative organizational structure *incentive referred to the share of the co-owners*—at the level defined by economic management—*in the common returns of work and of the indivisible common property ("incentive property").*[9] The "delegation" of the decision-making rights needed for a better operation of the property meant that the *bureaucratic élite which earlier monopolized property (cooperative property too!) now shared it.* It recognized the ownership—even if to a limited extent—of a group of society which had earlier been deemed a hostile one, had been pushed into the background and suppressed, i.e. *the members of (in this case the industrial) cooperatives. Also, in the proportion of the performance of their collective capital and as an incentive, they were even granted some capital income.*

5) The ideas of the 1968 reform, and in particular the conception of the reform about cooperatives, were never realized. (Antal 1985; Tellér 1984–85; 1987a) Though the reform was formally not withdrawn even in the cooperatives, by the early 1970s—after two or three years of hesitation—the movement's hierarchic mode of operation was re-established. And, following the short adventure of the incentive cooperative property—the processes continued together with the increase of

[9] The expressions "transitory property" and "incentive property" are inventions of the author.

the indivisible fund. This means that the most important material decisions (like selection of the presidents, or controlling the processes of fusions) were again in the hands of the ensemble of local institutions. These seized the power for themselves and protected selective interests which governed the operation of property. The hierarchy of the movement as a whole continued to convey the will of the state, i.e. fulfilled a function of transmission and industrial management. Income regulation controlled the cooperatives at the level of state-owned companies, and the occasional arrangements and lasting operation characteristics of the whole system of economic institutions kept them in a discriminative position with regard to the allocation of all resources (including buildings, machinery, labour, wages etc.)[10] What is more—and what was never done by traditional cooperative policy—in the mid-1970s, after the merger of companies owned by the local councils into large-scale state enterprises, the industrial cooperatives were marked out as the labour-reserves for those parts of state industry wishing to continue extensive development. Thus, a much more drastic form of nationalization was chosen than that of the original "transition". The cooperative policy then protected itself with the aid of a growth the magnitude of which was organized from above, i.e. by massive fusions. (*Kőhegyi* 1982)

Despite all this, in the mode of operation of the industrial cooperatives, other important changes came to pass as compared to the conditions of 1968 or to those before 1972. It may be considered as the most important one of these that the restoration and continued operation of the earlier hierarchic and transmission organization was primarily based on informal tools, i.e. on using coercive or incentive means of a material nature and by relying on the party hierarchy. Accordingly, the credits and loans raised and granted from the common development fund of the industrial cooperatives—which were also supported by local resources—obtained high importance.[11] Similar importance was attached to the selection of the persons of presidents whose task was to carry the hierarchy of the movement, to ensure their loyalty—and, in addition, as far as possible—their professional skills. (Bennó 1976; Adattár... 1981, pp. 301–314) The presidential and leading élite showed determination at the Congresses and behaved like an independent interest group. This élite represented an increasing professional level and was formed in the late 1960s and during the 1970s, being a result of this particular way of selecting the candidates. This group adopted informal management hierarchy which was contradictory to not only the cooperative character but even to the letters of law. They also accepted state-enterprise characteristics in the cooperatives' operation,

[10] The Ministry of Industry and OKISZ even signed an agreement in 1986 which created the "equality of chances" for the cooperatives in line with those of the state companies. (Az ipari... 1986, p. 295)

[11] For instance, in 1986–88 precisely half the total investments of industrial cooperatives were covered by loans and/or support from common funds. (Beszámoló... 1990)

though at the same time they anxiously preserved the cooperative appearances, the ideology of the members' proprietary position, and watched the operation of cooperative democracy. (Tellér 1981) *Very good reasons and motives were found for all this; on the one hand, it involved a significant growth of managerial power, parallel with the growing size of the cooperatives; on the other hand, the leaders' material interests and the level of their income were apparently adjusted to the level of the operation of the property. In fact, they operated according to the general judgement of the local power sphere, and significantly raised the profile of these factors.*[12] *As a matter of fact, this completed the development of a stratum of cooperative leaders attached simultaneously to power and to property.* The members of this stratum depended on their personal faculties and on the "importance" of their cooperative. They were no longer simply representatives of the local institutions operating property, nor were they just part of the hierarchy of the movement, delegated to the cooperative—they were members having equal rights and also participants in local decision-making. (Kőhegyi 1989)

Thus, in the seventies not all the membership of the cooperatives got behind the bulwark of cooperative property in its totality—as was promised by the ideas on cooperatives of the new mechanism. *This only involved the members of the thin stratum of cooperative leaders, and even these were only accepted after a careful individual selection, based primarily on the degree of their loyalty.*(Bennó 1989) This was the process through which the interests and career endeavours of the cooperative leaders became, in fact, inseparable from the existence of the cooperatives, when the members of their management *began to behave no longer as employees but as quasi-owners* ("property guards"). They still depended on their superiors—who resolutely kept tight hands on the performance and wage claims of the members in an employee-like position. However, as owners, they now hindered the excessive outflow of wages. (Bennó 1989; Tellér 1981; 1987a) At the same time, seeing also the instability of their position, like other leaders in the political sphere, they accepted—what is more, supported—the members who were unable to break through the cooperative's wage ceiling in utilizing their ideas, their labour power, and perhaps even their means of production, in the sphere of the second economy.

Thus, the changes in the seventies, instead of a radical reform of cooperative property, brought about a slight extension of the bureaucratic-managerial-proprietary sphere. Also, by involving capital motivation, it made its interests somewhat more complex and the interest-reconciliation mechanism a little more elastic. Selective redistribution within the movement resulted in the development of a cooperative or small-enterprise sphere which was relatively advanced, or which at least was not so far behind the average European level. At the same time it also

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[12] The local power sphere asserted its judgement among other things by determining a bonus factor to be included in the formula for calculating the leaders' bonuses—in the form of a proposition made by the KISZÖV.

brought about a *strong proprietary aspiration of élites both inside and outside the cooperatives.* In the meantime the cooperative-level decisions and interests completely fell out of the competency of the members, who were pushed entirely into the position of employees and/or wage-workers. Thus, in effect the nationalization of cooperatives, started with the aid of the "transitory" property and by other institutions, came to be *de facto* realized; the institutions of self-government—despite repeated modifications—lost their essential content and became once and for all the forums of bargaining between the members and the leaders. The latter appeared in the position of real owners and also members in a wage-workers' position. (Tellér 1983) Their cooperative form concealed the actual interest relations rather than expressed them. Paradoxically—as we have seen in connection with the mergers of the seventies—the obstacles to formal nationalization were no longer the interests of the members but those of the leading élites who were raised to the position of owners, or were pressing to achieve it. The economic reserves of the new operation that was started in the early 1970s were also exhausted in the industrial cooperatives by the end of the decade. Contrary to the earlier strong quantitative growth, the movement sank into decay.[13]

6) This decay, which occurred parallel with the hidden crisis of the whole Hungarian economy (in fact, in many aspects it was closely connected with it), was stopped and replaced with a new dynamism by the mid-1980s. This was due to the new form introduced in 1982, called the "small cooperative". The most conspicuous particularities of the small cooperative are the simpler ways of accounting and decision-making, the omission of the commitment to raise an obligatory indivisible fund, more liberty in utilizing the income, elimination of the limits on income deriving from higher performance and a much more favourable distribution of the produced surplus income. The latter was made possible by the new structure of the linear gross income tax. (Ipari... 1983; Gazdasági... 1982) After a waiting time of two or three years caused by political mistrust, i.e. between 1985–86, huge numbers of small cooperatives came into being.[14] The members and leaders of the small cooperatives which appeared in great numbers—even apart from those which originated from traditional cooperatives by transformation or by separation—were recruited from those mobile strata capable of mental and physical surplus performance. This strata had been afflicted by the income regulation of the seventies, including wage ceilings, that resulted in the retardation of performance. These groups or strata were waiting in the wings of the socialist economic organization or in the "halfway legal" spheres of the second economy. They were waiting for the possibility for free enterprise in order to achieve higher performance. They wanted

[13] (Adattár... 1981; Adatok... 1986)

[14] In 1985 almost six hundred newly established small cooperatives were already operating. (Adatok... 1986)

to sell their inventions, innovations and special professional skills, particularly if they could receive a safe and adequate income for them. (*Zsille* 1977; *Sok* 1989)

After several decades of their titular existence, ***this was the first time that real cooperatives were able to come into being.*** The organizations of small staffs were based mainly on live labour of low capital-intensity (from care and maintenance of flats, through the production of softwares and the organizing of economic activities). The internal operation, direct interest and distribution relations, elastic market adjustment and, last but not least, selected and qualified membership, resulted in significantly higher efficiency of live and embodied labour and, together with these, in high personal income. (*Laky* 1984) However,—because of the pressure of unfavourable regulation and uncertain political judgement—it was also a characteristic practice to ***conceal, in the form of cooperatives, private undertakings.*** These had narrow managerial-proprietary élites, showed fast accumulation, rapid growth in the quantity of assets and in the numbers of staff, and high motivation of capital utilization. In addition, even if some of them at the outset belonged to the former category, the rapid increase in the wealth of the small cooperatives which were well provided with capital, meant that they soon automatically slipped into the latter category.[15]

Thus, the small cooperatives—owing to the lack of the indivisible fund, direct interest and high incomes—were ***based on an interest-structure which was fundamentally new*** in comparison to that of the seventies: it was based ***on the acknowledgement of the operation and augmentation of private capital and on direct sharing in the common returns of private capital and the live labour absorbed by it.*** This explains the rivalry, adverse emotions and suspicion fostered by the quasi-owner leading strata of the traditional cooperatives towards the small cooperatives, since they were also striving to achieve the ownership position.[16] The history of the small cooperatives is contemporary history, and their economic results can be read in the introductory data of our study.

7) ***Thus, for the sake of increasing performance capacity of the economy and, as the result of forced and inevitable compromises in the seventies and eighties, the state bureaucracy and the proprietary bureaucracy of the cooperative movement brought about and/or allowed to appear within the cooperatives two legally not sanctioned but very strongly existing groups: that of the quasi-owner managers in the traditional cooperatives and that of the private owners' élite in the small cooperatives.*** Since the mid-1980s both proprietary groups have been involved in a stout fight to obtain the legally sanctioned positions of actual ownership and to control property on movement level, and also in particular cooperatives. It is again the

[15] See the case studies on small cooperatives by *A. Betlen, T. Fábián, Á. Hárs, R. Kravjánszky, É. Perger*, commissioned to be written by *A. Inzelt.* Institute of Economics of the Hungarian Academy of Sciences, 1989–1990.

[16] Az ipari... 1986 and the typed (draft) minutes of the 10th Congress.

paradox of the situation that for this fight the above-mentioned groups of leaders use mostly the slogans of the 1968 cooperative ideology that recognized the proprietary position of the members ("the cooperative is owned by its members, the movement by the cooperatives"; "the movement must be rebuilt from below" etc.).[17]

In the course of their endeavours first the small cooperatives—which are difficult to control and deal with because of their large number and new types of problems—evaded the traditional movement hierarchy in 1983–84. In fact, in some associations they obtained a majority, owing also to their great numbers.[18] Later on, at about the time of the 9th Congress in 1986, the organization of the whole movement started a fight against state institutions to protect their interests and to achieve a more favourable income distribution. This was done by changing the opinions in the whole organization and with the aid of the new institution—the so-called "social presidency"—and by placing practicing cooperative presidents into top positions of the national and local hierarchy. Then, before and after the 10th Congress in 1990, medium-level organizations and, within them, some individual cooperatives drew under their control the organization on the national level. This included the whole property of the movement, which was one of the sources of the former redistribution of power. (Az ipari... 1986) Since in past decades the state had imposed the industrial cooperatives' characteristics (or at least their legal forms) on the particular cooperatives with the assistance of the organization and apparatus of the cooperative movement, in the new constellation of the movement and power this obstacle was cleared away. Thus the groups endeavouring to achieve private ownership were allowed to assert their interests. One can also say that since the chief threat—namely the danger of nationalization—ceased to exist, the organizations that had earlier aimed to provide protection against it, as well as supporting the separation of the cooperatives, were no longer needed. Their hierarchic, power-exercising forms became especially unnecessary and therefore one can expect that after a short time the ideology offering the grounds for their existence will also disappear. The interest protecting organs themselves—according to their new dependence on power—also supported the endeavours of this group to annihilate the ideology.[19]

Another tendency of transformation affects the cooperative form itself, as the last, and at the same time, greatest obstacle to the development into effective private ownership. The leading groups of cooperatives wish to introduce the char-

[17] Such were the themes of the contributions to the debate of the 3rd Cooperative Conference in Hajduszoboszló in 1988. (See the minutes.) Since then similar reports have been published in the 1989 and 1990 issues of *Szövetkezeti Hírmagazin*.

[18] Ödön Sok's interviews with presidents of small cooperatives and with leaders of the Association of Servicing and Construction Cooperatives in 1988 and 1989. (Sok 1989)

[19] (Az ipari... 1990) Reorganization and the annulment of the ideology has been going on ever since.

acteristics of economic associations into the cooperatives. Such characteristics are the following: complete divisibility of the formerly indivisible fund; negotiable quotas of property, similar to shares and stocks; free structure of property; appearance of the weight of property in the power relations; limitless right to keep employees; total liberty in determining the parts of income due to work and due to capital; the right of having legal entities as members; complete liberty with regard to determining the internal organization structure, and to the delegation of rights; changing the concept of cooperatives from the idea that they are associations of persons, into associations of persons and capital, and fitting the legal regulation of the cooperatives into the law on joint-stock companies.[20] Thus, *the final aim of both types of the earlier cooperative owners or quasi-owners is to bring about an organization structure in which the basis of interests—at least for themselves—is to acquire an extra share from the net capital income and perhaps from the entrepreneurial income linked to it*, or the total of the income (e.g. by reducing membership to a minimum and employing unlimited numbers of employees). This means that the earlier informally nationalized cooperative property is to be transformed into effective private property, i.e. privatized.[21] To sum up: contrary to original ideas, property has been stripped of its cooperative wrapping, not by the upper stratum of the socialist proprietary class as the completion of hidden nationalization. Rather, at present it is carried out by the medium strata who have become capitalists. Thus it represents the prolongation of concealed privatization.

This means that in the course of the class struggle going on under socialism between the upper (feudalist type) and medium (capitalist type) professional and bureaucratic élite, from China to Albania, from Cuba to Romania, and also in the Hungarian industrial cooperatives, the ambitious representatives of knowledge and efficiency have come out as the victors.

We must note that the approximation of the industrial cooperative form to the forms of associations is almost a worldwide process; its most important motive and reason is to increase the capacity of the cooperative for absorbing external capital, i.e. a certain type of "effectiveness ideology". (*Luther* 1978; *Melvellec* 1983; *Gautier* 1983) In Hungary all this is accompanied by a few concrete incentives, stemming from the given system of economic regulation (free wage management, tax favours granted to foreign capital, technology import etc.). However, from here the analogy with Western Europe is exhausted. Namely, in Hungary for the time being there are no such internal borders which might protect the cooperative characteristics against the above-mentioned process. Presumably this is why the industrial cooperatives—or their leaders acting in the name of the cooperatives—are

[20] Előterjesztés... 1990. In many points the draft bill made by the working committee of the National Council of Cooperatives contains similar views.

[21] To the best of my knowledge, this is allowed by all the versions of the draft bill on cooperatives prepared by the Ministry of Justice, including the version of January 14, 1991.

already striving to transfer in great masses the capital of cooperatives into companies, jumping ahead of the above-mentioned legal transformation. This is carried out partly so that, on the basis of certain property elements of larger cooperatives, and by involving external capital, limited liability companies are established and, furthermore, the cooperative centre operates merely as a capital owning administrative centre. Also, some cooperatives—especially small cooperatives founded since 1982—change over into limited liability companies.[22] For the present only a single "cooperative counterforce" is acting against all this—namely, the interest linked to at least partially keeping together the property of the movement and to the continued operation of the movement's organization as a formal group exerting pressure.[23] It is a new paradox of the cooperative movement that fulfilling these interests is coupled with the maintenance of the name of the cooperative; i.e. *some of the cooperatives are simultaneously interested in acquiring the particularities of companies and in keeping up the semblance of being a cooperative.*

8) The industrial cooperatives of Western Europe (mainly France, Italy, Spain), despite the concessions made to the capital motive and despite their features of companies, preserve their theoretical-ideological dimensions and the resulting internal borders which clearly distinguish them from other forms of associations, i.e. they preserve the ideas that make them cooperatives.[24] In Hungary, for the moment there are no such internal borders. But what will or can the future bring? Will the transformation of the Hungarian industrial cooperatives, especially their sliding towards capitalist ownership, stop at such borders? This a controversial point. For a significant number of the cooperatives, it seems that they cannot be halted. In other words, it is not very useful to know thoroughly the theoretical boundaries protecting the cooperative characteristics, if within the cooperatives we do not know the interests or forces (e.g. in the form of a strong group of members insisting on the cooperative character) which are ready to protect the cooperative boundaries and willing to maintain the cooperatives as cooperatives. The vast majority of cooperative membership are quite prepared to tolerate the fact that their earlier wage-worker position, disguised with the title "membership", should even formally be transformed into a position of wage workers or employees. Instead of

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[22] Such transformations can be heard of day by day. However, the accurate number of these on the national level is not known.

[23] Typed (draft) minutes of the 10th Congress of the industrial cooperatives; For example, of special note is the changing organization of the KISZÖV of Komárom county over the past two years.

[24] This is shown by the West European laws on cooperatives: e.g. the French one: Guide juridique des SCOP. Scopedit; Recueil de textes législatifs et réglementaires relatifs ā la coopération. La documentation francaise; the Spanish one: Ley general de cooperativas. Ley 3/1987, de 2 de abril; the British one: Handbook to the industrial and provident societies act. Holyoake House, 1966 etc.

trying to seize power over cooperative property, the most they try to do is to found a trade union[25], or not even that.

It is precisely for this reason that becoming an economic company or changing into one of the companies cannot, and should not be stopped or hindered—in fact, it should generously be taken notice of. *In this transformation,—as we have seen—a social process of strong logic and privatization, pushing forward under the banner of economic efficiency, make their own way.* To keep these organizations—despite their substance and interests—in he strait-jacket of the current cooperative form would be a significant misunderstanding of the economic and social processes. Let them change into companies, or else it will be necessary to find those other transitory, semi-cooperative or semi-company forms in which their ownership relations, interests and power relations can find their proper expression. However, these forms or the single form to be crystallized from them *must not be considered and called a cooperative.* This would conceal their real essence or wrap them into the appearance of some other substance. The "cooperative" name has to be reserved for those organizations which undertake to preserve the internal theoretical limits of the cooperative character.

It is my opinion that there are and, more to the point there will be—albeit sporadic—such forms of interest groups as well. However, their clear organization and their appearance as a force has to be waited for. In my opinion, in the traditional cooperatives the denomination of property, and the consequent reinforced proprietary interest, along with the tightening interest of maintaining jobs, might lead to the appearance of these. There are, even currently, some latent groups interested in the operation of real cooperatives and in keeping their jobs. These can be found in traditional, mainly small, cooperatives and they will survive as long as the interests of acquiring and operating capital do not take possession of them.

The strongest motive, however, for creating true industrial cooperatives in Hungary will be—as it is in most places of the world—*the complete unfolding of the market economy and the tense relationship between capital and labour.*[26] In other words, under such conditions there are always some groups who cannot (e.g. in periods of unemployment) or do not want to remain within the framework of a wage-workers' livelihood but cannot or do not wish to become capitalist entrepreneurs either. Their strength in capital is insufficient for personal property but their spirit and their ideas and values make them fit for common action. In my view a cooperative form which has been adequately modernized, yet which upholds the internal boundaries of the cooperative character and, together with these, maintains

[25] Currently in the cooperative movements three different trade unions are active.

[26] For instance, *Claude Vinney* proves the interconnection between the periods of economic depression and the numerical upswing of industrial cooperatives with the aid of long chronological series. (Vinney 1966)

the cooperative designation, has to be preserved for these groups. Theirs is the cooperative future.

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ОТ СКРЫТОЙ НАЦИОНАЛИЗАЦИИ К СКРЫТОЙ ПРИВАТИЗАЦИИ

(УРОКИ ПРОШЛОГО И НАСТОЯЩЕГО В ПРОМЫШЛЕННЫХ КООПЕРАТИВАХ)

Д. ТЕЛЛЕР

За прошедшие тридцать лет в промышленных кооперативах по своеобразной логике прошел процесс "приватизации", увеличивающий заинтересованность в капитале. В конечной фазе этого процесса информальные внутренние отношения кооперативов приобрели черты присущие частной собственности и частным предприятиям. Возникло противоречие нового типа между кооперативной формой и фактическим содержанием. В наши дни это противоречие преодолевается все большим числом кооперативов путем приближения кооперативной формы к предпринимательству.

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THE (PSEUDO-) PRIVATIZATION OF STATE-OWNED ENTERPRISES (CHANGES IN ORGANIZATIONAL AND PROPRIETARY FORMS, 1987–1990)

M. MÓRA

For the future of Eastern Europe it is fundamentally important how the prevailing state property exceeding 90 percent of the total capital will be demolished and what sort of proprietary and company structure will result from the denationalization-privatization process. Although privatization is still in its initial stage, due to the peculiarities of the Hungarian development, some preliminary experiences have already been recorded in connection with their transformation and, in some cases, passing into private ownership, of state property. A study by the Economic Research Institute prepared in 1990 collected such initial experiences.

In the eighties the Hungarian economy was characterized firstly by stagnation, then by a deepening and ever more hopeless crisis situation.

Some of the state-owned enterprises *reacted* to the worsening economic conditions *by changing their organization.*

It was hardly unusual in the more than forty-year history of the Hungarian planned economy that attempts were made at changing the organizational structure of production and reorganization in the company sphere in response to economic difficulties. Here it is enough to refer only to the campaign of mergers between 1961 and 1963, to company incorporations in the seventies, or decisions on centrally directed decentralizations between 1980 and 1985. The organizational changes of the past few years, however, have differed from the previous ones in several respects. The most striking difference has possibly been the fact that this time they *have not been initiated by state administration, but by company management.* It was that managerial layer of large enterprises which firmly resisted decentralization efforts of state administration a few years before, and which mostly used the foundation of subsidiaries for obstructing attempts at separation and independence.

The other important difference is that organizational changes of the late eighties related to *changes concerning ownership.* In the beginning only the *form* of state property changed (from the ownership of instruments to the ownership of securities), as well as the *circle of owners* (in the established associations, banks and other state-owned companies also became owners, in addition to the "parent company"). Later organizational changes were accompanied by the *privatization* of a portion—although only a fragmentary one—of state property.

Due to recent political and social changes, *emphasis has been shifted* from the search for more efficient forms of operating state property, *to the demolition* *of a considerable part of state property.*[1] To be sure, the *starting conditions of the privatization process* are greatly affected by the organizational-proprietary changes of the past period.[2] It is an important circumstance that between 1988 and 1990 the previously rigid and overcentralized structure of state-owned enterprises has started splitting, while signs of the concentration of state property taking the form of shares were manifesting. It is similarly important that the Hungarian economy begins purposeful privatization with the experiences of the recent past in mind. The experience gained might be a valuable *advantage* over those former socialist countries which have begun thinking of the desirable ways of privatization only after the change in political systems.

A close shot of the types of organizational-proprietary changes
Associations (companies) from factory units

The modification of the Company Law in 1984 greatly extended the independence and rights of decision of the companies. Among other things, it provided that the company may manage its property independently and, within it, it may freely decide on participation in economic associations and on the foundation of subsidiaries. As a result of the reform of company management in 1984 and 1985,[3] the proprietary rights have practically been passed to company governments (managements). Supervision by state administration has remained only in one-fourth of the companies—although these companies are of key importance.

Since 1987 the provisions of law have also enabled the establishment of share companies and limited liability companies (exclusively) to domestic legal entities. (Before that domestic companies could form associations only not in a limiting liability form.) Their foundation was regulated by the Commercial Act XXXVII: 1875 regarding share companies and by Act V: 1930 regarding limited liability

[1] Naturally, there are some who challenge that private property would be more efficient than state property by definition (*Liska* 1990), and that state property could not operate—with proper entrepreneurial interest—with an efficiency similar to that of private property (*Bársony* 1990). According to the general opinion, however, the prevalence of private property is required (although not necessarily sufficient) for the proper functioning of an economy.

[2] Regarding the chances of privatization, beyond the movements that took place in the state-owned company sphere, the changes which were observed in the eighties in the circle of private enterprises are at least as important—probably even more important. The development of private enterprises—not free from contradictions, moreover, from backward steps—plays a decisive role in the fact that a market-oriented way of thinking is not alien from the Hungarian society and that there is a circle of entrepreneurs with relatively solid capital, whose participation in the demolition of state property may also be decisive.

[3] For the theoretical starting point, basic principles and execution of the reform, see *Sárközy* 1986.

companies. Since 1989 the Association Act (VI: 1988)[4] modelled after legislation of developed countries has determined the legal conditions for the foundation of associations.

The basic type of organizational transformation was provided by the MEDICOR Company in 1987. The company's separable units (activities) were reorganized into association (company) form by involving outside participants and by applying cross-ownership among one another. The majority of the securities of the associations was passed into the possession of the company center (property center) performing functions of property management and operating in a state-owned company form. Later on alternative solutions have become more frequent in which the companies have reorganized only one of their units into an association and have kept operating their other producing units in the traditional form.

No exact data are available to us regarding the proportion of state-owned enterprise property affected by the foundations of associations. According to a report published by the State Audit Office (ÁSZ 1990), the value of the invested assets of the more than 2000 state-owned enterprises amounted to 109 billion HUF in 1988 and to 173 billion in 1989, which reflected 6 and 10 percent respectively of their own property. According to a survey by the Ministry of Industry and Trade of June 1990, among the companies directly subordinated to ministries the share of assets operated through associations was 12.5 percent.

Since the method of *the foundation of associations which also ensured the maintenance of the state-owned company form* has been applied by a fairly wide circle of companies since 1987, we have relatively more knowledge regarding the *purpose, methods and impact* of the foundations of associations.[5] Experiences prove that the process incorrectly called "spontaneous privatization"[6] *cannot be regarded as uniform at all.* Its participants were driven by rather differing incentives and intentions, depending on *the situation of their companies, on the date the association was founded, on the intensity of the individual efforts at making a profit*, etc.

Initially, the transformation of company units into associations merely seemed to be *a means for large company centers to save their power*, or *their compromise with productive units.* As time passed and political conditions changed, it has become clear that *the foundation of associations directed by* company *managers can*

[4] In other English publications also called Company Act—Ed.note

[5] When writing this sub-chapter I relied on publications that appeared on this topic, in addition to the experiences of my own investigations made at companies. (See first of all the works of the State Audit Office 1990, of *Matolcsy* 1990 and *Voszka* 1990.)

[6] According to the terminology now wide-spread *spontaneous privatization means transforming the property of state-owned companies into associations based on managerial* (company) *decisions.* This name is actually misleading, since the change in the form of state property in itself does not mean privatization. The name is rightful only to the extent that the establishment of associations enabled the *handing over or privatization* of a part of state property *against compensation*, or *below the real value* based on unreal property assessment.

basically determine the chances of genuine privatization; at best, it can promote and, at worst, it can impede or substitute for the establishment of a proprietary structure thereby ensuring the overall effective functioning of the economy.

Until the Association Law entered into force, mainly *large industrial enterprises in several locations or with several branches* established associations.

The typical form was the transformation of factory units into *share companies with predetermined shareholders*. The outside founders were traditional partners interested in the maintenance of the company's production—its suppliers, largest users, account keeping bank—and whose entrance into the association was motivated not so much by the acquisition of property but rather by other aspects. When applying the *form of a concern*[7] the associations belonging to the same parent company acquired shares in one another as well. The application of cross ownership was justified, among other things, by efforts at preserving the unity of the large enterprise. The establishment of share companies was rendered somewhat difficult by the fact that, according to the prescriptions, at least seven founders were required. In addition to the foundation of share companies, certain functional activities (such as foreign trade, computing technique) were organized in the form of limited liability companies.

The decisive majority of proprietary shares—very frequently, a part exceeding even 90 percent—*remained in the possession of the company center whose function had changed*. The property shares remaining at the center served as *cover for debt burdens and other liabilities*, which also remained typically the center's responsibility. (The distribution of some liabilities among the companies occurred in cases when the proprietary share of the center was smaller.) In such cases, *the privatization of state property was still out of the question*; those entering the associations from outside were also firms in state ownership. (The foreigners participating in foundation did not buy state property either, but "associated with it".) Nor did the later "debt-shares swaps" lead to privatization, since the shares were in the possession of state-owned organizations (mainly commercial banks). The only exception was the sale (handing over) of shares to foreigners.

The applied model ensured *the organizational separation of proprietary from managerial functions, and gave a greater independence to the management of factories than before*. (Since the form of management by company councils made the achievement of total independence illusory from the outset, the company form usually meant an acceptable compromise for the units intending to leave the traditional large enterprise structure and wishing to become independent.) This solution *also enabled the maintenance of the large company center and the preservation of its influence* (although with a reduced staff and modified role).

In practice, the model did not prove to be entirely free from conflicts. Although the operational independence of associations typically increased, the organizationally separated proprietary position also *enabled* the company center to use more direct forms of intervention than before. The *proprietary* (property managing) *organization* established from the center *was not forced to exercise the proprietary*

[7] A form similar to but not quite the same as a holding company.—Ed.note.

rights entrusted to it by the state more efficiently than before. Lacking the criteria of efficiency regarding the property centers, even the (discrete) *consumption of property had no consequences.* Nevertheless, this solution was not absolutely free from dangers for the center either. It made necessary a drastic reduction of the central staff, as well as the delegation of operational decisions. Indeed, from the very beginning, *it implied the possibility of the center's elimination.*

The above described contradictions also justified that in most cases, *greatly indebted* companies in a difficult economic situation, were almost *forced to take a step* and to transform their organization. For them this step *offered an alternative to bankruptcy.*

The financial situation could be improved by swapping debts for proprietary shares, the involvement of external resources, the revaluation of parts of property, etc. *The outside founders (banks, suppliers, etc.)* practically *gave assistance in the financial rehabilitation of the company.* (This form was also much more favourable to them than participation in bankruptcy proceedings initiated before the court.)

Until the enactment of the Association Law, in addition to those escaping from bankruptcy, such companies also transformed their organizations which found the "structure of property center-associations" advantageous, but could not have fulfilled the provisions related to the foundation of associations stipulated in the draft bill. In the second half of 1988 transformations were also stimulated by companies motivated to receive the tax allowances[8] related to the foundation of associations, which were to be terminated at the end of the year.

After the law on economic associations entered into effect the circle of organizations undertaking the foundation of associations became much *wider, their motives more diverse* and, accordingly, the *ways of association foundation more varied. The escape from bankruptcy and the generally bad liquidity situation also explain the phenomenon that companies frequently applied solutions not contradictory to the letter of the law but rather its spirit.*

The lack of money and the incapability of involving external resources led to various "tricks" to avoid the 30 percent cash proportion prescribed for the foundation of associations. A frequent solution was to establish the associations with a *minimum capital,* then to raise the association's basic/stock capital almost simultaneously with foundation. (On the basis of the Securities Act (Act VI: 1990), in the case of share companies, the raising of the (registered) stock capital is no longer possible within a year!)

The essence of the other solution was that the prescribed money was made available to the established association only seemingly, *for a temporary period.* In some cases, the lack of money resulted in the case whereby the determined organizational transformation *was not performed in one step, but in a prolongated manner, unit by unit,* theoretically at the pace by which the prescribed cash could be made available. Step-by-step foundation could become the *source of*

[8] According to the regulations valid in 1988, the new associations as well as the ones established through organizational transformation could reckon with a 55 percent profit tax allowance in the first year of operation, 35 percent in the second year, and 25 percent in the third year.

serious tensions since the units still operating as sections of a state-owned company thought that the units already functioning as associations escaped from bankruptcy at their expense. The companies in the most difficult situation usually *could not find external partners for the foundation of associations*, therefore, they especially preferred the foundation of one-man ltd-s. (This is allowable under the Association Law.)

For the associations the lack of money rendered such solutions acceptable when the founder(s) *only took a part of the assets required for operation into the associations.* (In extreme cases, only machines or materials. The other assets needed for operation were leased or were continuously purchased by the associations from the founder which functioned as property manager.) Right from the outset, the *degree of capital supply was very low* compared to the volume of the activity and thus renders the survival of associations dubious in the long run.

The poor liquidity situation of Hungarian companies greatly motivated the efforts at involving foreign partners. Naturally, this was not the only motive that played a role in the search for foreign partners, but also the need for acquiring foreign products and technologies (and possibly markets) in addition to *tax allowances* due in the case of foreign participation.

During the foundation of associations the companies did not strive to have their properties assessed at values far exceeding the book values, even if this would have been reasonable. Beyond the lack of money other diverse reasons can be found. Revaluation would have increased the cash demand for foundation automatically, i.e.it would have worsened the chances of "bringing the associations together". The assessment of contribution in kind at a value less than actual, however, created a favourable situation for the other participants in the foundation since *their shares* were shown at a greater than *actual* value. In cases when foreign capital or Hungarian private capital also played a role in the founding, *this meant in real terms privatization of state property without compensation.*

According to a representative survey of the State Audit Office (1990), the companies founded by ministries *took their properties into the associations at a value exceeding the book value by 16 percent.* Real estates were revalued by 17 percent on the average, machines and equipment by 57 percent; while materials were taken into account at 80 percent of the book value, and own production stocks at 74 percent thereof. Since, according to the State Audit Office's data related to the same group, foreign proprietary contribution accounts for only 7 percent of the state property brought in and the participation of domestic private capital is of a negligible extent, *we have no reason to assume that unrealistic property assessment would have led to the handing over of state property to a considerable degree in this circle.* The interests in the low par value of shares (capital shares) are very diverse. In addition to facilitating the involvement of other founders, a low par value enables the avoidance of selling shares below par value, increases the chance of swapping debts for shares, and sets a dividend requirement for the associations which it is easier to meet.

As also shown by the cases tackled in the press with great publicity (Budavár Corp., Budapest Confectionery, Orient Catering Corp.), the foundation of associations arousing the suspicion of the (cheap) distribution of state property most often took place in the case of *trading and catering industry* companies mostly founded by the councils.

In this category it was standard procedure that companies *brought the decisive majority of their properties into share companies* by involving 10 to 30 percent external capital and then *they organized their shop- and business network into joint ownership of the share company and private individuals in the form of ltd-s.* (According to the survey of the State Audit Office, foreign participation is hardly greater than 10 percent even in the case of associations of companies founded by councils, while that of private individuals is 1 to 2 percent, with personal investment typically around HUF 100 thousand.) *Uncertainties in connection with the valuation of various rights enabling the use of real estate* (proprietorship, right of management and lease), as well as *the handing over of rights related to real estate at irrationally low values* resulted in that *foreigners and private individuals could acquire a property disproportionately high compared to their contributions.*

Among retail- and catering industry companies undergoing the association foundation was greatly motivated by the *intention of forestalling the privatization law which was being elaborated.* Since the draft bill (and the preliminary privatization law finally accepted in September 1990) threatened the existence of company centers, the centers frequently ventured upon the foundation of associations without proper preparation and the tendering of potential partners on the basis of the first acceptable offer.

Naturally, this rush and the fear from legal conditions becoming stricter[9] was observable not only in the case of trading companies. Industrial enterprises have not devoted a significant amount of energy to the search for partners either, therefore, the partners involved in the founding of an association usually came from their traditional circle.

Among the state-owned companies' stated objectives in connection with the foundation of associations, efforts at *improving efficiency* as well as the operation of state property ensuring higher yields than before were in the first place.

Investigations, however, *do not prove that the foundations of associations would have led to the improvement of the companies' results.* (ÁSZ 1990) It was rather the *place where profit* was generated which changed; profit being generated typically at the associations. Frequently, the increase in profit pointed out at the associations is misleading, resulting from the change in accounting within the company. The improvement of the companies' profits—if any—rather resulted from the self-reorganization activity accompanying the foundation of associations, as well as from the sale of property assets.

The associations usually made use of the opportunities of freer wage policies, and increased wages even without considerably reducing staff numbers or remarkably modifying the product structure. There are some examples of a major modification in production methods (or conditions) and product structure only in the case of associations with majority foreign participation.

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[9] In the first half of 1989 the act of transformation being elaborated, then the property protection act, also in preparation, accelerated the foundations of associations.

It is *an undisputable achievement* of the foundation of associations—which *can be judged in various ways*—that it *offered an alternative compared to* the less and less obtainable *reorganization (rehabilitation) by the state* or of liquidation proceedings replacing reorganization. (There are opinions, according to which the foundations of associations replaced reorganizations (rehabilitation) by the state in the amount of HUF 50 to 60 billion. (Matolcsy 1990, p. 51)) This is not uncontentious since from this perspective transformations served for the *maintenance of the existing production structure*. If, however, we also consider that in the examined period *bankruptcy proceedings have not led to the liquidation of outdated production either* (or the privatization of assets per se), then *the foundation of associations can be regarded as a socially less expensive method* than bankruptcy proceedings.

The positive consequences of the foundation of associations are much more unambiguous than the *disintegration of* the previous extremely *centralized organizational structure which has begun in the case of large enterprises as well.* Although, theoretically, the remaining state-owned company centers as owners may manage their associations even directly, the legal entities, the free market, and financial relations of the previous units can be regarded as important developments towards a more decentralized company structure.

It is a frequent accusation against organizational changes taking place according to the Association Law that such changes *have not brought revenues to the state budget*—as opposed to the changes corresponding with the Act of Transformation—and so *they have not contributed to the diminishing of state debts either*. This objection is difficult to interpret if we take into account that in the decisive majority of such actions *the selling of state property has not taken place at all*, or if it has occurred, the receipts did not reach beyond the circle of state-owned organizations.

It is a much more serious problem that, *in some extreme cases*, the transformations taking place on the basis of the Association Law also enabled the *disappearance of state property.*

During such actions at the state-owned company nothing remained but the low interest-bearing bond of the association founded by it (See e.g. the transformation of ÁPISZ). The preliminary privatization law (Act LXXIV: 1990) tried to remedy the loss suffered by the state in such a way that it minimized the interest of bonds passed to the State Property Agency at the highest interest rate set for deposits of domestic private individuals.

Until the establishment of the State Property Agency and the acceptance of the law protecting state property *no external control restricted* the company management's ideas regarding the foundation of associations. Usually, company councils could be convinced of the necessity of transformation, and *it occurred only occasionally that the company council defeated the intentions of management.* Although most companies informed the founder about the planned changes, in the case of self-governing companies, the founder did not have the right to supervise them. It is somewhat more surprising that *the ministry* did not exercise its rights evenin *the case of large enterprises under its administrative supervision, and transferred the right of decision to the board of directors of the individual companies.*

All this proves that the *accusation, in which the form of management by the company council is responsible for the "emptying" of companies and the establishment of a confused and not easily extricable proprietary structure, is simply not true.* Even administrative supervision could not promise a guarantee against this. At companies under administrative supervision, the employees' and factory unit representatives' control over the foundation of associations was also not enforced.

In addition to the rules in force, the founders' passivity was attributable to the economic political consideration which *regarded* state-owned companies' activity aimed at the foundation of associations as *basically promotive* (and therefore, not to be hindered), and which wanted to restrict the possibility of abuse at most.

From the second half of 1989, with the acceleration of the change of *political* systems, debates over the judgement of "spontaneous privatization" have become more fierce. There were considerable differences of opinion among the parties—but frequently even within the parties themselves—regarding the evaluation of spontaneous privatization and the possibility of its continuation. Still, there was a general consensus on the issue of efficient *control* of the fate of state property as something non-negotiable. The law about the State Property Agency and the protection of state property entrusted to companies, which entered into force in early 1990, intends to ensure the above.

According to the original law, the duty of the State Property Agency planned to have a small staff number and was to operate under *parliamentary* supervision was to *control* the establishment of associations (transformation into associations) of self-governing companies, and the *initiation* of transformation at those under administrative supervision. The State Property Agency could *veto* company intentions, but the decisions of the State Property Agency could also be *attacked before the court.*

Since the legislators did not mean to make the State Property Agency an organization with a wide range of activity or a great economic power, they restricted its scope of authority in several respects. Thus, e.g. the scope of authority of the State Property Agency *did not cover companies founded (supervised) by (local) councils.* In practice, this resulted in the fact that among companies founded (supervised) by councils (mostly trading and catering industry), until the modification of the Land Act (Act XXXVII: 1990) in early summer, the change from state property into the association form—in some cases, in a manner hurting state interest—went on without any control.

Following the change in political system the *government's judgement of "spontaneous privatization"* has changed considerably; it has become *more negative than before.* Accordingly, the government strives for a more intense control over the foundation of associations. This intention has also been indicated by the modification of the law regarding the State Property Agency (Act LIII: 1990).

Naturally, the change in the government's judgement affects ideas at the microlevel regarding organizational transformation. Today company management considers very carefully whether to "organize the company from under itself".

Concerning the privatization we are facing, it is of a fundamental importance that "spontaneous privatization"—while offering an opportunity for *practicing* certain privatization techniques as well as the operation of associations—***has created an unclear and, in several respects, confused starting situation*** for actual privatization and ***has rendered proprietary relations impossible to survey.*** (The associations of state-owned companies themselves have established associations with various partners, and so on.) Although the remaining company centers operate as organizations for property management in many respects, ***their role and scope of authority have remained undefined*** and their operation ***has not been regulated by any formal efficiency criteria.***

This may justify the fact that the Second Privatization Program of the State Property Agency is aimed precisely at those property centers now empty. The details of this program as well as the companies taking part in it have not been published as of the completion of this paper. So much is known that the program is aimed at the *restructuring of confused organizations, the termination of a part of the centers having become empty, the transformation of another part of them into actual property management organizations, as well as at privatization, wherever possible.* The company managers' future participation in privatization will be affected basically by the manner in which the Second Privatization Program is implemented. This is why it is especially important that the fate of empty property centers should be decided upon exclusively professional considerations and not political ones. The termination of these centers in a campaign-like way would also be a mistake because today there are no organizations in the Hungarian economy which could take over the duty of property management deemed necessary in the longer run as well. (This must not be a duty of the State Property Agency!) Therefore, it seems evident that—under proper conditions of efficiency—the State Property Agency entrusts the operation of property until actual privatization to the already existing organizations or organizations newly founded from existing ones.

State-owned companies' activity aimed at the foundation of associations entails the danger of a concentration of economic power even more intense than before. Concentration does not promote market competition but the emergence of a new type of monopoly. This is because the *organizational decentralization* favourable from the viewpoint of privatization *may be accompanied by the concentration of proprietary rights* (mainly in the hands of large commercial banks), meanwhile property will still not be out of the state-owned circle.[10]

[10] For the evolving of this idea see Éva Voszka's case study. (Voszka 1990)

Associations from companies
(The emergence of associations on the basis of the Transformation Act)

The foundations of associations discussed so far were characterized by the fact that the state-owned company persisted irrespective of whether a part, or even all of its property was taken into the form of an association. In most cases, this was a solution that was easy to manage. At the same time, practical demands indicated that the state-owned company has to be allowed to transform into an association entirely in such a way that the *association being established be the general legal successor*. The section of the *Transformation Act* (Act XIII: 1989) related to state-owned companies has regulated the technique of such "full" transformations. The act that entered into force in July 1989 has *restricted only slightly the rights delegated earlier to self-governing enterprises.*[11]

The transformation of the company could be initiated by the self-governing organ. In the first phase, out of the securities of the new association only part of the capital representing 20 percent of the former state-owned company's property went to the state property administrator, and the remaining 80 percent could be kept and marketed by the established association for three years. (20 percent of the amount received from sales was due to the association, while the remaining part increased the revenues of the state property center.) For the transformation of a self-governing company at least a 20 percent (or HUF 100 million) capital increase was required. In the case of companies under administrative supervision, the latter was not a condition of transformation. For the latter, shares representing the former company property went directly to the state property administrator. The law provided that a self-governing company with more than 50 percent of its property consisting of stakes in economic associations must transform into an economic association within 2 years. This presumed that the directing companies (property centers) established from large company centers could not survive in their existing form in the long run.

In September 1990 the Act was modified by the new Parliament in such a way that rules related to the transformation of self-governing companies become very similar to those related to companies under administrative supervision. Moreover, the State Property Agency has been given a greater role than before in the transformation process of self-governing companies (it may intervene to a greater extent).

The majority of the companies have circumvented the Transformation Act even after its enactment because generally the Association Law provided more favourable conditions and more flexible possibilities. Frequently, the self-governing

[11] With the knowledge of organizational-proprietary transformations following the introduction of the Association Law, even before the enactment of the Transformation Act, the demand for the protection of state property and for the *strengthening of rights related to state property* has arisen. For this purpose those opposing the enactment of the Transformation Act would have regarded the restriction of managerial rights as necessary. The legislators argued that the Transformation Act is neutral regarding property relations, and it only regulates the technique of transformation. For the opposing standpoints see: *Bokros* 1989, *Bokros and Tõmpe* 1989 and Sárközy 1989.

Table 1

Associations having been established in accordance with the Transformation Act

	Stock capital (million HUF)	State / Foreign share (percent)	
Transformations approved by the State Property Agency (up to November 1990)			
"Richter Gedeon" Chemical Factory Corp.	11,500	99	0
KAPOSCUKOR Corp.	2,570	65	31
Canning Factory Corp. of Debrecen	2,153	91	0
DÉLKER Corp.	2,011	57	0
Vineyards Corp. of Kecskemét	1,121	75	0
"Petőfi" Printing House Corp.	978	42	50
Clothing Factory Corp. of Zalaegerszeg	579	65	31
Building Ltd. of Pécs	527	43	50
TRITEX Trading Corp.	403	99	0
CARBON Light Industry Corp.	315	60	37
Glass Industry Machine and Instrument Factory Ltd.	258	100	0
KALIBER Ltd.	240	77	17
Volkswagen Car Repair Ltd. of Óbuda	141	65	0
Public Road Investment Ltd.	137	27	69
Some associations having been established before the foundation of the State Property Agency			
Chinoin Pharmaceutical Factory Corp.	3,000	90	n.a.
Biogal Pharmaceutical Factory Corp.	3,090	20	n.a.
Ganz Meter Factory Corp.	470	100	0
Styl Clothing Factory Corp.	481	14	n.a.
Metallurgical and Servicing Corp. of Diósgyőr	11,394	100	0
Sugar Factory Corp. of Ács	760	35	n.a.
Pannonvin Corp.	750	64	n.a.
IDEX Consulting Engineers Corp.	529	n.a.	n.a.
Promontovin Vineyards Corp.	580	63	n.a.

n.a.= not available
Source: ÁVÜ (1990 b)

companies could not meet the requirement of involving 20 percent external resources. In many instances, the transformation of the whole company was not possible. Stricter control as well as the property shares to be transferred to the state also restrained the companies from a wider application of the Transformation Act. Such transformations were encountered only a few times until the establishment of the State Property Agency, and until the end of 1990 hardly more than a dozen cases (actually occurred). (*Table 1*)

The rules of the Transformation Act were followed sometimes when *organs of state administration* themselves *initiated* transformation—in the interest of launching privatization (for the purpose of selling to foreigners)—(e.g. the Ganz Meter Factory). In other cases, based on the consideration of individual circumstances, company management decided on "full" transformation *as a general legal successor*.

Those choosing the Transformation Act "voluntarily" are rather small- and medium-sized companies which frequently operate only on one premise, or there exists close vertical relations among their premises (plants). In this situation, usually *there was no way* of a sharp organizational separation and *economically justifiable "logical" division* of the individual activities, or it was thought that such a division (e.g. a traditional state-owned company and ltd.) within the same premise would lead to the *emergence of inner tensions which would be impossible to manage*. Among the motives was the belief that given the application of the Transformation Act, the *remaining state-owned company center would not really have a function justifying its existence*. From among the large firms who made use of the opportunity of the Transformation Act they felt the keeping of the company's unity fundamental from a strategic standpoint. *Aspects of self-protection* also played a role in the decision of managers to choose the Transformation Act: they wanted to avoid suspicions accompanying transformation. During the various steps they strove for continuous coordination with the founder, then with the State Property Agency.

Company managers transforming their companies on the basis of the Association Law—in the cases familiar to the author—decided so based on *long-term economic perspectives*. They did not escape from immediate bankruptcy—as firms taking property into the associations and leaving the burdens to state-owned companies—but *recognized in time* that, as a result of the drastic changes in external circumstances, *the company's existence would become impossible in its unchanged form within one or two years*. Expected economic problems were forecast by the loss of traditional markets and clients, or the lack of necessary developments and the shortage of development resources. Since these companies in a relatively *good financial* situation actually "escaped forward", *they had a greater scope of movement when choosing from among alternatives and potential partners presenting themselves*. (The "still well-balanced" economic situation was usually a fundamental condition for the company to ensure the 20 percent external capital involvement prescribed for self-governing companies—with a property assessment acceptable to the State Property Agency.) Not being in a condition of financial emergency, the managers searched for such owners who *did not simply bring money*, but offered advanced *technologies*, easily marketable *products*, as well as *markets* for the products. And from among the expressly financial investors they tried to associate with the ones, who had *interests in the given production profile*. From the future owner they expected the promise of a solution for the company's fate *in the long run* as well. Obviously, it was also a motive—although not emphasized by company managers—that *the new (part) owner may accept the existing management.*[12]

Property assessment prescribed for transformation *usually resulted in property values exceeding the book values.* (In the 14 cases so far, approved by the State Property Agency, the property amounting to HUF 15.5 billion at book value was taken into the association at HUF 23 billion, i.e. revalued by 48 percent.) The difference is especially great in the case of companies having considerable real estate. During the establishment of joint ventures any deviations from the book value resulted in problems when the preliminary negotiations preceded property assessment. Consequently, the negotiating partner formed his own business ideas on the basis of the book value, and was reluctant to accept a higher value, therefore requiring a greater investment by him.

In one of the cases, with the consent of the Ministry of Industry, transformation took place without property assessment at an *"agreed"* value very close to the book value, which was still rather uncertain at that time. In another instance the foreigner accepted the result of the property assessment. Yet with the given value, it did not undertake to provide the 20 percent external capital but only to purchase the existing business shares. The State Property Agency gave its consent to this solution. (The modification of the Transformation Act no longer requires the 20 percent capital increase.)

During the transformation the State Property Agency strove for the enforcement of some general aspects corresponding to the Guiding Principles of Property Policy. The State Property Agency tried to get the promise of associations with foreign interests for the investment of the profit tax allowance in Hungary and for the achievement of a positive foreign exchange balance. The State Property Agency also intended to increase the value of companies by including their intangible assets, but the partner reacted with a similar effort. Therefore, during assessment, they typically stuck to the consideration of material-natural (physical) contributions.

In the known cases, simultaneously with transformation the *issue of employee's shares (property shares) has not taken place.* Meanwhile,—in accordance with §23 of the Transformation Act—the contracts of association held out the prospect of the *subsequent* realization of employee's ownership. Due to the *unclear nature of regulation*, the immediate application for employee ownership was indeed refused by firms where the required resources were already available separately. *In the case of the ltd. form, the possibility of giving business shares to employees is*

[12] It has to be noted that even then the company management involving a foreign partner assumed a considerable *risk of subsistence* since, even with a well-known owner selected on the basis of long-term cooperation relations, the owner's behaviour is not unambiguous. The quasi-proprietary nature of top management has ceased by transformation and also as managers they have got into a situation more uncertain than average.

absolutely unresolved. Nevertheless, the positive reception of transformation within the company could be promoted by the issue of employee shares or property shares.

It is also true that—according to the company managers—mainly manual workers do not firmly demand property shares in all companies. Company managers would require legal rules elaborated in more detail also to avoid that they are accused of getting unjust advantages during the distribution of property shares.

The companies having transformed according to the Transformation Act judge the chosen *form* in very different ways. Judgement mostly depends on the date of transformation—on the *difference between the conditions* hoped for and reasonable at that time and those which materialized or have changed by now. Thus, a company being one of the first to transform would not regard transformation "worthwhile" and feasible according to the present rules. The companies having transformed later (i.e. after modification of the law) could take into account the changes in the law and could accommodate them.

Although the modification of the Transformation Act has brought numerous disadvantages for associations, according to available information, *an increasing number* of companies planning and realizing the switch-over to association form presently apply this Act. Since the participation of the State Property Agency in privatization also cannot be avoided in the case of other forms, *the arguments against the application of the Transformation Act have weakened.* Since the modification the necessity of the 20 percent external capital involvement no longer represents an obstacle.

From the viewpoint of company self-government and especially of the company managerial layer, today it is not important whether to choose the Association Law or the Transformation Act, but to *remain a participant in* (or possibly a leader of) *the unavoidable privatization* program and not to become a simple *victim* of it. Therefore, for management such solutions seem as advantageous in which *it can take part in the selection of owners* and whose rules are at least somewhat *foreseeable.* This is why transformation according to the Transformation Act *may be a desirable way for companies finding their buyers and not requiring decentralization.*

If one considers the national economy, an unquestionable advantage of the application of the Transformation Act is that incomes from privatization of the associations transformed are due to the state budget through the Property Agency. Such revenues can serve as resources *to diminish state debts.* However, data has demonstrated that during the transformations performed so far on the basis of the Transformation Act "only" *adequate conditions for privatization have been established*, and *the actual selling of state property has taken place much more rarely.*

Becoming independent as a state-owned company

The group of organizational changes when separated units of state-owned companies initiate independence is not quite independent of the today "fashionable" process of the establishment of associations or the transformation into associations. Since the modification of the Company Law (§62 of the Act XXII: 1990) in spring the company council no longer has the last word on the judgement of separation movements.

According to the new regulations, at the request of two-thirds of the employees of the separated unit, the company council must decide within 30 days on becoming independent. If refused, the transformation into an independent company may be requested from the founder. The founder decides within 60 days whether to establish the unit as a new state-owned company. Units of companies under administrative supervision may request separation directly from the founder.

As a result of the law's modification, the number of factory units and sections wishing to become independent has increased considerably.

According to the records of the Ministry of Industry and Trade, up to February 1991 more than sixty units of more than forty companies requested independence. In *two-thirds* of the cases the founder *complied*, and in the case of one-third of the initiating units, the deed of foundation has been issued. Two units have withdrawn their intentions, and one has been sold. So far the Ministry has made negative decisions in six cases, referring to the advanced stage of privatization, or the bankruptcy situation of the company, and/or the low staff number of the unit wishing to become independent. In a few cases, the Ministry has made its standpoint dependent upon a decision of industrial policy expected in the near future, as well as the opinion of the State Property Agency.

Among those initiating separation the majority are units of companies *suffering from a drastic market contraction* and a *financial unstability.* Usually, units having *relatively better market perspectives* request independence since, if separated, they can see a greater chance of avoiding bankruptcy, while remaining within the company, they cannot find any solution also satisfying their interests. *The expression of the intention of become independent can frequently be interpreted as a direct reaction to the company center's plans, thus in defiance of the unit's interests.*

It happened in several cases I have become familiar with, that the employees of the plant initiated separation on hearing the plans related to the *closing down* or *selling* of their plant. For others, the base factory's efforts at *changing production profiles* resulted in the plan of becoming independent. The ideas related to the foundation of association, which did not reckon with the opinion of the unit and broke the logic of its operation, could also lead to the initiation of separation. There was such a case, too, when the unit being forced to bear the burdens resulting from the transformation of the other units of the company into an association requested independence.

There are examples when the declaration of the efforts of various units at becoming independent prompted the company center to devise plans for reorganization, but rather the opposite case is typical. The increasing number of requests for becoming independent encouraged a suspicion that the foundation of associations directed from the company centers *has not always corresponded to the interests of the units concerned even earlier, but with the given power relations and legal conditions, the units have not had efficient means for protection.* (In the case of a self-governing company, the transformation of a unit into an association resulted in the termination of the given unit's representation within the company council. Therefore, it has become even more exposed to the already "outside" owner—to the company council representing mostly central interests.)

Two-thirds of the requests for becoming independent were submitted by units of companies managed by company councils. According to experience, more frequently it occurs that the company council approves of separation, the parties agree on the sharing in property and burdens, and the founder only ratifies the prepared solution. Based on practice to date, resistance does not make great sense and often it only prolongs the state of *uncertainty* unfavourably affecting the company as a whole. A solution more favourable from the position of the remaining part of the company can be achieved if the company center is ready for compromise.

The process of becoming independent is the "smoothest" *if it also fits into the company's remaining plans, and if the company's economic situation has not yet worsened irreversibly.*

Paradoxically, even the company's actual bankruptcy situation can be favourable as regards independence. If the company can no longer be saved as a whole, the company council may approve of separation so that a unit may at least be given a chance for survival. If the company council makes a negative decision, it also determines the fate of the unit. (The founder may not decide on the change to independence of a company's bankrupt unit, since during the liquidation procedure it would be qualified as fraudulently saving property.)

Company councils firmly refused the efforts at separation in cases when they *felt the existence of the company and the company center to be endangered* by the unit's becoming independent. It is a justifiable fear that *the separation of a factory unit arouses similar intentions in the other units as well* (there have been several examples of others also joining a unit's efforts at separation). The defense aimed at preventing a unit's independence is especially strong in cases where *the company center is organizationally independent from the base factory as well,* and thus the company's possible disintegration may lead to the center's total loss of its functions and, consequently, its termination. Resistance is also strong when *the separation of a unit functioning well and bringing profit threatens with the bankruptcy of the remaining part of the company within a short time period.*

Company councils, where central interests dominate, usually refuse the efforts at becoming independent by referring to the *insolvability of financing* after separation.

This is an actually existing problem. In view of the "queue" and the general practice of credit granting, no special explanation is required for understanding that for a "new" company starting with burdens and having a poor supply of operating funds *it is very difficult to get enough credit for the financing of production.* Moreover, there is also the danger that, (referring to the reduction of guarantees for credit) the financing bank also withdraws the credits from the remaining part of the company. In the case of smaller dimensions, the chances of "financial fire-fighting" and "the stopping up of holes" will undoubtedly diminish. (At a large company there are always substantial receipts which ensure that the most threatening servicing enterprise or the most important supplier can be satisfied.) At the same time, experience has shown that when other conditions for independence (technical, personnel, etc.) are given, then usually the difficulties of financing can also be bridged.

In case of conflict, the chances of separation are greatly affected by the former *independence* of the unit wishing to separate within the company, as well as *by the degree of individual functions established and the amount of information available to the unit. Where the finances of the units are managed, where the payment of various bills is decided on is undoubtedly crucial.*

The company center may render very difficult the situation for its unit wishing to become independent for instance, by not paying for materials or deliveries necessary for the maintenance of production. If finances are decentralized, by holding back payments the company unit may enforce the factory unit's own interests against those of the company center.

On the other hand, the centralized management of finances may lead to the units' intention to separate which may prove to be unfounded. Outside the daily problems of direct financing, the units may be feeding a false illusion regarding the chances for independent operation.

At the same time, the stated goal of independence is complicated by the lack of information. Frequently, the company center is unwilling (or at least reluctant) to provide the information essential for a realistic judgement of the situation should an independent status be achieved. The difference in the degree of information may also be disadvantageous in disputes related to the distribution of property and liabilities. (Since the unit is not an independent legal entity, it is not entitled, for example, to commission an auditor to check the authenticity of the figures presented by the center.)

In the struggles for independence parties with conflicting interests try to use other means as well, in addition to the probative force of figures. Thus, some company councils tried to prevent the separation of their units by rapid foundation of an association and by regrouping property. Such actions are no longer possible under the most recent modification of the Company Law (Act LXXI: 1990).

In some units intending to become independent the *workers' council* led the relevant efforts. (There were cases where the workers' council was established just with the objective of winning independence.) Although the workers' councils tried to preserve their political independence (at least at the very best) *elements of party policy* were also involved in their activity. It happened that in order to achieve their goals, they tried to exercise pressure on the decision-makers through members of Parliament. There were even examples—although few—of the use of warning strikes, both on the part of those wishing to become independent as well as those opposing it.

The founder playing the role of an arbitrator—in these examples the Ministry of Industry and Trade—tries to judge the applications for becoming independent exclusively on the basis of *professional* criteria. It examines whether the conditions of independent operation are ensured at the given unit.[13] The Ministry *asks* the initiator of separation to present *its economic and financial calculations serving as a basis for its intention*, while from the company it requests the *presentation of the impact* of separation *on the remaining company*. If the capacity of operation of both parts of the company seems to be ensured, the Ministry establishes the new company. The founder does not wish to intervene actively in questions of the distribution of property, but recommends the involvement of an independent expert in the settlement of disputes.

After a decision of principle is made on separation, the elaboration of an agreement may take longer. Even after the acceptance of the *principles* of the distribution of property and liabilities, a lot of arguable questions are left for settlement. For the operation of the new company the elaboration of some base indicators (e.g. wage base)—essentially influencing the conditions—are also required.

The units striving for becoming independent do not judge the longer-term chances of *existence as an independent state-owned company* in the same way. There are cases where they *want to keep this status in the long run as well.* They wish to prove that "even a state-owned company can be as efficient and can operate as effectively as an association", and they have definite prejudices against a possible outside owner. In other cases, it is thought that independence is only a means *serving that the standpoint of the units be taken into account during the unavoidable privatization.* At some units *the employees themselves want to become owners* using the program of employee shares as well as the credit constructions for subsistence and for privatization. Employees think that as owners they *will be able to keep their jobs*, and thus secure their livelihood.

The units which reckon with the appearance of an outside owner—and the realities of the economy—believe that "no matter who it may be, it could only be

[13] After a short period of uncertainty following the appearance of Act XXII the routine of handling matters of separation has developed at the Ministry of Industry and Trade in a separate department. The Ministry intends to influence the companies in such a way that they should not hinder the efforts at becoming independent by rough means, and should provide the necessary information in the interest that the conflict may not become intensely acrimonious. (This could render both cooperation and the agreement on the details of separation impossible.)

better than the company council". Others *hope for a chance as an independent company to influence privatization.* They want to ensure their future survival by *searching for an owner bringing technical renewal and market-opportunities.*

Changes initiated by companies, from the viewpoint of privatization

As seen from the aforementioned, in the period under analysis the actual handing over of state property into private ownership—i.e. privatization in the narrower sense of the word—occurred only now and then. (Selling of TUNGSRAM and the Ganz Vehicle Factory to foreigners, the selling of IBUSZ shares on the stock exchange, etc.) The main movements were rather the changes described—the foundation of associations and transformation into associations by state-owned companies, as well as companies becoming independent. These changes influence the conditions of privatization we are now encountering and—although they have not changed considerably the proportion of state property—*their having taken place cannot be ignored during the actual selling of state property.*

The separation of units may certainly be favourable for a subsequent privatization. It is easier to find solvent buyers for a smaller company, and the prospect for employees' ownership may also be greater.

Usually, the transformation of a company as a whole into an association is also attractive since it becomes clear with whom the potential buyer must negotiate with regarding the purchase. The form of an association also simplifies partial selling in technical terms. It may cause problems, however, if the justified decentralization of the company does not take place before transformation since it makes it difficult for the buyer to acquire the part of the company he is interested in.

It is much more doubtful how the privatization of associations founded by state-owned companies may take place. In their case, numerous unclarified questions hurting interests *vis ā vis* both the state and the company may arise: e.g. whether the majority owner, the state-owned company (property center) or the State Property Agency should decide on selling; who should receive the income generated from privatization, etc. (A simple elimination of the property centers is hardly conceivable due to the arising problems of legal succession. It would be a critical—and not necessarily acceptable—change from the viewpoint of the outside owners of associations if the State Property Agency replaced the original founder as a co-owner!)

In the case of certain groups of companies, the confused and complicated ownership relations may also discourage the potential buyer. At the same time, the chances of privatization may be improved by the presence of outside (foreign) owners in the association, as well as by organizational decentralization having taken place simultaneously with the foundation of associations.

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(ПСЕВДО)ПРИВАТИЗАЦИЯ ГОСУДАРСТВЕННЫХ ПРЕДПРИЯТИЙ. ИЗМЕНЕНИЯ ФОРМЫ ОРГАНИЗАЦИИ И СОБСТВЕННОСТИ 1987–1990

М. МОРА

С точки зрения будущего стран Восточной Европы основное значение имеет, удастся ли и за какое время перестроить прежние плановые хозяйства в рыночное хозяйство. Успех процесса в большой мере зависит от того, как будет разбита преобладающая, превышающая 90 % государственная собственность, и какая структура собственности и предприятий создается в результате приватизации. Хотя приватизация только что началась, учитывая особенности венгерского развития, в Венгрии есть уже некоторый опыт касательно перестройки государственной собственности, или в некоторых случаях приватизации. Этот первоначальный опыт был собран в трактате от 1990 г. Экономического исследовательского института. Статья составленная на основе трактата показывает главнейшие типы изменений организации-собственности, указывая на то, в какой мере модифицировали эти изменения исходное положение приватизации.

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THE WEIGHT OF PRIVATE ECONOMY IN TERMS OF MONEY IN THE INCOMES AND EXPENDITURES OF HUNGARIAN HOUSEHOLDS

K. BALÁZS–M. LAKI

This article presents the results of an investigation carried out by means of a detailed questionnaire, covering more than a thousand Hungarian households. It turned out that the private economy had a relatively low, i.e. about 10 percent, share in the houselholds' monetary incomes and expenditures in 1989. A great part of the households had no contact with the private economy, either as buyers, or as sellers. Nevertheless, in a few markets where the households were present, the private economy did play a significant role.

This article presents the results of a long protracted study. At the beginnig of 1989 we were entrusted with measuring the share, i.e. weight, of the private economy in the Hungarian national economy, within the framework of the research theme "How far has Hungary got in eliminating the shortage economy?" led by János *Kornai*.

The time and money avaiable to us enabled only a part of the task to be completed. Instead of measuring the size of the entire private economy, we set out with the objective to reveal the share represented and role played by the private economy in the incomes and expenditures of the Hungarian households. We carried out our investigation by means of a questionnaire. The questionnaire asked for many details about incomes, expenditures, and the origin of the assets of the families. It was answered by more than a thousand households.

With the investigation finished and the data computer-processed, the first tables were analyzed, and we reported on the results at various professional forums. Both the domestic and the foreign audience received the results with surprise, disappointment, and consequently, protest, since the share of the private economy in the Hungarian households' inputs and outputs seemed too low to many. The protest arose mainly on account of the sample we used, and our particular conception of the private economy. Therefore, we shall first set forth the definitions used by other researchers, and present data on private economy to be found in the Hungarian statistical publications, scientific reports and other studies. In the chapter that follows, our research principles, and consideration in sampling will be given, as well as our definition of the private economy. We shall explain at that point the differences of our definitions from those of others. Only then shall we set forth the most important findings of our research. The differences which will be discussed first are those which were found between the different groups of society as regards relations between households and private economy. This will be followed by a chapter showing the stages of privatization of the individual markets.

Definitions

The data and estimations concerning the size of the private economy have several forms, and each form differs widely. Considerable differences may be caused by the method and date of the measurement, as well as by the activities considered by the experts as part of the private economy.

In the Kádár era, experts in this field of research needed prudence even in naming their subject. To divert the attention of the ideologues of the communist system, they made efforts to find seemingly harmless concepts to denote the economic sector that was beyond the power of plannig and party control. István *Markó* (1986) speaks of complementary or auxiliary economy which can be "distinguished from the prevailing relations of production and distribution", István *Gábor R.* and Péter *Galasi* (1981) and Pál *Juhász* (1981) use the term "second economy". Curiously, the concept of private economy was not used even by the sociologists who published their works illegally, or by those who were working in emigration. They, too, were careful when considering this sector of the economy in its relation to the ruling system. Zoltán *Zsille* (1980) and Tamás *Földvári* (1976) write about black or grey economy, and István *Kemény* (1982) about the unregistered economy. (A similar variety of expressions can be found in the foreign literature on the subject.)

To the different names belong different definitions, and this shows that where the world beyond party control began the authors drew the limits at different points. On a more thorough examination of the definitions of the second, the unregistered, the complementary, the black, etc. economy, it turns out that they all have a common part, while some parts are excluded, or inculded, as if by a spontaneous consensus.

In the literature it is generally agreed that in the countries of state socialism the state-owned and large cooperative sector—which ideologists and statisticians call the socialist sector—does not belong to the other section of economy. At the other end, those activities (or some of them) which belong to the sphere of household economics and are not earnings but saved income are excluded from the definitions (János *Timár* 1988). It is noticeable that at both ends there is a rather large grey zone: it includes those economic actors who could be put either here or there.

It is mainly the values important to the researchers, the place of the investigation, and its purpose, that decide what and where will be categorized. In the Western countries, those activities which are usually classified as second economy, are ones which are directed at acquiring money, but are not measured and registered by the statistical or the tax office.[1] This definition of the private economy has been adopted by several East European analysts as well.[2]

[1] On the subject, see for example *Tanzi* (1982).

[2] This approach is also adopted by Marian *Wisniewski* (1986) in his interesting research work.

It is, however, a characteristically East European idea that the unregistered or illegal activities represent an active resistance to the established system. For example István Kemény says:"... it is only thanks to the counter-strategies of the population that the production and service units manage—even though at times with difficulty—to function... In normal times, therefore, it is the counter-strategies which ensure the normal functioning of East European societies: it is not consensus but opposition that lies at the base of these societies." (Kemény 1982). This approach may be useful for someone intending to write the sociology for revolt in order to become independent. (Zsille 1980) However, in that case in an analysis of the second economy, the actors of the state-owned sector, and those of the legal private economy, setting themselves widely different objectives, will find that they are in one and the same group.

Therefore, other scholars do not determine the place of the second economy as being outside the sphere of taxation, instead, outside "the socially organized production and distribution". "In a broad sense, the second economy is interpreted as the ways of using working capacities outside the socialist sector of the economy—in other words, the aggregate of the redistribution processes that take place outside the socially organized distribution."(Gábor R. and Galasi 1981) In this interpretation, not only tax evaders are considered as actors of the second economy, but also those involved in commodity producing or self-sufficient farming activities—carried out individually, with members of the family, or with employed labour—on small or large holdings or on household farming plots. Also included are those who let out rooms of privately owned or state-owned rented apartments, those who are involved in the sale and purchase of movables and immovables, as well as those dealing with money lending transactions between private individuals. (Ibid. pp. 17–18)

The attentive reader may have noticed that Gábor R. and Galasi not only added the legal and tax-paying private transactions to the sphere of the second economy, which others determined as that of illegal and tax-evading activities, but the "value of consumption stemming from their own production and from the physical income at their personal disposal" (1967) as well. This step directly follows from their definition, since this huge sphere of human activities was practically outside of the socially organized and registered sphere (i.e. organized by the party and state).

There is no doubt that self-sufficient production plays an important role in people's lives, not only in the archaic but also in the modern societies.[3] The economic activities pursued in households, i.e. the household economy, greatly increases the GDP and stabilizes the economy. A considerable part of the national wealth is also accumulated in the households. Under the socialist system, the households became especially important, since without their activities, even survival would have been impossible in certain periods amid the tribulation caused

[3] An excellent selection from the international literature is found in Sik (1989).

by the system. If the subject of someone's research is to be the sphere beyond that organized and registered by the party and state, the household economy must by all means be examined. It also cannot be ignored if the history or sociology of socialism is to be written. If, however, the subject to be examined is economy, and in particular, private economy, the researcher will encounter serious difficulties in theory, measurement, and registration. The theoretical dilemma arises when drawing the limits of the modern economy, because this usually causes few unpleasant problems in the course of the subsequent measuring. (If a household's fruit growing or jam making are economic activities, then so are shoe cleaning and baby sitting, not mentioned the intimate spheres of personal life.) One can get round this difficult question with certain practical considerations,—for example, one can say that whatever can be substituted by servicing is household activity.

However, the question remains to be answered—what unit of measurement is to be used: money or worktime? Some of the researchers of household economy hold the view that "an important lesson... taught by the household economy is that money is no longer the adequate measuring instrument of economic activities." (Burns 1989) However, too many economic transactions are effectuated in money to allow us to adopt this view. All the same, it cannot be denied that in households and the consumption of work is organized upon other consideration, and there are other things which are considered useful and profitable, which lay outside the market processes. It can be said that in one section of the economy it is monetary inputs, and in another section it is the working hours that determine the price of exchange value of commodities and services. Therefore, if someone includes the consumption of self-produced goods in the private, second, etc..., economy, the price paid in money will have to be converted into working hours, or conversely, the performances of the sphere in which transations are made for money will have to be measured in working hours (Timár 1988). These computations, which point to a significant weight of the private economy, are mostly based on the assumption that productivity is by and large the same in the first and the second economy. It is, however, not at all sure that this is the case within the sector itself. And, if private activities in certain sectors are on the increase, as is the case in Hungary, productivity differences between the sectors may largely affect the proportions under examination.

It is also not so easy to determine the money value of home labour input. The seemingly simple question "what is the price of the home-made jam?" can justly be answered by saying that it is the same as that of a jam bought in the shop. The approximate price can, however, also be computed by counting the working hours spent in making it and multiplying the number of the hours by the maker's average hourly wage. The two "prices" may show a significant difference.

Even this brief survey indicates that, *because of the differences in the values and computation methods used by the researchers, different weights of the private economy may be found in the same period and in the same country.* (In addition, the difficulties that may arise related to the transfers of the budget and social insurance have not yet been mentioned: for example, that the distribution of incomes and expenses between the private and the non-private sector may be different also on account of taxes, insurance premiums, or subsidies considered or neglected.)

In determining the subject and method of our research, not only these considerations and definitions have been taken into account, but also the results produced by the measurements and analyses carried out upon such bases. Before setting forth our own definition, computations and analysis, we shall present the results of the most important measurements and computations concerned with the size of the private economy in Hungary.

Data of the Central Statistical Office

The Central Statistical Office compiled detailed time series only on the legal private economy. The data on the number of actors (*Table 1*) clearly show that the legal private economy was growing fast during the 1980s. This growth was especially fast in passenger transport and the transport of goods.The number of private passangers carriers was 12 thousand in 1985 and has already reached 21,5 thousand in 1989; the number of freight carriers rose from 16 to 30 thousand during the same period.[4] It deserves attention—since it points to the rising performance of the private economy—that the number of employees grew faster than the number of owners in private industry and trade.

The figures in terms of value also show fast growth. At current prices, the outpout of private small-scale industry grew from Ft20.4 thousand million in 1985 to Ft40.1 thousand million in 1989, i.e. it nearly doubled in four years. During the same period, the output of the whole industry increased only by 26 percent, also at current prices.

Similar differences in growth rates are found in the consumption services (*Laczkó* 1990) and in the private retail trade. Retail turnover grew from Ft46.5 thousand million to Ft115.9 thousand million from 1985 to 1989, i.e. to 249 percent of the turnover of four years earlier. This is much higher than the growth in the whole of home trade, where its was only 161 percent.

The output of the private sector grew faster than the average also in the consumption services. The price receipts made in this field amounted to Ft26.3 thousand million in 1985 and to Ft70.6 thousand million in 1989; i.e. grew to 268 percent. During the same period, the growth of the total receipts from consumption services was less than that: 218 percent.

[4] Statistical yearbook, 1989. CSO Budapest, 1990. In the following, if the source is not given, the data are taken from the Statistical yearbook of the Central Statistical Office, or from the Statistical pocketbook.

Table 1

Number of artisans, retailers and employees

Year	Artisans	Artisans' employees	Retailers	Total number of workers in retail trade
1980	103,418	16,497	n.a.	n.a.
1981	111,860	18,224	n.a.	n.a.
1982	121,400	18,471	n.a.	n.a.
1983	131,803	20,562	n.a.	n.a.
1984	138,950	21,242	22,394	36,085
1985	145,583	22,966	25,445	42,085
1986	150,664	24,660	28,965	48,312
1987	154,011	38,897	31,827	55,041
1988	168,217	55,921	34,541	60,300
1989	174,837	73,554	39,612	68,200

n.a.= not available

Source: Statistical yearbook 1988, 1989. Budapest: Central Statistical Office

In the traditional fields of private activities—in the building industry and in agriculture—the output of small-scale industry and of the household and auxiliary farms also grew further, even if not so spectacularly. In the building industry, the number of artisans grew from 24,607 to 26,359 during the period under investigation. In agriculture, it was the auxiliary farms whose output was increasing the fastest, mainly because the land area worked by them grew from 557 thousand hectares to 703 thousand between 1985 and 1988. During the same period, the gross output of the household and the auxiliary farms increased from Ft88.1 thousand million to Ft114.7 thousand million, i.e. by 30.2 percent. This is also a higher growth rate than the 21 percent measured in the same period for the whole of agriculture.

It is now clear that the forms of private ownership—legal small-scale industry, retail trade, household and auxiliary farms (more or less tolerated by state socialism)—were of widely different weight in the different sectors of the economy. Their share was lowest in industry (see *Table 2*) and trade, and very slight in transport and wholesale trade. As against this, in agriculture and even more in the field of cunsumer services, private entrepreneurs had a determinant share.

Today, no correct statement can be made on the real weight of the legal private sector in industry and building industry, without analysing the new forms of enterprises.

These new forms of enterprise expanded initially at a fast rate in industry. However, growth stopped in the second half of the 1980s, when the new organizations still contributed a relatively small part of industrial output. The same process took place in the building industry.

Table 2

Share of the legal and the traditional private sector in the output of the major economic branches (percent)

Year	Industry	Building industry	Trade	Services	Agriculture
1981	n.a.	9.6	n.a.	n.a.	21.4
1982	1.3	9.8	1.3	n.a.	20.6
1983	n.a.	10.6	1.6	n.a.	20.8
1984	n.a.	11.3	1.8	n.a.	21.5
1985	n.a.	11.9	2.1	54.0	21.4
1986	1.5	11.8	2.5	55.5	22.2
1987	1.6	12.7	2.7	56.8	23.0
1988	2.3	n.a.	n.a.	63.7	n.a.
1989	n.a.	n.a.	n.a.	67.0	n.a.

n.a.= not available
Source: Statistical yearbook, 1989. Budapest: Central Statistical Office

All considered, sectoral data and the figures of the industrial branches indicate a gradual expansion of the legal private economy. A similar conclusion emerges from the analysis of the internal proportions of the national income, or the gross national product.

The legal privately owned sector, and the auxiliary farms also working on a private basis, grew faster than the average in the 1980s. However, these factors hardly changed the predominance of the so-called socialist sector in the economy. In 1988, about 9.4 percent of the gross output was contributed by the households' auxiliary activities, and the self-employed. What effect has this had on the Hungarian households?

The Central Statistical Office provides data, relying on the figures of the National Bank of Hungary (NBH), on the households' money incomes. *Table 3* shows that the weight of payments made to private enterprises considerably grew in the households' money incomes in 1989–90.[5]

As compared with the manifold and detailed data gathered on the legal private economy, relatively little is known about grants (benefits) in kind. In two national economic sectors—agriculture and building industry—the volume of own consumption and self-completed construction are separately recorded (*Table 4*); this is also the case with household budget statistics which show retail trade prices,

[5]Later on, the data given in *Table 3* will be compared with the data of our investigation. However, it can be said right now that the comparison will be made rather difficult by the circumstance that the CSO data cover only legal and untaxed incomes, whereas our investigations covered taxed legal, and untaxed illegal incomes.

Table 3

The share of small-scale and private enterprise in the households' incomes (percent)

Year	Month	Share of private incomes	The corresponding period of the previous year = 100 percent
1989	January	12.7	n.a.
	February	11.8	138.8
	March	10.7	129.1
	April	14.7	125.7
	May	16.0	124.1
	June	15.1	122.1
	July	16.2	118.0
	August	14.1	116.8
	September	16.1	117.0
	October	18.2	117.0
	November	16.9	116.7
	December	13.0	n.a.
1989	Total	14.6	114.1
1990	January	14.5	
	February	13.0	
	March	13.3	
	April	14.8	
	May	17.3	
	June	16.3	
	July	16.9	

n.a.= not available

Source: Statisztikai havi közlemények (Statistical monthly bulletins) 1989–1990. Budapest: CSO

and the consumption of foodstuffs, drinks and tobacco coming to households in the form of own produce and grants in kind (*Table 5*).

The Statistical Office also knows that in Hungary today the share of home produced goods and services in consumption is significant not only in foods, drinks and tobacco; there is also a high share of self-implementation not only in the building industry, but with other commodities as well. These mainly involve domestic consumer services, i.e. market-evading activities have a considerable weight. When this is investigated, however, the work accomplished is not registered at consumer prices but on the basis of partial or comprehensive time budgets.

According to an investigation carried out in the early 1980s, there is an especially hight rate of "services outside the organized forms"—and in it of services for own use—in the repair of motor vehicles, repair work in the building industry, and washing and dry cleaning.

Table 4

The rate of own consumption in the building industry and agriculture (percent)

Year	Construction	Individual consumption of home production
1981	4.0	
1982	4.6	
1983	6.3	
1984	8.1	8.6*
1985	8.8	
1986	9.4	
1987	8.1	8.8
1988	n.a.	8.9
1989	n.a.	9.1

*average of 1981–1986
n.a.= not available
Source: Statistical yearbook 1982–1989. Budapest: CSO

Table 5

The rate of own consumption in foods, drinks, and tobacco (percent)

Year	Share of consumption from home production and in kind in households' expenses on			
	foodstuffs		drinks and tobacco	
	active earners	inactive earners	active earners	inactive earners
1985	22.1	25.2	10.9	15.6
1987	22.4	25.0	11.0	18.2
1988	24.4	24.9	10.6	17.9

Source: Statistical yearbook 1988, 1989. Budapest: CSO

The detailed household-statistical investigations also estimate the weight of home-produced consumption as part of the per capita income, not on the basis of the time budget computations but on that of the "pricing" of home-produced consumption. As can be seen in *Table 7*, this constitutes a rather important part of the gross income.

As for the legal private economy and consumption from production, sufficiently detailed data series can be presented. On the other hand, the data gathered in the course of the regular data registrations concerning the weight of the illegal private economy and on the size of incomes earned there are considered too low by the Statistical Office's own experts. "In the 1982 investigation, for example,

Table 6

Distribution of the frequency of services according to the banches of service (percent)

Denomination of the type of activity	Socialist Sector	Small-scale industry	Services outside the organized forms	Of which: for own use
Repair of motor vehicles	30.9	9.1	60.0	54.7
Reparation of electric install.	59.9	15.2	24.9	15.3
Repair work in building ind.	7.2	21.7	71.1	55.2
Clothing services	29.4	32.9	37.7	24.8
Other industrial services	66.6	24.2	9.2	5.3
Washing, dry cleaning	44.8	2.9	52.3	51.5

Source: A lakosság szolgáltatás-fogyasztási szokásai (Households' habits in the consumption of services.) CSO, June 1983

Table 7

The share of consumption from home production and of in kind in the gross income (percent)

Type of household	1985	1987
Gainfully employed	7.95	8.25
Inactive	10.73	10.60

Source: Statistical yearbook, 1987. Budapest: CSO

the answers given reveal an income of Ft8.3 thousand million on a yearly and total population basis, which makes 1.8 percent of the households' income computed on the macro level. This amount is sure to remain well below the real amount of the invisible incomes." (Éltető and Vita 1987)

The fact that official data were not sufficiently useable prompted several researchers to rely on expert estimations in determining the size of the invisible incomes. The method of estimation is as follows: first the yearly occurrence (frequency) of market transactions bringing illegal incomes is determined, then the average amount of the illegal income (paid and received) produced by each transaction. The product of the two are then added together and the estimated size of yearly invisible incomes is received. Endre Sik's (1987) study makes it clear that the differences in the size of the invisible incomes is not caused by the different estimation methods alone, but also by the differences in the spheres that are made subject to investigation. Thus István Gábor R. estimates the size of the yearly invisible incomes for the early 1980's at between Ft17–23 thousand million, Mária Petschnig at between Ft65.6–75.1 thousand million and Ildikó Ékes at between

Ft70.4–82 thousand million.[6] The three variants of the microsimulation computations of Ödön Éltető and László Vita (1987) assume invisible incomes of Ft33, 46, and 62 thousand million "on a yearly and countrywide basis".

Table 8

The size of invisible incomes in 1985 (thousand million Ft)*

Type of income	Size of income
Tips, bribes	20–22
Gratuities (to doctors and lawyers)	7.1–8.2
Turnover in real estates	43–51
Work done on one's own account with the firm's material and armateur work	16–17
Lease	6–7
Foreign exchange transactions	1–1.5
Stealing, speculation	11–13***
Tax fraud	9–11***
Defrauding consumers	8**
House cleaning	6–7***
Education, baby-sitting, etc.	5.2
Money lending	3.2
Black trade	1–1.5**
Total	136.6–156.6

* Relying on Petschnig's estimation
** 1985 estimation of the Ministry of Finance
*** Ékes's 1981 estimation, capitalized at 10 percent
Source: Endre Sik (1987)

Table 8 shows the figures of the most detailed estimation that was carried out by Endre Sik (1987). "Accordingly, the value of the invisible incomes amounts to 16–19 percent of the 1985 national income (Ft842.3 thousand million)." Other estimations must also have been made; for example, "according to data made public by the Ministry of Finance when the tax laws were passed by Parliament in September 1987, such incomes are in the range of Ft100–200 thousand million."[7]

[6] Endre Sik presents and compares three estimations in his study. They are: Gábor R. (1985), Petschnig (1987), Ékes (1986).

[7] "Látható részletek" (Visible details) *Heti Világgazdaság*, November 14, 1987

Considerations and definitions

The analysis on the data that can be found in the Hungarian statistics and studies on private economy in Hungary has been a great help in defining the subject and purpose of our reserach.

The secondary sources, i.e. the data collected in differing spheres and with different methods all show the expansion of the private economy during the 1980's. This is to say also that the expansion of the private economy need to be confirmed by further time series.

The data make it very clear, too, that the sphere beyond party control and planning has for long not (maybe it has never) been just a marginal phenomenon. What they do not make so clear is the number of possible markets in which the actors of the unofficial economy may be present, and on how many of those markets they represent a determinant power.

From this point of view, it is especially important to analyze the "one-sided" expansion of the private economy. We have found growth higher than the average also in the traditional sectors of the private economy (constructions industry, agriculture). However, the decisive element of the expansion is the considerable growth of the private economy's share in commerce, passanger transport and consumer services. In the major important sectors, such as the generation and distribution of energy and the manufacturing industry, wholesale trade, foreign trade, and production infrastructure, there is still not a considerable amount of private activity. Owing to the peculiar pattern of private economy brought about in the course of expansion, the households as buyers or sellers come into contact with private economy practically every day, while they effect many of their transactions exclusively with the firms of the state or large cooperative sectors, since they cannot do otherwise.

The number one target of our research is to reveal the share of the private economy in the households' income and expenses. As has been shown, this can be measured using various methods, depending on what is considered private economy and what unit is used to measure its performance. Our intention is, however, not only to measure a volume which suits us, but also to measure the integrating ability of the private economy. Therefore we do our best to select such definitions and measuring methods which are expedient to the targets of our research.

First and in the most general sense, private economy is determined as one different from the socialist sector. We do not interpret the socialist sector simply as the set of enterprises and institutions in state and cooperative ownership.

The state-owned enterprises, publicly (budget) financed institutions, cooperatives, and those who come into contact with customers or clients together get identical or, characteristically, higher price receipts than those figures which appear on the enterprises' and cooperatives' accounts. In our interpretation, *the size of the*

socialist sector is measurable by the quantity of money which the state-owned firms, cooperatives, and publicly financed institutions enter on their accounts as receipts in a given period. Therefore we measure the size of the socialist sector in terms of money.

It follows that the *private economy* itself is not just a set of firms, because its ***size is measured by the receipts realized beyond the above defined socialist sector.***

We also use another (similarly general) definition: measuring is further done in terms of money and on the basis of the priciples presented, with the same actors, but now it will not be receipts but expenditures—i.e. the money flowing from money holders to the private and non-private actors of the market—that will measure the size of the two sectors. The sizes as measured on the basis of the two different—"receipts" and "expenditures"—types of definition do not, as a rule, produce identical results, since the balance of money turnover between houselholds and the private sector vary.

Of the definitions set forth in the first chapter of this study, the ones laying stress on autonomous initiative against the established system were considered as insufficient for our research. It is important to make it clear that our investigation was caried out in 1989, in the last months—as we now know—of real socialism. As that time, weighing the chances of evolvement of a modern market economy, we thought it more essential to treat the legal and illegal private economy beyond the sphere of the party-state uniformly, as defined by István Gábor R. and Pál Juhász. We did not distinguish between registered and tax-evading activities, as suggested by István Kemény and Zoltán Zsille.

The introductory chapter further demonstrated that whether we measure receipts or expenditures, two different-sized private economies exist. The larger one includes friendly services in the form of labour or in kind, and activities serving self-sufficiency. The narrower one covers only the real money flows (money receipts and expenses based on exchange of commodities) following the transactions effected in the sphere of legal and illegal private economy, outside the state and cooperative sector. At this point we depart from the conception of Gábor R. and Juhász and define private economy according to the *latter, narrower* interpretation.

Our decision was not motivated by the possibility of avoiding complicated conversions from working hours into money and drawing the lines between household and economy with the household. The essential consideration was that we did not expect either a sudden expansion or a sudden shrinking of the activities aimed at self-sufficiency. As has been seen, their share is relatively stable: following some growth in recent times it is estimated at 7–10 percent of the consumption of Hungarian households. Knowing this, and taking it into account, the narrower definition allows us to turn our attention to the legal and illegal private economy participating in—borrowing János Kornai's (1989) conception—market coordination which will hopefully grow prevalent in the course of social and economic transformation.[8]

Whichever definition is used, some of the transactions between private economy and socialist economy do not come into contact with households. Receipts and expenses covering them do not show in the household budget. (For example, private enterprises' turnover among themselves, or the turnover between private enterprises and the state-cooperative sector.) Therefore we do not measure the whole size of the private economy in this study.

Table 9

The possible sizes of the private economy

	Self-sufficiency	Legal	Illegal
		market transactions	
Households not avoiding	a_{11}	a_{12}	a_{13}
avoding	a_{21}	a_{22}	a_{23}
altogether	A_1	A_2	A_3

As against private economy interpreted in the widest sense' including from *Table 9* the fields $A_1 + A_2 + A_3 = A$, we shall measure only $a_{12} + a_{13}$.[9]

We are of the opinion that the statements concerning the size of the private economy presented in transactions measured in term of money can be extended as a kind of optimistic variation on private economy defined on a broader basis. Let us remember that statistics have shown an insignificant weight of private economy in large-scale industry, foreign trade, wholesale trade and transport, which have only loose relations with households as customers. Therefore, following an analysis of the households' receipts and expenditures, the statement can most probably be made about the entire private economy that it has a weight that is probably less in the entire economy than in the households' receipts and expenditures.

The houselholds' receipts

Relying on the above-mentioned details (using a balance of incomes and expenditures drawn up in a microeconomic approach), the following are considered as private incomes of households:

[8] A similar standpoint is represented by Zsolt Spéder (1990) in his study on self-sufficient production: "... the facts of life.... 'resist' our attempts to look exclusively for the 'buds of enterprise' in the unorganized economy outside the first economy."

[9] Accordingly, the second economy of Juhász and Gábor = $A_1 + A_2 + A_3$, and the second economy of Zsille and Kemény = $a_{11} + a_{13} + a_{21} + a_{22}$.

— illegal incomes gained through employment of the family members at state-owned enterprises, institutions, or cooperatives;

— illegal incomes gained through other channels (for example, doing odd jobs);

— incomes from contracts concluded by state enterprises, publicly financed institutions and cooperatives with enterprising members of the family;

— (after-tax) incomes earned in the legal privately owned sector as entrepreneurs or employees;

— incomes flowing from one household to another.

By dividing these by the household's total income, the share of the private sector in the household's income is received.

Expenditures of the households

The majority of commodities and services can be found in both the private and the "non-private" sector. There are, however, such groups of commodities and services which the houselholds can only get from the state-owned and cooperative sector defined above.

The following are considered to be private expenditures:

— that part of the expenditures on commodities and services to be had from both the private and the non-private sector, which is spent in the private sector;

— the households' payment made to other households.

By dividing these by the household's total expenditures, the share of private expenditures is received.

The sample

The investigation was made by means of a questionnaire covering the yearly (1988) incomes and expenditures of the households. It was composed of four major sections. In section one, the *fundamental sociological data were collected*: number of the members of the household, number of dependants, basic data on domicile and family members (age, education, occupation, type and sector of employments), and the origin of incomes (active, inactive). The analysis was made in relation to the head of the household.

Section two contained the *household's incomes*, categorizing them as basic incomes from the socialist and the private sector, and various secondary incomes (secondary employment, odd jobs, extras). Within the latter, we distinguished between those coming from the socialist and those from the private sector. (They were considered as coming from the socialist sector if the member of the household concerned was in employment. If he earned the income as a self-employed entrepreneur, or as a casual independent worker, it was put into the private sector category.)

Section three covered the ***households' expenditures***, distinguishing between those going exclusively to the socialist sector, and those going exclusively to the private sector. In the case of mixed supply possibility, the estimated rate of the two sectors was asked for food, clothing, housing, car, etc.). For example: total expenditure on food, sub-divided into expenditure on food bought in the private sector). Receipts as well as expenditures were considered on an annual level, taking into account a single characteristic month and making corrections for extreme or casual occurences.

Section four of the questionnaire was concerned with the assets (property) of the household, and with an estimation of the weight of the private sector in the origin of the assets. The questionnaire was closed by questions on the consumption of home-produced goods and services.

The sample covering 1014 houselholds ***is not a representative one.*** This is deliberately so. In deciding for such a solution, we were motivated by the knowledge that private activities are the most confidentally handled affairs of Hungarian families. With unknown interrogators they were not going to answer such questions or, if they were, they would still conceal part of their illegal activities. A higher degree of sincerity was expected in cases in which the interrogator and the household are acquainted with each other. Only two indicators were prescribed: the sample had to observe the national proportions of active and inactive, and of the Budapest, town, and village households.[10] Given these facts, our sample was of the same pattern as a representative sample would be. However, the interrogators' social background is reflected by the higher proportions of the higher middle-class, and the lower share of the households of a lower standing.

The main findings of the research

In processing the data, three indicators were used to measure the integrating ability of the private economy of Hungary. (In the following, private economy is to be understood as we have defined it.) The volume indicators refer to the private economy's share in the households' incomes and expenditures. Participation indicators refer to that part of households that are in contact (as customers or as employees) with the private economy. To refine the data obtained more specific, ***intensity indicators*** were used: the proportion of households entering the market in a given period were used to measure the frequency of market transactions. Distinction is drawn between markets regularly sought, and those visited only occa-

[10] On the basis of the data of the Hungarian statistical pocketbook 1988.

sionally. The first category includes the markets which the overwhelming majority of the households in the sample entered, and the second those where less than half of the households bought commodities or services.

Volume indicators 1

Incomes

Table 10

The rate of private incomes in the households

Type of settlement	Earn private income (percent)
Village	10.04
Large village	10.24
Town	9.81
Town of county rank	9.64
Budapest	17.41
Households, total	10.20

First, the share of private economy in the households' incomes was calculated. This amounted on average to 10.2 percent.

Table 11

The rate of private incomes according to educational level of the head of the family

Educational level	Earn private income (percent)
Less than 8 forms (grades) of primary school	8.91
8 forms (grades) of the primary school	10.63
Vocational school	11.84
Secondary school	11.72
University, other institution of higher eduation	11.46
Full sample	10.20

Incomes from private economy are of a higher rate in Budapest than in the countryside (*Table 10*). The same rate is also higher in households where the head of the family is well-educated (*Table 11*). Further, the incomes from private economy are of a higher rate in the families where the head of the family is gainfully employed than where he is a retired person (*Table 12*).

Table 12

The rate of private incomes according to origin of the income of the head of the family

Head of the family	Earn private income (percent)
Gainfully employed	12.40
Retired	8.80
On child-care aid and child-care allowance	22.20
Full sample	10.20

With regard to the position of the head of the family (*Table 13*), the rate of private income rises considerably above the average in two groups: in that of self-emloyed intellectuals, and of other self-employed. As against the differences discussed above (by education, gainfully employed—retired), the difference here is indeed considerable. *Table 13* also clearly shows that the rate of private incomes among the highly positioned (top executives) is also somewhat higher than the average.

Table 13

The rate of private incomes according to position of the head of the family

Position	Earn private income (percent)
Top executives	13.5
Medium executives	9.8
Lower executives	7.5
Professionals in subordinate position	9.1
Intellectuals in subordinate position	9.9
Self-employed intellectuals	49.2
Dispatchers, foremen	4.6
Skilled workers	11.3
Semi-skilled workers	12.5
Self-employed agricultural manual workers and helping family members	5.9
Self-employed non-agricultural workers and helping family members	12.9
Other self-employed	71.4
Full sample	10.2

This is related to the fact that, as the sample shows, the rate of low-income earners is higher among the houselholds where no private income is earned than among those also earning private income. This is to say that the research showed that the more well-to-do groups of society earned a higher share of their incomes in the private economy than the poorer groups.

Table 14

Distribution of the sample according to the households' yearly income

Yearly income (1000 Ft)	Full sample	Do not earn private income (percent)
Less than 100	11.2	15.8
100–200	24.9	30.6
200–300	25.2	24.1
300–400	17.6	15.0
400–500	8.3	6.9
500–600	4.3	2.5
600–700	2.5	2.2
More than 700	6.0	3.8
Total	100.0	100.0

The findings of our investigation are more or less *different from those of other researchers.* The estimations collected and made by Endre Sik (*Table 8*) point to a higher rate of illegal incomes than the figures that we received as the share of the entire private economy, on processing the questionnaires. Also, in *Table 3*—which contains the monthly figures of money flowing to the households from enterprises and public institutions—the legal private economy alone weights more (14.2 percent in 1989) than the combined weight of legal and illegal incomes in the households' money incomes according to our measurements. In other words: it cannot be excluded that, owing to some mistake in our investigation method or presuppositions, the rate of the households' money incomes from the legal and illegal private economy was underestimated.

Discrepancies will be smaller (but will probably not disappear), if certain differences of recording and methods are taken into account. For example, Endre Sik registers certain kinds of money incomes which we did not include in the category of private economy; without the incomes from theft, embezzlement and tax evasion, the illegal incomes of his estimation would be about 15 percent less.

The discrepancies will be even smaller if it is considered that in the course of 1988–9, the rate of incomes from private economy grew continuously in the households' incomes. As against the average 14.2 percent rate of 1989, private incomes reached only 11.8 and 10.7 percent, respectively, in March and February, i.e. at the time of our investigation. It should also be noted that our investigators inquired about the data of the preceeding 12 months. In that period, the rate of such incomes may have been even lower. This is shown by the data of *Table 3*, according to which the rate of incomes from small and private enterprises exceeded that of incomes in the corresponding period of the preceeding year by 38.8 percent in February and by 29.1 percent in March 1989.

We also may refer to the uncertainty of the estimations, which is clearly shown by the wide distribution of the figures received. In addition, it should be remembered that in the data series of the Central Statistical Office and of the National Bank, the volume of cash flowing from public institutions and enterprises is categorized according to the receivers. The list of the latter do not include either the budget, or enterprise (business) sector. The list of the senders is not complete, either: legal personalities with a turnover less than Ft25 million a year are not included, nor are such important public institutions as the armed forces and police organizations.[11]

It would be a bold solution, yet it would not suffice, to disregard—following a reduction of discrepancies, and referring to the undoubtedly existing difficulties of comparison as mentioned above—our impression that the weight of private economy in the households' incomes computed on the basis of the sample is smaller than what was expected (or, better to say, what might be considered realistic). Attention is called to factors that are in contradiction with each other.

First, at the time of our investigation, the concealment of incomes must have been higher than usual since, exactly at that time in spring 1989 people had to fill in their first tax returns after the introduction of the new system of personal taxation. This coincidence made answers cautious, without regard to whether the investigators were received with confidence or not. What is more, the weight of private incomes is, as a rule, smaller than the average in the first months of the year (See *Table 3*) and therefore, fresh impressions also pulled estimations downwards.

While these factors reduced the admitted rate of the high incomes in comparison with the real figures, the composition of the sample must have had a contrary effect. Social groups more closely integrated in the private economy were present among the households questioned at a rate higher than the average. As against the former factor, this tended to pull the results upwards.

We did not undertake to measure the effects of opposite tendencies. According to our estimation, concealment and short-term impressions exerted a greater force than the upward-pulling effect of the sample. That is to say: the weight of the private economy in the households' incomes is more likely to be above than below the 10.2 percent we calculated.

[11] The Decree No. 10/1988. (XII. 31.) NBH of the Presidium of the National Bank of Hungary on data supply concerning cash turnover. *Magyar Közlöny*, No. 69/1988, pp. 1773–5.

Volume indicators 2

Purchases from the private economy

The analysis of the households' expenses revealed that Budapest households purchase commodities and services at a higher than average ratio from the private sector, as was the case with the incomes, too (*Table 15*).

Table 15

Share of the households' expenditures in the private sector according to type of settlement (percent)

Type of settlement	Share of private expenditures
Village	8.89
Large village	8.44
Town	9.31
Town of county rank	9.09
Budapest	13.19
Full sample	9.66

It is interesting that the share of the private economy in the expenditures of retired households is a little higher than the average (*Table 16*). Let us remember that in these households private incomes had a lower than average share.

Table 16

Share of private expenditures in the private sector according to type of household (percent)

Head of the family	Share of private expenditures
Gainfully employed	8.80
Retired	11.61
On child-care aid and child-care allowance	8.60
Full sample	9.66

Expenditures in the private sectors also have a higher than average share in the households that are more highly placed on the social ladder or employment (*Table 17*).

The share of the households' expenditures in the private sector also showed differences according to the sector in which the head of the household worked.

Table 17

Share of expenditures in the private sector according to position of the head of the family (percent)

Position	Share of private expenditures
Top executives	10.3
Medium executives	9.1
Lower executives	9.1
Professionals in subordinate position	10.9
Intellectuals in subordinate position	11.4
Self-employed intellectuals	11.9
Dispatchers, foremen	7.4
Skilled workers	8.6
Semi-skilled workers	9.4
Self-employed agricultural manual workers and helping family members	11.7
Self-employed non-agricultural workers and helping family members	5.3
Other self-employed	9.6

Expenditures on commodities and services coming from the private economy were higher than average in the households in which the head of the household was working in the servicing field, in the public health service or in cultural institution. Also, the households earning higher incomes purchase more than average on the private market. While, in our sample, the households with more than Ft400 thousand yearly income had a 21.1 percent share in the total of private incomes, their share in private economy expenditures amounted to 29.6 percent.

As we have seen, the size and distribution of private incomes has been the subject of several research works and analyses, whereas the purchases of households did not seem to interest the researchers. Therefore, it is not easy to compare our results with those of others.

To evaluate the results, it will be useful to look over the data published by the Central Statistical Office. They say that in 1989, after deduction of money savings, the households disposed of Ft846.1 thousand million of income. Legal private trade earned Ft29.3 thousand million in 1989; the total value of the servicing industry to households amounted to Ft55.6 thousand million. That is to say, nearly 10 percent of the households' legal incomes flowed into the legal private economy. This rate is very near to what we have calculated. However, we should not forget that the data of the Central Statistical Office do not contain either illegal incomes or the incomes earned in the illegal private economy.

Participation indicators

In addition to the share in incomes and expenditures, the role of the private economy in also reflected by the rate of households having contracts with the sector of economy either as employees or as buyers of goods and services.

The research results showed that a large number of households had no money incomes at all from the private economy. Of the 1,014 households in the sample, 448 (44.2 percent) said they earned no income outside the socialist sector. The ratio of households thus avoiding the private economy is higher in the country than in Budapest (*Table 18*). This ratio is striking, but only at first sight. The number of household and auxiliary farms is 1.435 million. This is to say that agricultural production on a private basis is carried on only in about half of the approximately three million households outside Budapest. Yet even some of these do not come to the market, since many of the household and auxiliary farms produce for their own consumption only.

Table 18

Ratio of households having no private income, according to type of settlement

Type of settlement	No private income (percent)
Village	49.2
Large village	41.2
Town	49.2
Town on county rank	49.5
Budapest	40.5
Total	44.2

Table 19

Households having no private income, according to the type of household (percent)

Type of the household	No private income
Gainfully employed	38.7
Retired	56.8
Total	44.2

The houselholds where the head of the family is retired earn less income in the private economy than those where the head of the family is gainfully employed (*Table 19*). The ratio of absence shows considerable differences also according to the position of the head of the family (*Table 20*).

Table 20 again shows the differences found in the analysis of the volume indicators: the households where the head of the family is more highly qualified (professional or skilled worker) have a higher than average share in the private economy measured in terms of money.

Table 20

Households having no private income, according to position of the head of the family (percent)

Position	No private income
Tope executives	42.1
Medium excutives	44.0
Lower executives	51.9
Professionals in subordinated position	40.2
Intellectuals in subordinated position	41.5
Self-employed intellectuals	–
Dispatchers, foremen	51.5
Skilled worker	43.3
Semi-skilled workers	44.5
Self-employed agricultural workers	59.6
Total	44.2

Table 21

Households not purchasing from the private economy, according to type of settlement

Type of settlement	No private expenditure (percent)
Village	19.1
Large village	20.6
Town	18.0
Town of county rank	17.1
Budapest	8.2
Total	17.1

It appears from the research that rather a high percentage of the households are not only without private incomes, but they do not even buy from the private sector. The percentage of such households is lower than the average in Budapest, and higher in the villages and small towns.

Intensity indicators

New indicators were introduced to measure the weight of the private economy:

— the ratio of households entering the market in a given period was used to measure the frequency of market transactions. A distinction was made between the markets frequented regularly and those sought only occasionally. The former are those which the overwhelming majority of the households (covered by the sample) entered in the year prior to the investigation; the latter are the markets where less than half of the households purchased commodities or services.

— the ratio of households that purchase certain commodities or services exclusively in the socialist sector was used to measure the importance of the private economy. A distinction was made between the markets fully held by the state, where the households have no choice but to purchase from the state-owned sector, and those in which the state holds a large or a small section. In the former category, the ratio of households purchasing from the state-owned only, is above the average, while in the latter it is below the average.

With the aid of the two indicators six different types of market can be distinguished. It is clear from *Table 22* that the state fully or predominantly held 22 forms of expenditures, i.e. two-thirds of the "markets". There are, on the other hand, 11 markets in which the state had only a moderate weight. This points to the relatively small weight of private activities involving money payment in the life of households. The same conclusion can be drawn from the fact that the majority of the markets fully or overwhelmingly held by the state (14 out of 22) are sought regularly, whereas the situation is the reverse on the markets where the weight of the state is only moderate: there the majority are sought only occasionally.

These points indicate that, if market transactions are used for measuring it (as opposed to share within expenditures), the state's weight seems even more overwhelming in the Hungarian households and thereby in the economy.

Conclusions

We stress once again that the definition we have chosen, and our method of sampling and investigation, by no means exclude the possibility of error (more exactly, of underestimation). Although being fully aware of the fact, we still claim that the weight of the private economy measured in terms of money was not particularly heavy in the life of the households covered by the sample. A considerable number of the households did not earn income in the private economy and did not buy from the privately owned sector. Also, the analysis of the intensity indicators showed that the fundamental commodities and services could only be found in the state-owned sector, whereas on the markets with a traditionally high rate of the

Table 22

*Frequency of entering the market; weight of the state-owned market**

Market	Ratio of households entering the market (percent)	Ratio of households purchasing only from the state owned sector (percent)
Public transport	72.6 +	100.0
Insurance	90.4 +	100.0
Monthly fee for TV and radio	92.6 +	100.0
Water, gas, electricity, district heating	97.7 +	100.0
Petrol	49.1 +	100.0
Telephone	25.0 –	100.0
Postage	52.5 +	100.0
Personal income tax	68.1 +	100.0
Other kinds of tax	27.9 –	100.0
Deed stamps, duties	14.8 –	100.0
Food	99.1 +	60.2 –
Toilet articles	98.2 +	93.3 +
Drink and beverages, coffee, tobacco	92.4 +	91.2 +
Clothing	91.7 +	68.7 –
Barber's, hairdresser's, beauty parlour treatment	64.5 +	55.0 –
Car and motorcycle maintenance	42.4 –	58.1 –
Other repairs and fitting work	21.5 –	64.6 –
Books, cinema, theatre, etc.	74.5 +	97.6 +
Health	73.0 +	78.3 +
Entertainment	37.9 –	68.2 –
Hobbies	28.2 –	80.4 +
Gifts	57.6 +	70.3 –
Tuition, private lessons, sports	29.4 –	74.1 +
Lending	7.3 –	26.3 –
Donations	8.9 –	54.4 –
Purchase of foreign exchange	29.4 –	74.1 +
Holiday	52.7 +	80.3 +
House renovation	46.5 –	66.1 –
Consumer durables	48.4 +	85.6 +
Construction work	16.9 –	76.0 –
Change of apartment	1.1 –	63.6 –
Purchase of homes or flats	3.3 –	64.5 –
Schooling	55.3 +	96.5 +
Overall average	46.6	72.3

* (+) marks above-the-average figures, (–) marks below-the-average ones.

private sector activity (for example, the housing market), a relatively small number of the households was present in the period under examination.

Statements have been made not only about the size of the private economy, but also its "tendency". Both the indicators of volume and those of participation

Table 23

A few charasteristics of the markets of commodities and services (percent)

The state's weight	Frequency of transactions regular sought on the market	ocassional	together
Full	7	3	10
Overwhelming	7	5	12
Moderate	4	7	11
Total	18	15	33

showed that the households in which the head of the family is higher educated than the average, holds a higher post, has a higher income and further, the households that do not live in villages but in Budapest, have more intensive relations with the private economy. They earned relatively higher private incomes and spent more money on the private market than the households in which the head of the family had a lower position, a lower income and lower standards of education, and lived outside Budapest.

While the latter statements agree with those of other researchers, our statements concerned with the volume (size) may elicit disputes among professionals. Some will probably hold that the private economy is larger than we suggest. At this point we call attention once more to the differences in definitions: we disregarded, unlike other researchers, self-sufficiency. The latter is certainly significant in certain social groups, and the wide networks of mutual (unpaid) services. Neither did we consider incomes from theft, corruption and tax evasion to be part of the private economy. In other words: the differences in the estimates of the size of private economy are probably less than one may think at first sight.

The reception of the measurement results, by all means different, may be largely influenced also by the expectations of professional and political public opinion. For example, the fast increase of the private economy may have contributed to forming the idea that the private economy has rather a large weight in the sectors having intensive relations with the households. The idea of the large private sector may be further supported by the fact that it has a considerable weight on the markets sought occasionally, i.e. where the households do not make routine decisions, but well-considered and therefore well-remembered ones.

The primary conclusion drawn from our investigation must be that the weight and integrating power of the modern private economy, were not particularly significant in the last months of the communist system. This it not contradicted by the fact that the private economy had a high share in the markets of a few products and services. Although the starting position of privatization may be more favourable in Hungary than in the rest of the East European countries, there is no question about the predominance of state ownership.

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ВЕСЬ В ДЕНГАХ ЧАСТНОГО ХОЗЯЙСТВА В ДОХОДАХ И РАСХОДАХ ВЕНГЕРСКИХ ДОМАШНИХ ХОЗЯЙСТВ

К. БАЛАЖ–М. ЛАКИ

Статья заключает в себе результаты исследования обоснованного на подробной анкетной опросе больше чем тысячи венгерских домашних хозяйств. В ходе анкета выяснилось, что удельный вес частного хозяйства в денежных доходах и расходах домашних хозяйств в 1989 г. был относительно небольшой — приблизительно 10 %. Значительная часть домашних хозяйств не связалась с частным хозяйством ни как покупатель, ни как продаватель. Но на некоторых рынках, которые были в связи с домашними хозяйствами, частное хозяйство сыграло определяющую роль.

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HYPERINFLATION, CREDIBILITY AND EXPECTATIONS (STABILIZATION THEORIES AND EAST EUROPEAN STABILIZATION PROGRAMMES)[1]

L. HALPERN

The Eastern European stabilization programs introduced in Poland and Yugoslavia used exchange rate as nominal anchor. In both countries foreign currency played substantial and growing role in financial transactions of the population. The nominal anchor was to replace the price and wage freeze in heterodox stabilization programs to reduce inflationary expectations. In both countries the exchange rate played this role but its impact on fundamental economic variables was dubious. In the future the rule of the game between the population and the government about the inflation and expectation has to be learned as showed the successful Israeli stabilization program.

In the mid-1980s stabilization programmes were introduced in four countries stricken with extraordinary high inflation: in Argentina (July 1985), Bolivia (September 1985), Brazil (February 1986) and Israel (July 1985). Owing to the chronological closeness of the introductions of these programmes it is customary to discuss them together, though there are significant differences between them (Bruno et al., 1988). One of the symptoms of crisis in Eastern Europe is an accelerated inflation, and hyperinflation has also become manifest in the region.[2] In our paper we first wish to outline the particularities of orthodox and heterodox stabilization programmes; using the examples of a few countries we will demonstrate their ways of functioning and present the so far recognized theoretical explanations of their success or failure. Experience confirms that the key role of expectations is unquestionable and the factors influencing the credibility of stabilization programmes can also be identified. Following this we shall present the stabilization programmes introduced in Poland on January 1, 1990 and in Yugoslavia on December 17, 1989, as well as their results. Finally, some macroeconomic conclusions will be drawn from the lessons gained so far from the East-European stabilization programmes.

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[1] This paper is an extended version of the lecture entitled "Stabilization theory and stabilization programmes in Eastern Europe", delivered at the conference "Stabilization and Privatization", organized on November 30 and December 1, 1990 by DELTA of Paris and the Department of Macroeconomic Theories and Analyses of the Institute of Economics. An earlier version of the lecture was presented at the Stabilization Conference of the "Rajk László" Special College on Nov. 17, 1990, under the title "Hyperinflation, heterodox stabilization and fiscal policy".

[2] According to its traditional definition, hyperinflation begins when the monthly rate of price rise first exceeds the level of 50 percent, and it ends after 12 months in which the rate was lower than that, following the last time it was above this rate.

An evident common characteristic of the six countries in question was that the strongest danger threatening them was hyperinflation. Therefore the most important thing to do was to restrict it drastically and rapidly. The results and failures of this can be followed up by looking at the data in *Table 1.*

Table 1

Consumer price indices in the months before and after stabilization (percent)

	-3	-2	-1	0	1	2	3	4	5	6	7	8
Argentina	26.5	29.5	25.1	30.5	6.2	3.1	2.0	1.9	2.4	3.2	3.0	1.7
Bolivia	78.5	66.3	66.5	56.5	-1.9	3.2	16.8	33.0	8.0	0.1	3.6	1.0
Brazil	11.1	13.4	16.2	14.4	-0.1	0.8	1.4	1.3	1.2	1.7	1.7	1.9
Israel	19.2	10.2	13.6	27.5	3.4	2.2	0.6	2.2	1.0	2.3	1.5	1.3
Yugoslavia	52.3	40.3	59.7	37.5	12.7	3.9	4.4	2.0	-0.9	1.7	1.8	7.7
Poland	54.8	22.4	17.7	78.6	23.9	4.7	8.1	5.0	3.4	4.9	1.5	4.5

Sources: Kiguel and *Liviatan* (1988 p. 277); *Barkai* (1990 p. 3); International Financial Statistics October 1990; Main Economic Indicators OECD December 1990; *Mizsei* (1990a); *Machinea* and *Fanelli* (1988 p. 130); *Modiano* (1988 p. 247).

Hyperinflation can also develop in countries where it was not preceded by a permanently high rate of price rises. However, its occurrence is much more likely in countries where there has been a high and increasing inflation through a longer period of time. In general, it is easier to put a brake on hyperinflation than to slow down a permanently high inflation. The explanation for this can be found in the hyperinflationary process itself. In the countries with low- or medium-level inflation, nominal contracts concluded in either explicit or implicit form are in force with regard to future wages and prices, and these cause a certain lag in the system. The longer these contracts remain valid, the longer will be the time necessary for the reaction to the measures of stabilization. The time period for which the contracting parties are willing to fix nominal prices or wages shortens with the increasing rate of inflation. During hyperinflation both prices and wages move parallel with each other and both of them become completely elastic. Thus the possibility is created for the participants of the economy to immediately respond to anti-inflationary measures.

In the course of implementing an economic policy of stabilization the social acceptance of the programme has a great significance. It is much easier to obtain credibility for a programme wishing to stop hyperinflation than for one aimed at slowing down a high but chronic inflation. As we shall see later on, credibility influences the expectations of the participants of the economy. It is not only the observance of budgetary discipline that plays a part in winning credibility, for the fixing of a so-called nominal anchor is also very important. The majority of the stabilization programmes which have been implemented so far, hoped that deceleration of the price rises would be brought about by fixing the increase of the money supply, or by fixing the exchange rate as a nominal anchor. If the economic policy that attempts to develop a nominal anchor is not convincing, then—owing to the expectations that deem the government budgetary policy to be accommodating—prices and wages will continue to increase. Thus, expectations can be self-fulfilling. In such cases the government is forced to increase the money creation or to devalue the currency, in order to prevent the crisis of the balance of payments caused by a real appreciation.

A number of theories have been born concerning inflation having the effect of enhancing money supply (*Blejer and Cheasty* 1988). In these theories the deficit of the budget always plays a central role. The connection between inflation, the quantity of money in circulation and the budget deficit can most simply be described by the so-called inflation tax model.

The real value of the budget deficit is financed by the increase of the real value of the state debt and by the inflation tax revenue of holding real money balances.[3] If the deficit can no longer be financed by issuing state bonds, the creation of money is inevitable. As can be seen in the figure, with growing inflation the propensity to hold real money balances decreases. In other words, if the tax rate grows, the basis of inflation tax will decrease. If the government wishes to maintain a given level of the real budgetary deficit, then, linked to the increasing inflation, the printing of money has to be increased at a growing rate. The conclusion is that the real deficit has a maximum (D^*) beyond which it cannot be increased.

Should the government wish to achieve an inflation tax revenue higher that this maximum, money supply will grow higher than money demand, and the expected tax revenue will not be realized. If, despite this, the government insists on printing money, inflation will continue to grow, without increasing the real income of the government. (This is called the high inflation trap.) This means there is a good chance for the development of hyperinflation.

Thus, according to this hypothesis, financing of the budget deficit has an absolute limit, which can be reached with the threshold value of inflation. When inflation exceeds the threshold value, the government will be unable to finance its budget by issuing money.

Another conclusion of the hypothesis is that the same deficit (D^0) can be financed by either a higher (Π_2) or a lower (Π_1) inflation. Therefore in countries with an extraordinary high inflation, an efficient policy that increases money demand may finance the deficit along with a decreasing inflation. The demand for money depends on the expectations regarding inflation and on the degree of confidence placed in the economy; therefore the dilemma of economic policy is how to find a

[3] The fiscal aspect of the seigniorage is the real value of money creation. The monetary aspect of the seigniorage is the inflation tax which is the private sector's cost from holding real money balances. (See *Klein and Neumann* 1990)

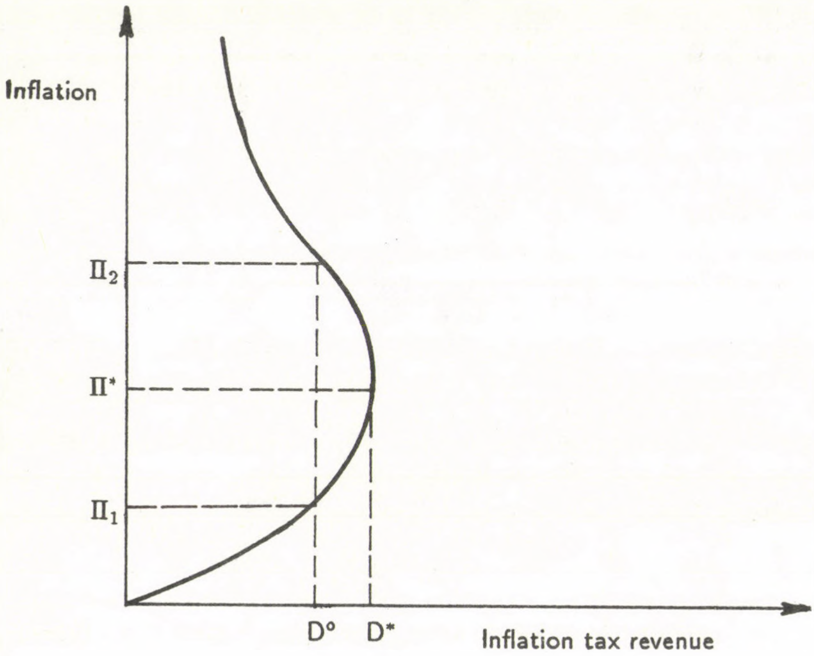

Fig. 1 Inflation tax revenue

combination of economic policy measures that influence the expectations regarding inflation and which can make it possible to get out of the high inflation trap. The desired result is a situation in which real money demand is higher and inflation is lower.[4]

It is a general opinion that if inflation reaches a certain level, two factors play a part in its subsistence and duration. The first one, recognized by the *orthodox* stabilization programmes, is the pressure of demand on the prices, and in this case domestic excess demand is the cause of the inflation. The conclusion of this is that the most important macro-variables have to be limited. This is why in such programmes the control of demand plays a decisive role. On the other hand, in

[4] An even deeper analysis can be found in the works of *Bruno and Fischer* (1990) or Kiguel (1989). If the government finances the deficit by money creation, two sorts of equilibrium are possible: one with a low, and another with a high inflation. Presuming rational expectations the equilibrium with high inflation is stable and that with low inflation is unstable. If money holding is adjusted by adaptive expectations or in a lagged wy, and other expectations are rational, the low-inflation equilibrium can also be stable. If the budget deficit can also be financed by issuing bonds, both kinds of equilibrium can continue, provided that the government fixes the real interest rate. On the contrary, there will only be unique equilibrium if the government applies a nominal anchor to the economy. Thus, the possible occurrences of the dual equilibrium are the results of the government's mode of operation.

the development of inflation, inertia plays a part which is in general the result of expectations. The inflationary expectations—which are either informal, or institutionalized by indexing—are generally self-fulfilling, provided that the participants of the economy act in conformity with their forecasts regarding inflation. The heterodox elements applied in the course of shock therapies try to eliminate precisely this inertia and to separate today's and yesterday's inflation from one another.

Orthodox stabilization programmes

First of all, with the example of Bolivia, we wish to demonstrate why the orthodox stabilization programme based on the reduction of the budget deficit and on fixing the exchange rate has proved to be an effective means in fighting against hyperinflation. The examples of several countries show that the same is ineffective against a chronic high inflation. We shall compare three types of stabilization programmes applied in countries with chronic high inflation. The *first* one was based purely on the reduction of the budget deficit, and it failed because of the lack of nominal anchors. This was the experience gained in the 1980s in Mexico and Brazil. The *second* type already applied nominal anchors—of course together with the correction of the budget. An example of this was Chile in the mid-1970s. The *third* type of the stabilization programme is fundamentally based on the exchange rate policy and it mostly developed from the monetary–fiscal programme preceding it. This can be characterized on the one hand by Argentina's programmes and, on the other hand, by the experiences of Chile in the late 1970s.

Hyperinflation without a chronically high inflation

The effect and functioning of an orthodox stabilization programme in a country where the development of hyperinflation was not preceded by a historical experience of high inflation, could be observed, so to say, under laboratory conditions, in Bolivia. When, in October 1985, the tin market—the market of the main export article of Bolivia—crashed and, as a result, significant devaluation became necessary, inflation increased merely for a short period of time (see *Table 1*). This could only be observed in a country such as Bolivia which was devoid of a chronic high inflation. In countries having chronic high inflation the great devaluations necessary at times of such crises increase inflation both in the short, and in the long run.

According to *Sachs* (1986) the programme in Bolivia was not too credible; there were doubts first of all with regard to the possibility of maintaining it, owing to the uncertain political situation. At the same time he notes that long-term credibility of budgetary policy is not a precondition for short-term stabilization, as long as the exchange rate is stable.

In general, it can be said that under the conditions of hyperinflation the stabilization programmes based on the stability of exchange rates are less dependent on the credibility of reducing the budget deficit than they are in the cases of chronic high inflation. Sachs does not deal with the question of what makes the stabilization of the exchange rate credible when the pressure to increase the wages is built upon the expectations of continuously adjusting devaluations.

Though the theory of Sachs (1986) seems to be convincing, analysts of the Bolivian stabilization came to the conclusion that elimination of the budget deficit was successful not only in the long run, but also in the short term. In their opinion the role of the exchange rate was only secondary, and its stabilization can be considered as the result of the drastic reduction of the budget deficit.

An analysis which considers budget stabilization as the key element of the anti-inflationary programme, has to explain how the monetary policy of the government—which stops adjustment to inflation—can become credible if exchange rate stabilization is not a precondition of it. If such a monetary policy is not credible, then those who determine the prices and wages will continue the inflationary trend, expecting the government to adjust its monetary policy to the rate of inflation. Why is it sufficient in the context of hyperinflation to merely eliminate the budget deficit in order to get the programme accepted and for the sudden stopping of inflation? This depends, first of all, on credibility which is influenced by several factors.

One of these factors results from the fact that during hyperinflation an excessive money creation can be unequivocally considered the main reason of the acceleration of inflation. Therefore, a policy stopping the printing of money is a clear and authentic solution. It allows a rapid stabilization.

In general, such a credibility cannot be created where inflation is chronically high and its rate grows even without a changing seigniorage. It is true that in Bolivia inflation was characterized by a drastically increasing money supply. For comparison, in *Table 2*, in addition to those of Bolivia, we also show the figures calculated for Brazil and Argentina.

The *second* factor influencing credibility is the degree to which the government is able to offset the effects of the accelerating inflation. In the countries of chronically high inflation, generally complex defensive mechanisms—such as increasingly perfect indexation—are developing, aimed at coexistence with inflation. Such mechanisms are completely missing in the countries of hyperinflation, where this was not preceded by a longer period of chronically high inflation.

The ability of the countries with chronically high inflation to adjust to inflation can be best demonstrated by the behaviour of government revenues during the acceleration of inflation. It is well-known that in the course of hyperinflation the real value of tax revenues is strongly reduced by inflation, and this strengthens

Table 2

The interconnection between inflation and money issue (percent)

	1979	1980	1981	1982	1983	1984	1985
Argentina							
Inflation	159	101	104	165	344	627	672
Budget revenue/GDP	29	31	32	28	29	31	32
Seigniorage in percentage of GDP	5.9	4.8	3.5	7.8	8.6	7.1	6.5
Bolivia							
Inflation	20	47	29	133	269	1281	11750
Budget revenue/GDP	9.4	9.6	9.4	4.6	2.6	2.6	1.3
Seigniorage in percentage of GDP	1.1	3.2	1.6	12.1	10.0	15.9	8.8
Brazil							
Inflation	53	83	106	98	142	197	227
Budget revenue/GDP	28	28	31	34	32	30	33
Seigniorage in percentage of GDP	3.3	2.0	2.0	2.1	2.0	2.7	2.7

Source: Kiguel and Liviatan (1988, p. 279.)

the inflation.[5] Bolivia, in contrast to the countries with chronically high inflation, visibly followed this way in the 1980s.

The countries with chronically high inflation were able to avoid the excessive increase of seigniorage and, at the same time, the economy got accustomed to inflation. This prevented them from changing a chronically high inflation into the state of a hyperinflation of the Bolivian type. This entailed the survival of inflation at least in the medium range, despite the fact that this inflation was fairly high. Under such conditions society considers it possible to postpone the anti-inflation programmes—thereby their credibility declines. On the contrary, the explosion-like character of hyperinflation cannot be maintained even for a short time. The potential programme—namely, stopping to finance the budget deficit by money creation—may contribute to an increasing credibility.

Orthodox stabilization in countries with chronically high inflation

While questioning the inflation therapy of the school based on rational expectations and built upon eliminating the budget deficit, Kiguel and Liviatan (1988)

[5]This is the so-called Olivera-Tanzi effect (*Olivera* 1967; *Tanzi* 1977). In the period when inflation is accelerating, the real value of tax revenues decreases, since there is a time lag between making the income and the tax payment. The function can also have a reverse effect, i.e. the slowdown of inflation increases the real value of tax revenues. This was the basic reason why in Central Europe in the 1920s the huge budget deficits changed over into surpluses.

demonstrate that a given budget deficit can be linked to any rate of inflation, i.e. under certain conditions any rate of inflation can belong to a balanced budget. This, of course, does not preclude that the budget should be balanced and at the same time there should be no inflation, for in the case of a balanced budget a positive inflation any expectation is not at all necessary.

The case is quite different when the participants in the economy have deep-rooted inflationary expectations. The cause of this may be the assumption that the inflation of the past will continue, or a basic distrust towards the inflation-reducing ability of the government programme. It may also be that people believe that the government wishes to use inflation in order to reduce real wages so that it can maintain the level of employment. Whatever the reason, if the central bank decides not to accommodate to the growth of prices and wages completely by printing money, this may lead to a recession.

Fiscal stabilization programmes

The 1983 Mexican and the 1983-84 Brazilian programmes drastically reduced the budget deficit. The result of these programmes was that the balance of payments improved significantly, but inflation increased rather than diminished.

The examples show that the reduction of the budget deficit in itself is not a sufficient condition for reducing the inflation. It is, of course, possible to ponder on whether consistent implementation of such a policy for some longer time reduces inflation in the long run; however, accelerating inflation does not seem to support this line of reasoning. We must recall that reducing the budget deficit does not necessarily put a brake on inflation if it is not accompanied by a proper nominal anchor.

The endeavours of governments to restore the external balance actually inverted the reaction of inflation evoked by the reduction of the budget deficit. What is more, since the primary aim of these governments was to restore the external balance, the central authorities not only accepted but even utilized the accelerating inflation for reducing real wages, thereby improving the international competitiveness of the economy.

In both countries strong nominal devaluations were made, which caused the explosion of inflation, eroded real wages and, by doing so, improved international competitiveness and the balance of payments; at the same time, they reduced consumption. This was typical when the acceleration of inflation was not linked to any target regarding the budget deficit. Accelerating the inflation caused by a more rapid devaluation was an important part of the adjustment programme.

However, the question arises, whether a one-time reduction of real wages must inevitably go together with the long-term growth rate of inflation (and devaluation); or does it have to involve a single leap of the price level? If the development of nominal wages completely adjusts to the prices of the previous period through either a formal (Brazil) or an informal (Mexico) wage indexing, a one-time change of the price level will have only a transitory effect on real wages. The growing *pace* of inflation continually reduces real wages by bringing about an accelerating decrease of purchasing power.

This results from the fact that in the case of predetermined intervals of wage adjustments, an increasing inflation reduces the real value of wages within the given time interval. If the intervals grow shorter—which is usually the case when there is a great nominal price-shock—then for a given reduction of real wages a higher growth of inflation is needed.

What conclusions can be drawn from these two programmes? The most important one is that budgetary measures have to be complemented by adequate nominal anchors. This is not at all simple, especially when balance-of-payments problems also exist. Beside a given rule of wage indexing, inflation—as a result of applying a nominal anchor—raises real wages. However, this does not lead to the reduction of the deficit in the balance of payments.

With a persisting deficit in the balance of payments, the stabilization programme requires other types of wage determining rules, i.e. the reduction of real wages has to be carried out by controlling the inflation. This is what Chile did in 1982, abolishing at the same time wage indexing and the minimum wage which was introduced in 1979. Implementation of these was rendered possible by the dictatorial system; in the cases to be dealt with below the stabilization programmes included some income policy measures.

Combined fiscal and monetary policy

We have seen that fiscal policy in itself is unable to provide the nominal anchor which is indispensable for the success of stabilization. The central bank may be able to contribute to the stabilization of prices, if it does not adapt its policy to the inflation. If there is a very strong inflationary inertia in the economy, a very high level of unemployment might occur.

The 1974-75 Chilean experiences show that the government, amidst an increasing inflation, insisted with relative steadiness on restrictive monetary measures. The monetary rigour was part of a comprehensive stabilization programme aimed at a drastic reduction of the budget deficit. This programme has to be considered the classical case of an orthodox stabilization programme. Here one can study how far the fiscal monetary package was effective in a country with chronically high inflation.

The initial experiences were disappointing, since the implemented exchange rate policy was aimed at maintaining the purchasing power parities. Hyperinflation was avoided, but inflation did not go below 150 percent per annum; unemployment also increased significantly and the GDP declined by almost 15 percent in 1975.

Despite monetary restrictions and a decreasing budget deficit, inflation was stabilized at a quarterly level of 45 percent, which indicates a significant inelasticity of the prices. The high level of inflation which persisted in 1975, was attributed to the significant devaluation which became necessary because of the fall of the world market price of copper at the end of 1974. The inflationary effects of devaluations should have been counterbalanced by the radical reduction of the budget deficit. The fact that this did not come to pass reflects that there was a significant inflationary inertia in the economy. This is diametrically opposite to the Bolivian experiences, where the serious external shock during stabilization caused merely a transitory growth of the inflation.

Stabilization programmes based on the exchange-rate policy came to the fore in the late 1970s. This was precisely because of the experiences of the fiscal and monetary stabilization programmes which had a slow inflation-reducing effect.

Stabilizations based on exchange rates

These programmes wish to reduce inflation in such a way that they consider the decrease of the budget deficit as the most important real variable of economic policy, and exchange rate as the nominal anchor. This, of course, does not necessarily mean the fixing of the exchange rate; a slow, systematic devaluation linked to another currency, or a decelerating rate of devaluation may also play the role of the nominal anchor.

From the aspect of such programmes fiscal policy is extremely important, since money supply comes to be an increasingly endogenous variable of the system, depending primarily on capital mobility. The fixed exchange rate may reduce inflation for a short time, even without an appropriate fiscal policy, and it may also lead to the inflow of foreign capital, taking into account that the demand for money is growing. The starting inflow of foreign capital and increasing international reserves may create the dangerous illusion of success. The crisis of the balance of payments might come later on.

The greatest problems of the exchange-rate-based stabilization programmes are the inertia inherent in the price and wage agreements and pessimistic expectations. Two kinds of failures of exchange rate stabilization can be distinguished. One of them is caused by an inadequate fiscal policy and the other one is the result of price-inelasticity and the lack of credibility.

The experiences of Argentina are primary examples of the above. At the outset of the programmes of 1959–62, 1967–70 and 1979–81 budget deficits were drastically reduced. However, the rigour of the budget was only sustained for a short time. Later on the budget deficits significantly increased, and they exceeded even the level that had existed before the programme started. The decreasing pace of devaluations ought to have slowed down the inflation. However—owing to the increasing budget deficit—this had to be given up.

Another particularity of such programmes is that, despite the diminishing budget deficit, the current balance of payments tends to deteriorate from the introduction of the programme, accompanied by a real appreciation and increase of real wages. The deficit of the balance of payments becomes intolerably high.

One of the possible explanations can be found in the fact that the credibility of the maintenance of fiscal rigour is missing, and this reveals itself in expectations towards future devaluation. The consumers increase their spending; furthermore, owing to the devaluationary expectations and quantitative limitations on imports, the date for purchasing durable consumer goods is also brought forward. The lack of credibility leads to a situation in which inflation diminishes at a slower rate than that of the devaluations. Consequently, this reduces the real domestic interest rates.

The Chilean experiences with regard to fiscal policy differ decisively from those of Argentina. The stabilization programme of Chile (based on the exchange rate) started in 1976 with a few devaluations and, following this, by the preliminary announcement of the rules of future devaluations. From the middle of 1979 they changed over to a fixed exchange rate. All this was accompanied by a gradual reduction of tariffs.

Although the programme was successful in suppressing the inflation and reduced it to an internationally acceptable level, it must be noted that it lasted five years and within it the exchange rate—deemed to be decisive—was pegged for three years. In the course of the stabilization programme based on the exchange rate, inflation proved to be as persistent as it was in the fiscal-monetary phase.

What can explain the slow adjustment of prices in the exchange-rate based stabilization programmes? One of the possible reasons is the rule of wage indexing which applies a backward-looking formula. At the same time, this also explains how the internal inflation—which adjusts slowly to the pace of devaluations—leads to a real appreciation.

Another explanation connects real appreciation with the economic boom stimulated by the opening up of the capital market. Both explanations are acceptable for a transitory overvaluation of the currency. However, neither of them explains why the system is unable to carry out a real devaluation which would be consistent with internal and external equilibrium. In the case of fixed exchange rates a real devaluation would require the reduction of domestic prices. Yet this is, from the outset, impossible, owing to a downward rigidity of prices. The persistence of overvaluation can be explained by the lack of price elasticity and by the recognition that the situation could at any time be improved by a nominal devaluation. At the same time, the effect of price inelasticity may be counterbalanced by the overfulfilment of budget adjustment.

The lessons of the orthodox programmes

It seems that only Chile, despite the mistakes which were made, can be given as an example in which both fiscal and monetary policies were consistent. Fiscal discipline has been maintained up to now, although some budget deficit did appear at the time of the 1982 recession. Yet despite the minor setback, the effect of the nominal anchor has also been successfully asserted. In 1982 wage indexing was eliminated, indicating thereby that economic policy was unwilling to coexist with inflation.

Thus, it seems that Chile succeeded in overcoming the chronically high inflation. The annual rate of inflation fell to less than 15 percent, this being primarily the result of the great devaluation in 1982. One of the tests of getting rid of inflation is how the country responds to the crisis of the balance of payments. In Chile the level of inflation did not grow despite the big devaluation, in contrast to the cases of Brazil and Mexico.

Perhaps the most important lesson is that orthodox methods can cure inflation but the time needed for the recovery might be a decade or even more. During that time both fiscal and monetary policies have to be permanently rigorous. The primary requirement is permanence and not the type of the exchange rate or wage policy adopted by the given country.

The most serious disadvantages are the low growth rate and the deep crises which shocked the Chilean economy (*Moran* 1989). Therefore it is a big question whether or not heterodox policies offer better alternatives.

The lessons of the heterodox stabilization programmes

Let us study the common characteristics of the programmes introduced in the countries mentioned in the foregoing. These meant new elements in comparison to the earlier stabilization programmes, from two aspects. First, because they produced an immediate break in the trend of the major macro-variables, in contrast to the cases when gradually changing trends could be observed after the introduction of stabilization. This is why these programmes are also called shock-therapies. Another important element is that price- and wage-freeze is introduced simultaneously with fixing the exchange rate or pegging it to another currency, and with the abolition of wage indexation. These are the reasons why these programmes are called heterodox ones, in opposition to the orthodox stabilization programmes which try to regulate the demand by using fiscal and monetary tools. At the same time it has to be underlined that in practice traditional demand control measures were also parts of the programmes and in the course of practical implementation heterodox elements were mixed with traditional tools of demand control.

The interconnection between inflationary inertia and demand management is two-directional. On the one hand it has to be recognized that inertia may cause effective price rises only if monetary policy is accommodating. In the traditional models of inflation money supply is the variable determining the actual inflation; therefore inflationary inertia does not play a continuous role. If the government decides not to let money supply increase, the starting inflation, be it the result of excess demand or expectations, will not continue to exist, since there will not be enough money to pay the higher prices. From the great number of unsuccessful experiments it is clear that in reality creating money is subject to many pressures and inflation itself also increases them. The pressure that tends to increase the quantity of money can come from spheres beyond the scope of monetary authorities. It is especially important that monetary policy is never independent of fiscal policy. This being so, it is difficult to implement a restrictive monetary policy if the budget and other external effects are not kept within bounds. Furthermore, if monetary authorities attempt to reduce the quantity of money (or its growth rate) without bringing other measures, the adjustment of the economy to a lesser quantity of money will be chaotic and painful.

On the other hand monetary authorities may influence inertia's impact on inflation; inertia at the same time may reduce the effectiveness of traditional demand control. The related train of thought is the following: according to a theorem of the school of rational expectations, inflation can be stopped at a small cost and at once stroke, if the government implements a drastic fiscal and monetary policy, consistent with stable prices. Together with that, such policies must not only be consistent but also credible: it is necessary to convince the population that fiscal and monetary rigour will persist throughout a longer period of time. Unfortunately, to win this kind of credibility is not a simple task. If public opinion does not believe that the government will keep itself to such a rigorous policy because it is, for instance, afraid of high unemployment, inflationary expectations will continue to exist. In such a situation the government will not implement a severe policy, inflation will continue to be high, and thus the expectations of public opinion will become self-fulfilling, i.e. rational.

Public opinion, for instance, may not accept a long-term anti-inflationary policy announced by the government because it basically does not believe that the government is able to influence inflation. Expectations regarding inflation are downwardly rigid. This can be in the background of basic inflationary expectation and of its inertia, and this makes increasing monetary and fiscal strictness, as an anti-inflationary tool, extraordinary costly. In such cases the high costs appearing in the form of increasing unemployment and declining production can only be saved with a heterodox stabilization programme. This programme has to combine monetary and fiscal policy—i.e. demand control—with a transitory income policy including the temporary freezing of prices and wages as well.

What can assure that the inertia which can be observed in expectations will change by the price and wage freezes and by fixing the exchange rate? Firstly, if the macro-variables (balance of payments, balance of budget), following this freeze show adequate values, this can demonstrate to society that the economy is able to operate without inflation. Thus, public opinion will be willing to accept the state of low inflation as a realistic possibility and thus develop its expectations accordingly.

On the other side, if the government combines price and wage freezes with fixing the exchange rate, it will be obvious that it will not use inflation as a tool for achieving its objectives (e.g. to make the economy more competitive by reducing real wages). If the values of the most important macro-variables are more or less in equilibrium, this commitment will gain credibility and this will survive even after the freeze has come to an end.

Let us suppose that the government is able to finance its deficit and thereby its consumption, and that it is also able to bring down inflation by influencing expectations. However, here a much more general question arises: is it not possible to reduce inflation without decreasing production? In countries that have used shock therapy for the sake of minimizing losses (which were caused by the slowdown of production because of the reduction of inflation) policies are implemented which freeze prices and fix the exchange rate. At the same time these are considered temporary measures aimed at getting from one inflationary equilibrium to another.

The primary common feature of these programmes was that inflation was immediately and drastically reduced by them.

Another common characteristic was the comprehensiveness of the programmes.

The third common characteristic was that attempts were made at synchronizing heterodox policies and primarily at adjusting the exchange rate and wages to the price freeze. This task required accurate coordination, and it was considered a basic one, because of the possibility that serious distortions in price proportions might burden the early phase of implementation of the programmes.

Before formally proclaiming the heterodox programmes certain preparatory measures were taken, aimed at balancing the price- and wage-proportions, the exchange rate and the interest rates. In other cases these also included the restructuring of fiscal and monetary policy and, occasionally, of other important spheres too. Should any serious imbalances appear in the course of freezing prices and wages, the endeavours aimed at equilibrium would take on the form of quantitative adjustment and the pressure on prices would also not lessen.

The extent of the measures taken was much larger than it had been in the case of a permanently sustainable demand control policy. Taking into account the fact that the measures were non-recurrent, owing to their temporary character, they could not have harmful effects in the long run.

Particularities of the Yugoslav and Polish stabilization programmes[6]

The basic particularities of the stabilization programmes developed in the two countries were that they included both short-term and long-term stabilization ideas. Beside implementing short-term stabilization the aim was a basic restructuring of the economy with the aid of privatization.

The ground for the *Polish* programme was *prepared* by bringing about a significant reduction of the budget deficit and this resulted in a lessening of the budget's urge to create money. The temporary budget of the government passed through the Parliament and remained in force for the rest of the year. Expenditures on capital investments were strongly curbed, and still existing subsidies on foodstuffs, imports and agriculture were abolished. Secondly the rules of wage indexation were rendered more severe, and the highest wages were no longer indexed. The decrease of real wages in the major industrial sectors between August and November 1989 amounted to 37 percent. Thirdly, the National Bank of Poland made efforts to keep the growth rate of the stock of credits below that of inflation. In the last quarter of the year the quantity of money (M2) decreased by 27 percent. Owing to these preliminary measures—though the restriction on credits was of primary importance—the zloty strongly appreciated on the free market. The exchange rate of the USD decreased from 10,000 zloty in September to 7,000 at the end of November and beginning of December. In almost the same period the National Bank of Poland devalued the zloty against the dollar from 1340 to 6500 zloty. The reason for this was to try to adjust the domestic prices of importable goods to world market prices before the stabilization programme.

The preparation of the Yugoslavian programme involved the gradual liberalization of prices and imports. Between September 1988 and September 1989 the proportion of products sold at free prices increased from 49 to 74 percent. By the end of 1989 87 percent of the imports were liberalized. At the same time monetary policy was rendered more severe. The largest tensions between wages were mitigated. Those whose wages significantly declined in 1989, and whose wages did not reach 80 percent of the average wage of the given member republic, received a 20 percent wage rise.

The *Polish stabilization programme* included the introduction of five measures which strengthened one another and the aim of this was to strongly curb macrodemand and to stabilize prices. They continued to reduce budget deficits primarily by reducing capital investment outlays and subsidies. Net domestic credit expansion was strictly controlled by significantly raising the interest rates. The zloty was devalued (1 USD = 9500 zloty) and then they fixed the exchange rate and introduced internal convertibility. Nominal wage increases were rigorously regulated by

[6] The analysis is based on the works of *Bajt* (1990), *Gáspár* (1990), *Lipton and Sachs* (1990) and Mizsei (1990a; 1990b).

a policy based on taxation, in order that the outflow of wages should not grow. Prices were liberalized, except those of a few public services.

When the Yugoslav stabilization programme was introduced, the dinar was denominated,[7] and a new, fixed exchange rate was introduced (1 DM equalled 7 new, or 70,000 old dinars). The commitment was made to maintain this exchange rate for a minimum of six months and convertibility was also declared. Interest rates were radically raised and a positive real interest rate was achieved. Wages were frozen, together with 25 percent of the prices.[8] The government expected a decline of consumption, owing to the decreasing domestic demand and the reduction of real incomes.

In *Poland*, in the first year of stabilization the decrease of production was 23 percent in industry, 37 percent in light industry and 17.6 percent in construction.[9]

When judging this, one has to take into account that the sphere of companies falling outside the scope of official statistics was rapidly increasing. In December 1990 the rate of unemployment was 6.5 percent.[10] In the past two years Poland has not even been able to pay the interest on its international debts. The creditors grouped in the Paris Club have rescheduled all the due interests and instalments up to March 1991. Stabilization is nourished by two western financial sources: one is an IMF stand-by credit of 700 million USD and the other one a 1 billion USD loan granted by the advanced industrial countries' governments. The foreign-trade surplus is made up of 4.785 billion Rbl and 4.7169 billion USD. The dollar exports have reached an amount of 11.4 billion USD. This positive result might strongly reduce the hardly quantifiable chances of relieving the international debt. Surplus of the budget is 8800 billion zloty (925 million USD) in comparison to 3800 billion zloty in 1989. The rate of inflation was 640 percent in 1989 and 250 percent in 1990, and the wages increased by 142 percent.

In Yugoslavia the decline in industrial production was 14 percent. In the first half of the year Yugoslav international reserves increased from 5.6 billion to 9 billion dollars, the growth rate of exports was 21 percent, and that of imports was 40 percent. In March the IMF granted a stand-by credit of 800 million USD. The problems first appeared in October when the imports increased by 28 percent (those of foodstuffs by 120 percent) and the exports declined by 4 percent. This was unequivocally the result of the initial overvaluation of the dinar,[11] which was

[7] Meaning that 10,000 old dinars were worth 1 new dinar.

[8] The IMF wanted a 100 percent price freeze but, based on the lessons of earlier stabilization programmes, the conclusion was drawn that it is better not to freeze the prices since after the freeze, if there is no possibility for short-term price movements, a price explosion may occur.

[9] *Világgazdaság*, January 11, 1991.

[10] *The Economist*, January 19, 1991. p. 75.

[11] On this topic Bajt (1990) wrote that after having started the stabilization programme, a significant increase of wages followed. In January 1990 the wages in industry were 9.8 percent higher than they had been in December.

counterbalanced by the guest-workers' transfers and increased credibility in, and high demand for, the dinar. This overvaluation originated from three factors. On the one hand the initial exchange rate did not include such a large gap as it did, for example, in the case of the zloty, and the increase of wages and prices was significant. Wages increased by 25 percent between July and September, and prices by 12 percent. The real exchange rate became strongly appreciated and this affected the balance of trade. The third relative factor was that the exchange rate of the zloty was bound to the weakening dollar and that of the dinar to the strengthening German Mark.

Lessons of stabilization

J. Sachs, a professor of Harvard University, played an active part primarily in developing the Polish, but also the Yugoslav and, earlier, in elaborating the Bolivian stabilization programmes.

In their study Sachs and Lipton (1990) wrote: "... A threat to stability often comes from the IMF, which pressures countries for devaluations to restore real exchange levels that existed at an arbitrary date of the stabilization program. The IMF wrongly tried to target the real exchange rate by means of changes in the nominal exchange rate, a strategy that leads to rapid, if not explosive, inflation. The best chance for stability is to recognize that the nominal exchange is the fundamental 'anchor' to the price level in an open economy the size of Poland. The prices should therefore adjust to the exchange rate, rather than vice versa." ... "In our opinion IMF policy in Yugoslavia during 1988-89 that pressed for nominal exchange rate adjustments to maintain a target real exchange rate was a key factor in the outset of the Yugoslav hyperinflation." (p. 127)

The most important reason is that the nominal exchange rate is the most important—or maybe the only explanatory variable of inflationary expectations.

S. Fischer in his comment on the foregoing says: "Lipton and Sachs seem to imply that the exchange rate should be kept for a long period or forever. Commitment to this goal would be a mistake. Fixing the exchange rate helps bring inflation down rapidly, but the costs of overvaluation are so high that the government has to recognize that it may at some point want to change the exchange rate—and it should therefore not stake its prestige on holding the exchange rate at its current level forever or even for a long time." (p. 135)

Let us see where the same debate has led in economic political practice following the stabilization in Israel.

Bruno and Meridor (1990) try to find out what caused the two-year recession in Israel following the successful stabilization and the significant growth of unemployment which occurred in 1989.

A close survey of the experiences accumulated by the countries of Latin America, and of the stabilization which followed the hyperinflation in Central Europe which took place in the 1920s, shows that a recession after stabilization is almost a general phenomenon. The basic reason is said to be that it is difficult for both economy and society to recover from the distortions caused by hyperinflation.

The authors think that in the connections between wages, prices and exchange rate the role of inflationary expectations is decisive. Expectations influence the behaviour of wages, owing to the part they play in wage negotiations, and they also have a heavy impact on the development of prices. Inflation can be considered the outcome of the game played between the government and the population (consumers and producers). The rules of the game make it possible for the government to make announcements about its future policy, especially with regard to the exchange rate, and in particular a fixed exchange rate. Public opinion takes into account the credibility of such declarations and forms its inflationary expectations accordingly.[12] These expectations influence wages and prices and, in the course of developing its future policy, the government must take notice of these expectations. Both theory and practice show that in the course of a stabilization based on the exchange rate this kind of game usually leads to a real appreciation, together with the development of the government's expectations and the building up of credibility towards it.

In Israel, in the course of implementing the stabilization programme the introduction of a stable exchange rate was declared without announcing that the objective was to fix the exchange rate. What is more, the contrary was the case and the development of the exchange rate was made dependent on the future formation of wages. In fact, owing to the significant growth of real wages in 1986, in January 1987 a devaluation was carried out. Following this, a somewhat more severe statement was made that devaluation would not be automatically adjusted to the changing of wages. The idea of the National Bank of Israel was to gradually increase the period between the two devaluations and to reduce the extent of devaluation, until prices and wages became stabilized. Accordingly, in March 1988 the NBI supported a 6–7 percent devaluation, 14 months after the earlier devaluation. But because of the approaching elections, the minister of finance assumed an expectant attitude. Only following the elections, in December 1988 (23 months after the previous devaluation) was it introduced, by which time significant amounts of capital had already left the country. Owing to the postponement, a greater degree of devaluation came to be necessary than that of 1987. Thus, the earlier planned

[12] In the first five months of 1985 the rate of inflation was 3–7 percentage points higher than was expected. In June, preceding the stabilization, the trend turned around and expectations exceeded the rate of inflation by 5–8 points. Only after half a year following the introduction of stabilization did inflation and the expectations approximate each other. This was the time needed for the programme to become credible in the eyes of the population. (*Cukierman* 1988, p. 58)

and announced gradual devaluation policy became strongly discredited. In January 1989 a 3 percent margin around the exchange rate was introduced in order to increase elasticity of monetary policy. The fairly influential and loud export lobby came to the conclusion that a still more export-oriented exchange rate policy would follow. In addition, the statements of economic politicians contradicted one another, with some demanding a softer and others a harder line. Hence, they made it difficult for public opinion to form its judgement on the government's objectives, based on its statements.

The background of such contradictory statements was the conflict between different views. A natural opposition came into being especially between two kinds of views. One of them considered a stable nominal exchange rate to be the nominal anchor, while the other one wanted to protect the real exchange rate against revaluation. The first one was the standpoint of NBI, while the second one was supported by the export lobby and was substantially backed up by the Ministry of Finance.

According to the opinion of the authors one of the most important explanations of the recession is this contradiction in economic policy. This is where the reason can be found for keeping the inflation rate at a level of around 20 percent. This is, of course, a marked result, but in comparison to those in the western countries, it is still very high.

Coming back to Eastern Europe, we can find that one of the most debated questions of Polish stabilization is whether in fact they overshot their mark, i.e. were the stabilization measures too rigorous, did they cause a too serious shock? This conclusion can be made on the basis of the astonishingly high surplus of the 1990 trade balance. The degree of recession measured by an international yardstick cannot be considered alarming, especially when it is compared to other countries in the region. The 6.5 percent rate of unemployment may only be compared to that of other countries after a thorough analysis.

In Yugoslavia inflation continued to increase, by 9.1 percent, as compared to September. The second half of the year was completely characterized by the expectation of a heavy devaluation and, finally, the dinar was devalued (1 DM = 9 dinars). This was coupled with strengthening inflationary expectations. Trade balance and international competitiveness seriously deteriorated. All this seems to illustrate that price expectations were not primarily dependent on devaluation.

In the light of what has been said above, two kinds of conclusions can be made. According to one opinion the success of the stabilization programme depends on the correct selection of the size of the nominal anchor. According another evaluation, gradual adjustment will adapt the nominal anchor to the changing situation without undermining the confidence in the stabilization programme.[13]

[13] The situation with the interest rate is the same. At the beginning a strongly positive real interest is needed which, if it lasts too long, may have a negative effect on healthy companies, too.

Finally, based on the example of Israel, it seems that the modification of a properly chosen nominal anchor has less negative effect on the expectations and on the whole stabilization programme than a stubborn insistence on the selected value of the nominal anchor. Namely, if the important macro-variables approach the critical value, they can only be brought back into equilibrium with higher social costs and this would strongly affect the credibility of the whole programme. Another important lesson is that by applying gradual corrections, the rules of the game between government and public can be more rapidly learnt by both parties.

Of course, it can be said against all this that the success of the short-term and especially of the long-term stabilization of the East European countries depends first of all on the extent to which the transformation of the basic structure of property and of the economy will be successful. Beside emphasizing this, when making the economic policy decisions one must not forget about the changing or changed rules of behaviour of the participants of the economy. With regard to these the results of the stabilization theory also have to be taken into consideration.

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ГИПЕРИНФЛЯЦИЯ, ДОВЕРИЕ И ОЖИДАНИЯ (ТЕОРИИ СТАБИЛИЗАЦИИ И ВОСТОЧНО-ЕВРОПЕЙСКИЕ ПРОГРАММЫ СТАБИЛИЗАЦИИ)

Л. ГАЛПЕРН

В середине 80-х годов программы стабилизации были введены в четырех странах, где инфляция была чрезвычайно высока: Аргентина (июнь 1985 г.), Боливия (сентябрь 1985 г.), Бразилия (февраль 1986 г.) и Израель (июль 1985 г.). Программы стабилизации, которые были внедрены в начале 1990 г. в Польше и в Югославии во многом исчернули из уроков успехов и недостатков этих попыток по стабилизации. Теория стабилизации различает ортодоксальные и гетеродоксальные программы стабилизации. Прежние попробуют сбивать инфляцию посредством мер по снижению спроса, пока последние ставят в центр подавление инфляционных ожиданий, которые считаются важнейшимы факторами высокой инфляции, пользуясь частичным или полным замораживанием цен и заработных плат. Обе программы подчеркивают значение т. н. твердого пункта. Статья анализирует вопросы выбора номинального фикса применяемого в Восточной Европе.

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CREATIVE LABOUR—REPRODUCTIVE LABOUR AND THE MARKET

J. RIMLER

According to the neoclassical school all economic labour is but a forced sacrifice for the sake of consumption and individuals try to minimize effort relative to the pleasure of consumption gained. One may try to qualify the theory with the following: 1. not only economic benefit but various non-economic advantages may also motivate labour; 2. all labour is a combination of two elements: reproductive and creative activities; 3. non-economic benefits are proportional to creative activity.

This study investigates how an individual optimizes his or her labour input and to what extent the results differ from the conclusions of the neoclassical model.

The neoclassical theory of labour and its economic utility

Due to the neoclassical theory, in the majority of the world's countries generations of economists have learned and continue to learn that the supply of one of the main active forces forming a nation's economy, i.e. human labour utilized in the economy, is determined solely by economic factors. According to this school of thought labour is purely a sacrifice, and enjoyment can only be achieved by consumption. The owners of labour as a factor of production compare the sacrifice made i.e. labour performed, to benefits due to wage earnings received and then decide on this basis their labour supply.

This phenomenon can also be graphically illustrated, if we take into account another theorem of the neoclassical theory, i.e. the decreasing marginal utility of the consumer. This is expressed in *Figure 1* by the "consumption-pleasure" curve sloping downwards from north-west to south-east and becoming increasingly flat (CP). Contrarily, the curve representing the marginal labour sacrifice rises increasingly abruptly from south-west to north-east, expressing the growing burden of additional labour input (LS). The point of intersection of the two curves, point E marks the state of equilibrium. This is the most favourable place in terms of the individual's utility, defined as the difference between enjoyment due to consumption and total labour sacrifice. Namely, before point E or left to it, individual benefit has not yet reached its maximum level, the marginal utility of consumption still exceeds the marginal sacrifice of labour, so by extending labour, surplus utility can be obtained. However, passing beyond point E, when the increment of sacrifice exceeds that of enjoyment, the total utility is less than that at the point of equilibrium.

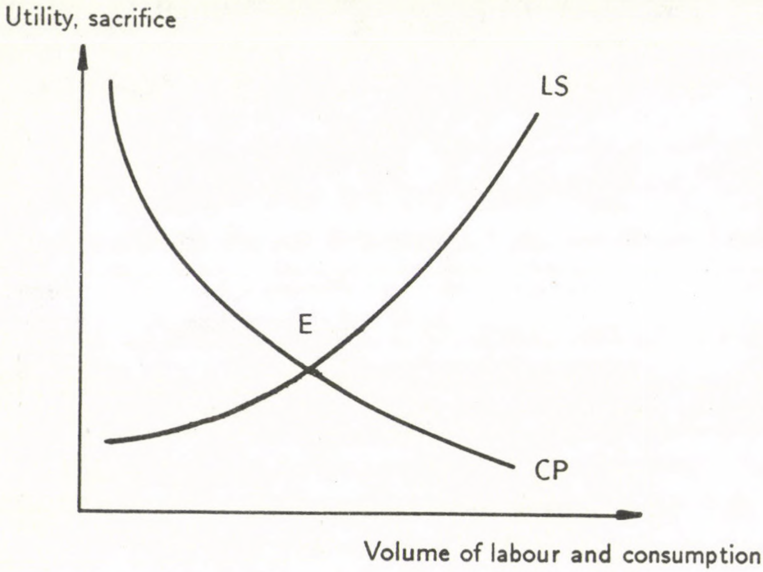


Fig. 1 Determining the individual supply of labour

According to the neoclassical explication (*Koopmans* 1957) the equilibrium point E in *Figure 2* corresponds to point B lying in the plane of labour input and food output. In the figure we have shown the (partial) production function of labour which demonstrates that in the beginning yields grow faster and later slower than the input does. The area below the curve may be called the *set of production possibilities*. The *set of consumption* possibilities is demonstrated by the area demarcated by the curve indicating the minimum consumption possibilities, rising ever more steeply along with the growth of labour input, and by the output-axis. The individual's alternatives of choice are embodied in the common area of the two sets, its form resembling that of a fish, therefore we shall call it hereinafter the FISH. Under the conditions in the work referenced—of which no details are to be given here—the individual as producer aims at profit maximization and, as consumer, at the realization of maximum utility of consumption. The respective point will always take place on the back of the FISH, on the upper delimiting curve of the common set. In the simplest case of Robinson, i.e. when producer and consumer are the same person, the place of this point depends on how he evaluates the enjoyment of consumption relative to the sacrifice of labour.

Under the conditions of perfect competition this point can be determined with the aid of the so-called iso-utility curves expressing equal utility; namely by finding the point where the partial production function curve is precisely touched by such a curve. The slope of the tangent line drawn through the point obtained

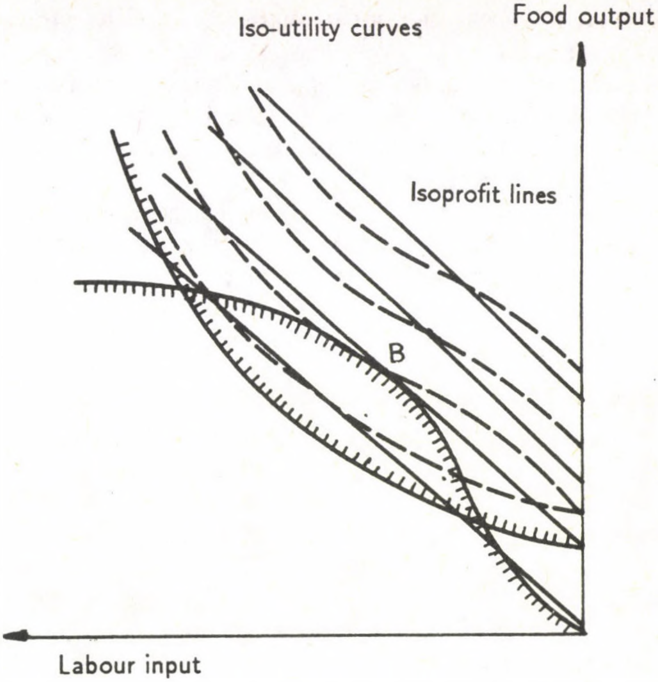


Fig. 2 **Optimizing production and consumption**

in this way reflects the value proportional to consumption output and labour input expressed in equilibrium prices. Thus, in this case the interests of the producer and the consumer are complementary. Point B, representing the highest consumption utility also marks the point at which the greatest profit is found for the producer.

Extension of the theory: creative labour and its extra economic utility

The above theory includes—among other things—the following assumptions; labour is nothing else but sacrifice and consumption is purely pleasure. One takes upon himself the burden of labour merely for the pleasure of future consumption, and the individual, with all his strength, strives to reach, as far as possible, the most favourable ratio between the sacrifice of labour and the joy of consumption.

Initially, such an assumption of a close connection between labour and its remuneration seems to be justified. With the modern present-day socio-economic order the aspect of material recompensation is, even if not an exclusively, still a decisive motivation to work. This is a fairly obvious statement. At the same time it is also evident that the above mentioned implicit assumptions restrict the validity of the theory. Indeed, there are exceptions. There are people, even today—and not even small numbers—who, beyond toils and troubles, find more in their work. Hence, they work not only, and not even primarily, for wages and salaries. They cannot be characterized by efforts to minimize their labour input or by trying to achieve the most possible economic gain out of it.

In the following I shall attempt to extend the theory into a more general and one in which the aforementioned irregular behaviour can also fit. The assumptions applied in the course of this analysis are the following:

1) We set out from the belief that in choosing work, one does not only consider the expected economic utility but also takes into account the advantages and disadvantages beyond the economic ones. For instance, he will pay attention to how the work in question suits his personality, and will prefer those activities which better conform to his human faculties. He will also ponder what position he can reach through his fellow people, what human relations can be generated and maintained by it and he will attribute a higher value to the one earning greater appreciation and human relations more appropriate for his demands. It is also significant to what extent the economic activity will exercise his faculties, erudition or training, how much possibility will it grant for applying postgraduate studies and utilizing his creative power, and those tasks will always be more appreciated which are more challenging. Summing up, *we presume that when choosing or undertaking labour, people are motivated by economic values and values beyond the economic reasoning to be obtained by the work.*

2) We also presume that any work undertaken has also some result beyond the sphere of the economy. (It is evident that some economic result always comes into being, so this need not be emphasized.) Extra economic utility necessarily appears, since any human activity, including the economic one, contains certain special human contribution, i.e. activity of the brain. Economic activity quickens the power of imaginative thinking, utilizes the combinative capacity and the inclination to make innovations. Mental efforts, on the other side, however little or marginal, contribute to the spiritual development of human personality and, as a result, they also serve as sources of values beyond the economic ones. Let us call the first type of labour, i.e. that of the muscles, *reproductive labour* and the second one, the work of the brain, *creative labour*. Assertion of the second assumption, using the latter formula, means that *any economic labour consists of two components: a reproductive and a creative one.*

As it is well-known, the particular economic tasks significantly differ from one another with respect to their composition. There are some which hardly need or allow any creative human contribution, and some which need practically uniquely the work of the brain and almost no manual labour.

3) Presumably, reproductive labour (i.e. the reproductive part of labour) is burdensome for those pursuing it because it raises requirements toward them

which are less in compliance with human nature. These may be heavy or prolonged physical performance, repetitive tasks, and unpleasant or harmful working conditions. Given these characteristics, no one undertakes reproductive labour (or part of labour) without being compensated for it. The countervalue of such work is the actual economic utility, the pleasure of consumption, according to the neoclassical theory.

Creative labour is, by definition, varied, consequently ever new challenges and problems are to be resolved. It requires mental immersion and as such, is much more appropriate for human nature. This type of labour, though it may be just as tiring as the reproductive one, is not burdensome; what is more, it may even cause pleasure, inasmuch as it may free one from his inner stresses caused by his repressed creative power. Creative work is done by the individual by and for him- or herself, and not out of necessity, or for the purpose of some economic gain. It is not the pleasure of future consumption to be purchased with the money received as compensation which determines the quantity of creative work. These two things have almost nothing to do with each other.

4) We presume that the productivity of both types or parts of labour can be determined. That of the reproductive labour can be measured by the ratio of the economic gain and the respective labour input and that of creative labour by the total of economic and extra-economic results and the respective labour input. It is furthermore presumed that in the course of selecting and performing labour, one is motivated by the best possible utilization of one's physical power and mental capacity. For this purpose he or she will select the *quantity of work* and its composition by reproductive and creative parts, i.e. *its quality*, so as to achieve maximum total results, economic and extra-economic utility.

The geometry of optimization in the case of two labour dimensions

Extending the neoclassical theory produces essentially two points. On the one hand it means that, in addition to quantity, also the quality of work is taken into account. On the other hand, that in addition to the economic gains also reward beyond the sphere of the economy appears. Therefore the selection between them is influenced not by two, rather by four factors.[1] In order to illustrate, two factors are combined and it is assumed that the economic and the extra-economic results can be measured on the same axis.

For the sake of simplicity, in the following scenario the individual choosing work will be represented by Robinson living alone on his island. Robinson will

[1] Of course, during economic activities one does not merely consider two or four factors, since both the results, and the work performed for them, may have several components. However, the many dimensions may be arranged into the above main groups.

look for the optimum point not on a plane but in space. The change may be so interpreted with the FISH formerly flattened now into being three-dimensional and regaining its true form. The FISH resulting from the possible selections in space as well as of those on a plane is outlined by two decisions made on the basis of various goals and motivations. The top surface is defined by the curve of the maximum production possibilities and the lower one by the minimum consumption function. As shown, the difference between the two approaches means either a narrower and/or broader interpretation of outputs and inputs; the principles of optimization, however, do not change.

The output "mountain"

The surface of the three-dimensional production function can be thought of as a mountain towering above the basic plane. The basic plane is stretched out by the two kinds of labour, its points represent various combinations of creative and reproductive labour. Above every point the output mountain rises higher or lower depending on the used quantities of the two types of labour and on productivity. The greater the labour input, i.e. the farther the distance from the origin—marking the outset—along a radius, the less extreme are the input combinations, the higher is the mountain above the point in question. The first part of the statement is evident, but to throw light upon the second one certain explanation is more suitable.

Presumably, reproductive and creative labours are interchangeable; the same job can be done mechanically, in a reproductive way and also creatively, utilizing mental gifts of the individual. But interchangeability has its own limits. We have already mentioned that neither of the labour types can be reduced to zero. For instance, no work can be performed in an entirely creative way. Owing to the character of the activity, it always contains some reproductive elements. Another limit is connected with the quantitative relations of substitution. We must presume that the more extreme the combination, the more creative labour falls to a unit of reproductive one (and *vice versa*), the more difficult further substitution will be. A unit of the labour type employed at the lower rate has to be replaced by an increasing quantity of the labour type used at the higher rate, or not at all, if we wish to avoid the decline of production. In our opinion this assumption used in production functions for describing the possibility of substitution between capital and labour, may also be applied to the two types of labour. Precisely, we think that these also have a particular optimal combination, similar to that between capital and labour, which gives the highest possible result; and this point is not situated very close to the input axes. There may be, of course, tasks which can be completed much more effectively by creative methods, and some others whereby increasing mental efforts will bring no special results; however, the majority of economic activities fall between the two extremes.

The surface of the production function, i.e. the concrete shape of the "mountain" can differ greatly, depending on the interconnections allegedly existing between inputs and the result. *Figure 3* represents a possible form of the surface, i.e. that of the well-known Cobb-Douglas production function. In the figure the two axes of the basic plane measure the quantities of creative and of reproductive labour, and the results are shown on the vertical axis. The surface which consists of a network of the so-called partial production functions curves, rises, starting from the origin and shows that higher inputs bring about higher results.

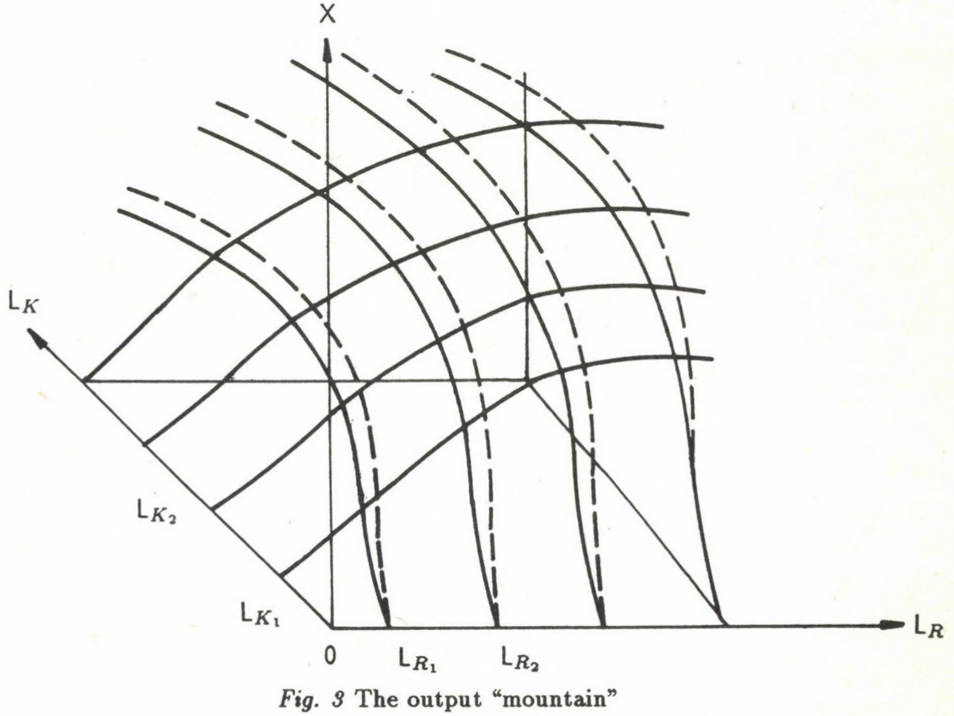


Fig. 3 The output "mountain"

There are several versions of the Cobb-Douglas production function. To present Robinson's situation we have chosen the simplest one, the homogenous formula of first degree. From the outset, I should like to emphasize that it is permissible to choose the simplest form and to make the following assumptions, since they do not lead to unrealistic conclusions, they merely affect the strength but not the direction of the tendencies.

Later on this shall be argued by presenting some revealing examples. The simplifications at the same time will greatly facilitate understanding into the spatial relationships, which are otherwise difficult to show, and can demonstrate the deviations from the traditional neoclassical model.

From the three intertwined particularities of the first-degree homogenous Cobb-Douglas functions which influence the choices of Robinson, the first one is linked to the partial productivity of the inputs, the second, to the possibility of substituting one for the other and the third, to their combined effect, the so called return to scale.

Partial productivity of inputs of the one type with the constant volume of the other type of inputs can be seen in *Figure 3*. The curves going in north-east direction from the OL_K axis show the increments of output resulting from the growing inputs of reproductive labour with constant L_{K_1}, L_{K_2} etc., creative labour inputs. Similarly, the curves rising to north-west from the OL_R axis are the partial production functions of creative labour with L_{R_1}, L_{R_2} etc. quantities of reproductive labour.

We introduce the further simplifying assumptions that the contributions of creative and reproductive labour of the *economic* results do not differ from one another, i.e. the partial production functions of the two kinds of labour are equal. In *(a)* part of *Figure 4* we show two coinciding partial production functions in two dimensions, assuming that the inputs considered to be constant equal each other ($L_{K_1}=L_{R_1}$). Additionally it is believed that creative labour produces not only economic output, while the reproductive labour produces only economic output. Hence, in aggregate, the productivity of creative labour is higher than that of the reproductive one. This is demonstrated by *Figure 4(b)* where the partial productive function of creative work rises higher than in *Figure 4(a)* where purely economic results are shown on the output axis. (The partial production functions of reproductive labour are the same in both parts of the figure.) In *Figure 3* the appearance of the dotted output lines show the same, i.e. a steeper rising of the mountain on the side of the L_R axis.

It may be observed that the partial production functions for a while show a rising trend, the rate of which is higher in the beginning but later it decreases. The rising curves indicate that by increasing the variable output, it raises the results up to a certain limit, but the rate of this growth sooner or later decelerates, since keeping the other input unchanged makes the labour combination ever more extreme, hence substitution becomes increasingly difficult.

Otherwise the characteristics of substitution are shown by the so-called isoquants. The isoquants—obtained by projecting horizontal cross-sections of the mountain parallel with the basic plane unto the basic plane—are the series of geometric points of creative and reproductive labour combinations belonging to equal levels of production, wherein the level of production is measured by the distance between the basic plane and the intersecting plane.

The isoquants are convex with respect to the origin, meaning that the more balanced the input combinations, the less total labour is needed to reach the same

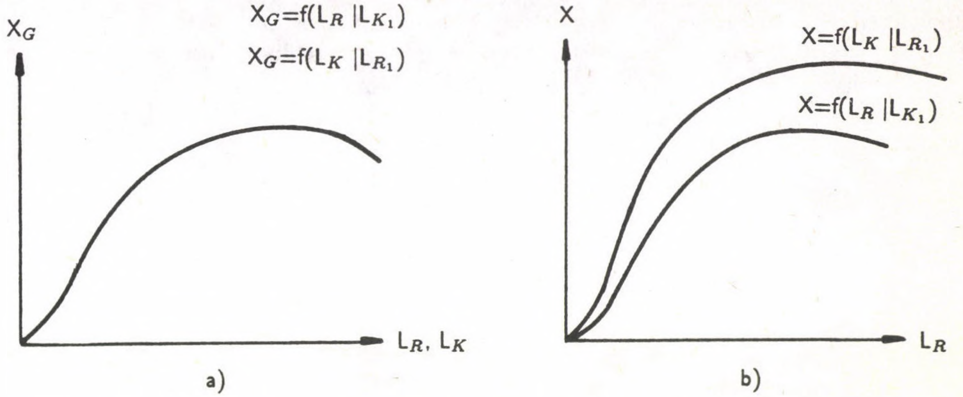


Fig. 4 The partial production functions with regard to the economic (a) and to total results (b)

result and, conversely, the more extreme the combinations, the more labour is necessary for it. This necessarily follows from the particular form of partial production functions.

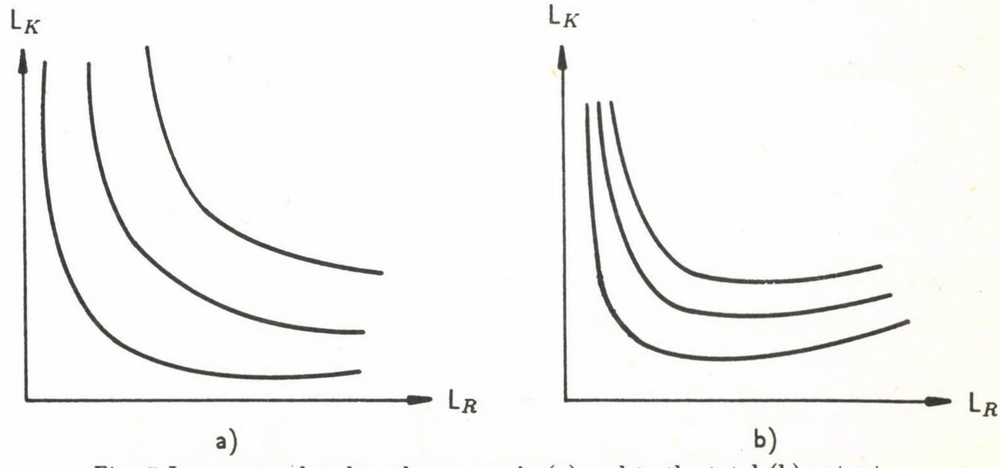


Fig. 5 Isoquants related to the economic (a) and to the total (b) output

The isoquants of the economic output surface are symmetrical to the bisectrix starting from the origin, assuming identicalness of the partial production functions when the two types of labour are measured using the same measurement criteria (see *Figure 5(a)*). This means that the economic production surface is the same, as seen either from the axis of creative labour or from that of reproductive labour.

With regard to the production surface of the total output, symmetry is not characteristic, presumably due to the proclaimed higher productivity of creative labour. The side starting from the creative labour axis demonstrates a mountain steeper than it is on the other side. As a consequence of the steeper slope, the isoquants along the vertical axis are lying nearer to one another than those along the horizontal one (See *Figure 5(b)*).[2]

The input "valley"

In either of the cases—be it the symmetrical mountain of the economic, or the asymmetrical one of the total output—the aim of those striving to reach the top of the mountain is, provided that they have no tendency towards self-destruction, to find the way requiring the least amount of effort. If we wish to study Robinson's behaviour on the basis of this analogy then, beyond the above listed features of the production function, it must be clear what sacrifice and burden is meant for him in order to exert the labour spent on achieving the result.

In the foregoing we have assumed that, because of the employment of mental faculties, creative labour is, in the final analysis not burdensome for man, though it may be tiring, whereas reproductive labour is both tiring and toilsome. Robinson, when evaluating the various labours, naturally considers these differences. When summarizing the inputs, he will give less weight to creative labour than to reproductive. By aggregating such weighted quantities of labour the whole quantity of Robinson's efforts and toils linked to the work in question can be obtained, thus, the cost of his labour. In the following we shall label this cost the wage (W), for if he worked for money, he would have obviously demanded at least a wage (salary) equal to the cost of the work performed by him.

Similarly to the production surface, the three-dimensional wage function can also be created. This indicates respective wage costs belonging to any possible combination of creative and reproductive labour. The stereoscopic picture of the cost surface is demonstrated by *Figure 6*. Again, the quantities of the two kinds of labour are measured on the basic plane and the wage cost on the vertical axis. The surface of the costs (continuing with the geographical analogy) is like a valley, drawn according to the costs rising ever more abruptly. We presume that, on the whole the costs of the less multifarious reproductive labour grow faster and reach the abruptly rising phase sooner than those of the creative labour do. This is

[2] Symmetry of the economic isoquants to the bisectrix is a simplifying assumption serving as an easier illustration of the characteristic differences. We might also argue that one of the types of labour is more productive than the other one. Accordingly, the curves appearing in *Fig. 5(a)* would be asymmetric. In comparison to this, the isoquants would deviate in the same direction as it is shown in *Fig. 5(b)*, by changing over from the economic to the total output. Thus, the result would show the same tendency. We think, however, that it would be less revealing than if the effect were indicated by the deviation from symmetry.

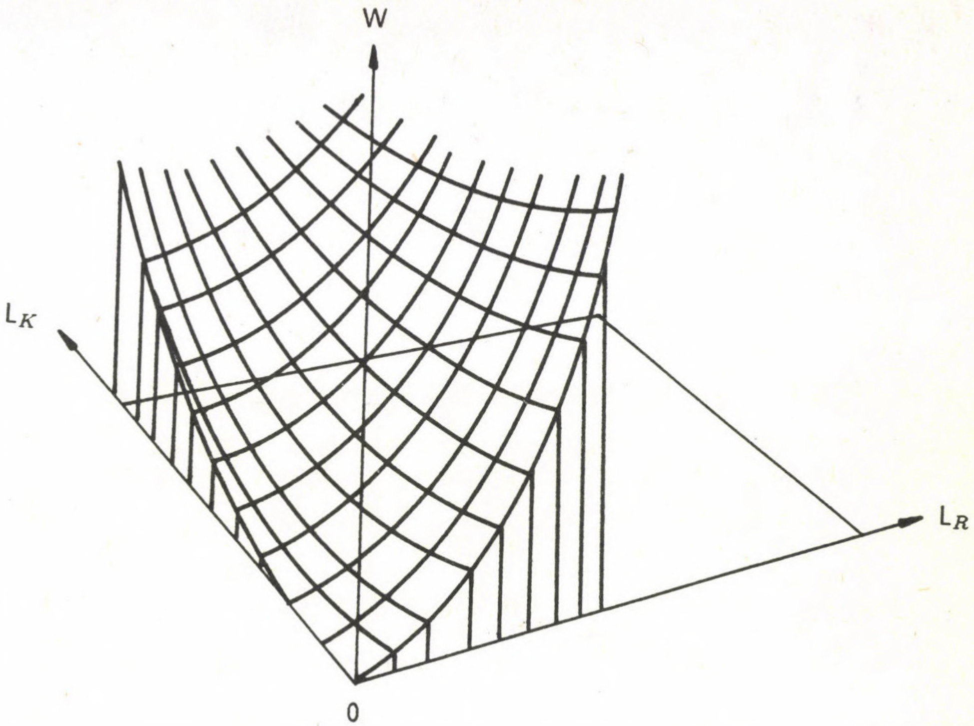


Fig. 6 The input "valley"

demonstrated by the partial cost functions shown in *Figure 7* which are obtained so that, while assuming the quantity used of one type of labour to be constant, we intersect the input "valley" by a vertical plane, perpendicular to the axis of the type of labour in question.

The isocost curves of the cost functions can be obtained in a way similar to that of the isoquants of the production functions. Thus, the cost function curve is intersected by planes parallel with the basic plane and the cross sections are projected to the basic plane. The isocost curves are concave with respect to the origin, assuming that the more extreme the labour combinations, the less diversified and, therefore, the more tiring is the work; consequently the higher is the cost of it.

Figure 8 shows the isocost curves. The interpretation of these can be made easier if we attach numerical values to them. Let the curve closest to the origin represent, 100 unit total wage cost. The diagram shows, on the one hand, that if this amount is to cover solely creative labour, more work can be obtained for it than from reproductive labour, given the relative cheapness of creative labour (the

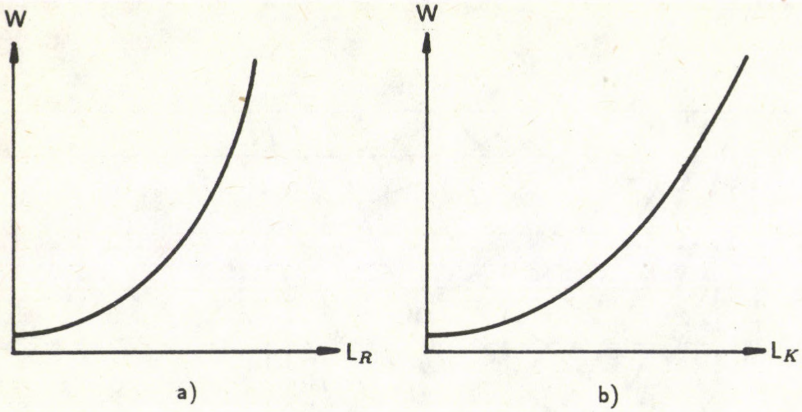


Fig. 7 Partial cost functions related to creative (a) and reproductive (b) labour

curve crosses the L_K axis at a greater distance from the origin than the L_R axis). Alternatively, in terms of cost development, it is favourable to combine the two types of work. The more balanced the combination, the cheaper the labour, i.e. the more labour can be purchased for the given 100 units, and the curve protrudes.

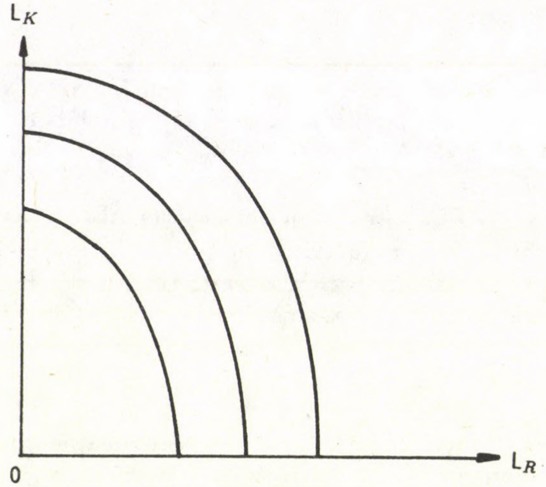


Fig. 8 The isocost curves

Robinson's alternatives

The question as to which are the most favourable combinations on particular levels of production can be decided by isoquants and isocosts together. In *Figure 9* it can be traced that along an isoquant, setting out from either direction, and substituting either type of labour for the other one, the cost of the combination first decreases, since the isoquant curve will be crossed by an isocost curve ever closer to the origin, and thus meaning ever less costs. The decrease continues until the crossing changes into contact, and, after this, the cost of production again begins to increase. In short, a given quantity of labour can be produced at the least labour cost, when the two types of labour are combined at the ratio and quantity shown in the point of contact.

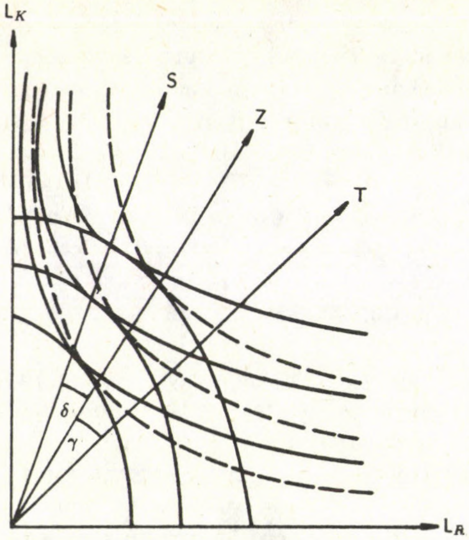
At the point of contact the two curves coincide with regard to their steepness. The slope of the common tangent in the case of the isoquant shows the marginal rate of substitution of the two labour types; in turn, when related to the isocost, it shows the marginal rate of substitution with regard to the costs. (The substitution rate is the quantity of labour which can be substituted for a unit of the other labour, without changing the production, or the cost, depending on which is meant.)

It applies to any set of homothetic curves, such as are also with the isoquants of the Cobb-Douglas production function, at those points on them to which tangents of identical slope can be drawn fall on a half-line starting from the origin. The straight line out of these which connects the optimum points is called the scale-line.

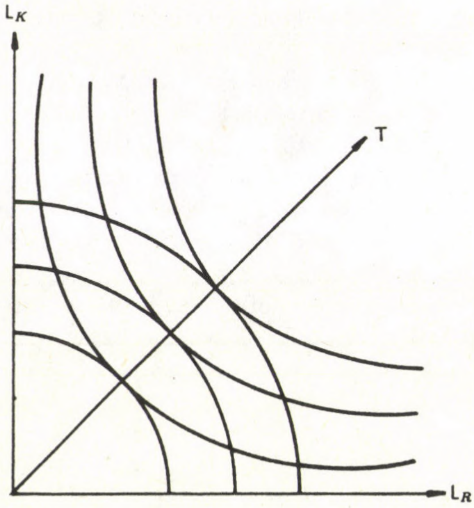
In *Figure 9(a)* three scale-lines marked T, Z and S, show three possible paths for Robinson. The decision on selecting the path depends on how he values his work and his results.

He will choose the T path if the two labour's productivities are the same; if he does not deem his creative work more opportune than his reproductive efforts; and, if he is not aware, or if he neglects it, that even in the course of economic activities some value beyond the economic values is created. Under the said conditions the best solution is to combine the two types of labour in a proportion of 50:50. This corresponds to T scale-line which coincides with the bisectrix. In order to make it easier to survey, the respective isocosts belonging to it are not shown in the summarizing part *(a)* of the figure. Instead, in *(b)* part of it, we have separately drawn the isoquants and isocosts which determine path T.

If Robinson recognizes that creative labour is more fit for human beings but pays attention even further to merely the economic result, he will deem it best for himself to follow the path Z. Variant Z differs from T purely with respect to the cost curves. Here, instead of cost curves symmetric to the bisectrix, the isocosts extend towards the vertical axis, indicating that one is ready to perform more creative work for the same amount of wage. Z path leads north-east from T, closer to the L_K axis. The extent of the shift is shown by the angle between them



a)



b)

Fig. 9 The most favourable labour combinations with regard to the total (a) and the economic (b) results

(γ), which is larger, the greater the difference the two types of labour and/or their value based on this difference.

Variant Z of the path is practically a transitory one between the two extreme cases, for it takes into account only the advantage of creative labour which appears on one side, namely, that of input. T is a path formed exclusively on the basis of economic considerations and S is the one which reckons with the extra-economic factors for both inputs and outputs. This means that, owing to the yield of creative labour beyond the economic sphere, the production surfaces of total output and of economic output will differ from one another—as previously shown—and, in consequence, the isoquants will extend towards the axis of creative labour. It follows that path S will take place to the left from even the Z line. Its angular turn from scale-line Z is given by angle δ, and from T by angle $\delta+\gamma$. Angle δ will be the greater, the more significant the extra-economic result is in comparison to the economic one.

The scale-lines tell Robinson how he should combine—involving also his personally developed preferences—creative and reproductive labour, but not how much he should work. In order to find a response to this question he too has to compare the results produced by the optimum combination of the two labour with the disadvantages of working as the costs of labour.

As in the two-dimensional case, here we may also predict that the best choice will the one which maximizes the difference between inputs and results. We must look for a point between the mountain-like protruding production surface and the valley-like hollow cost surface below it, which lies in the vertical section determined by the scale-line (see earlier, for attaining the best results when only points lying on this plane come into question) and which would be the most profitable for Robinson, i.e. where the greatest difference is found between the cost of labour and its results.[3] was based on assumptions about the surface forms of production and costs. The optimum point will be where the steepness of the rising cost function equals as that of the output surface. (see *Figure 10*).

[3] So far we have distinguished between two kinds of results, an economic one and a total one, augmented by the extra-economic result. To simplify matters, until now we have not specified how the results can be expressed in some kind of physical unit of measurement or in terms of value. To be sure, for determining the optimum path this was not even necessary. Also in the course of looking for the optimum point on the path, it is unnecessary to deal with the problem of valuation of the outputs, if we presume that the valuation we make, say, of prices, does not depend on the produced quantities. Namely, at constant prices the value surface will be parallel with the production surface expressed in physical units. Consequently, the slope of the tangent determining the best point will not be changed by calculating in terms of value.

Consequences of the selection

Robinson's best choices in the two so-called extreme cases are shown in *Figure 10.* The third variant, belonging to scale-line Z is not represented, in order to preserve clarify of the diagram. This is possible because variant Z lies between the two extremes many case, so its position and the conclusions of it can be drawn with no special illustration. *Figure 10* the outputs and inputs expressed in physical units of measurement determine the best B points. On the production surface this is B_T and with the function expressing the total output it is B_S.

In accordance with the two systems of condition—three of them, if we reckon with the intermediate one as well—characteristic differences can be observed in both the results and inputs. The most important difference is that *Robinson*, if he makes his decision based on purely economic considerations, works less in its totality, and h is work includes more reproductive elements, while if he also considers the extra-economic results and the different significance of creative work, his total work will be more and a greater part of it will be performed in a creative way.

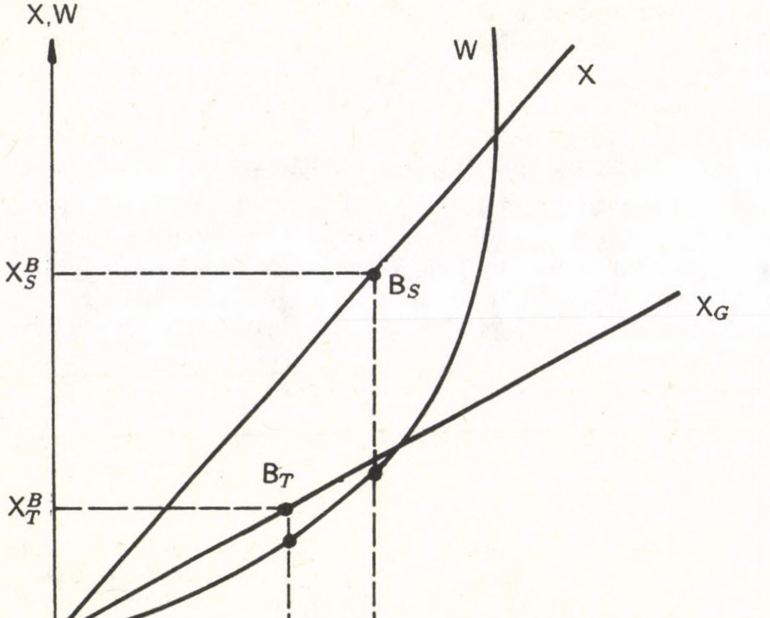


Fig. 10 Efficient choices

This conclusion will not change even if we give up our reservation regarding constant prices. Yet another condition, complementing the foregoing ones also has to be mentioned. This is that not only the demand for economic goods, but also that for creative labour may become saturated, though the latter more slowly than the former. For this reason the price of the economic output will decrease sooner than that of the whole output which is also influenced by the price of the extra-economic output, the demand for which is fulfilled at a lower rate.

The faster declining price of the economic output lowers the output surface expressed in value terms relative to the one expressed in physical measurements sooner and to a deeper level than the total output surface will be lowered by its slower declining price. Thus, the difference between the economic and the total output surface continues to exist even if the assessment is made on a value basis, and is similar to the one shown in *Figure 10*, which was the foundation for our conclusions. Economic Robinson will work less than his fellow-man striving not merely for economic utility, and his labour combination will not be dominated by creative work.

It is another question how the analysis using declining prices—which entails that the linear homogenous character of the production surface ceases to exist—will change the total quantity of labour to be used at the optimum points. Several solutions are possible, depending on the relationship between linear scale-lines and those of declining and falling prices. The optimum points belonging to the outputs expressed in physical units of measure may coincide with those in terms of value, but they may also mean lower or higher outputs and inputs. Now we will not go into the particulars of this problem, because we are less concerned with the differences between values and physical units of measurement and more with the differences of decision-making based on economic, and on not uniquely economic points of view, and these are obviously independent of the problem of coincidence.

Thus, according to the extended theory, Robinson's behaviour is characterized by the fact that, in addition to the economic results he also considers the extra-economic results, and this means that he will combine the creative and reproductive elements of his work in order to achieve the optimum total results. In contradistinction to this, the neoclassical definition claims that our man will prefer the solution in which the economic results given by the difference between the attained utility and the homogenous labour input is the most favourable. Apparently, the two formulations are very similar to one another. The difference between them seems to be that in the first one the result is composed of two parts and there are two types of labour, while in the second one there is only one kind. It must be underlined, however, that there is an essential difference hidden here. While in the world of neoclassics, labour has by all means to be minimized in relation to the result. According to arguments expounded in this study, this is not always so. There can, and there will be, situations and domains in which Robinson—stressing the assumption that everything else remains unchanged—will undertake work, like many others of his activities, for nothing else but in of itself. Namely, in work he can find the possibility self-realization, mitigate tensions, or, he may simply enjoy it. However, we formulate his motive, it is certainly not to obtain money or any material gain. Man, aspiring towards perfection, slips out from the economic rationality of the classical theories, or, to put it more precisely, Robinson re-examines and overrides himself the "homo oeconomicus". He will recognize the results beyond the economic ones even in his work and takes them into consideration in the course of optimization. Thus he may continue to work, even when regarding its economic results as no longer worthwhile and the marginal sacrifice of labour proves to be higher than the marginal pleasure he finds in consumption.

The "one-sided" market

From Robinson's position who aims at perfection, his fellow-man who is only economically motivated acts irrationally, and one could also say, he is wasteful. On the basis of *Figure 10* the following can be said about this wastage. The best point of the set representing the possible choices is marked B_S. To the right or left of this, proceeding along the isoquant representing the output quantity X_S^B, wastage comes about by choosing unfavourable labour combinations. Moreover, going downward from B_S, in the direction of the basic plane, wasting is shown in the form of insufficient utilization of the production possibilities, and appears as a loss of volume.

The best points of merely and half-way economic selection, i.e. B_T and B_Z (the latter is not shown in *Figure 10*) are unfavourable in comparison to B_S as regards both inputs and results. Point B_T marks the economic output to be produced most efficiently by undifferentiated labour, and the respective inputs. It is an uneconomic placement in comparison to B_S, first because it uses relatively more reproductive and less creative labour than a man striving for perfection would dedicate to it; and secondly because it is within the set of production possibilities, hence it produces results less than possible, the difference being $X_S^B - X_T^B$.

What is true of B_T also applies to the point B_Z, which is not indicated in the figure but easy to visualize, though here the losses will be smaller than previously, since B_Z is closer to the optimum than B_T. Hence, a choice taking into consideration the advantage of creative work, appearing in its relative cheapness, is less wasteful than the one which does not reckon with it at all.

The market which is, according to basic assumptions, is so far the best known tool for asserting economic efficiency; it recognizes, *by definition*, point B_Z as the optimum. In the course of bargaining about wages, individual working people take into account also the factor of creativity, and engage in tasks where they can utilize their creative energy even if for lower wages. At the same time, in the market only the economic goods appear as results and the outputs beyond the economic ones do not. In the course of price formation values are attributed to economic goods only, owing to their power of satisfying needs.

Hence, the market is one-sided: in valuing the inputs, it considers both components of labour, but with regard to the output, the results beyond the economic sphere are not accounted for. This indisputably means devaluation of creative labour in relation to reproductive activities.

The devaluation affects two basic functions of the market. On the one hand, the tasks which are destined to distribute the produced goods, and, on the other hand, those which have to assure the efficiency of production. This one-sidedness influences productivity in a negative sense and distribution in a way which may be deemed rather positive.

Ethically speaking, the complaint against the market is that in the course of distribution it takes into account not only individual merits and/or endeavours but also some potentials which are independent of these. Here we mean first of all hereditary financial and mental capital which are very unevenly distributed among the members of society. These involve, from the outset, large unjust advantages to some and disadvantages to others. Further, the market instead of mitigating these advantages and disadvantages, actually increases them, i.e. the welfare-type argumentation against the market. (*Buchanan* 1985) The aforementioned negative effect on distribution is somewhat moderated by the one-sidedness of the market. Supposing that a part of economic tasks to be performed allow less to some and more creative contribution to others. Furthermore, supposing that cherished jobs are awarded to creative people given their aptitude to undertake the work, and the less attractive jobs have to be carried out by less creative persons. Finally, proposing that the persons starting with the potentials described above have more chance to develop their inherent creativity and thus obtain better jobs, the devaluation of creative labour seems to be ethically justified. Namely, the unjust access to better jobs is counterbalanced by the economic overcompensation for disliked work.

As an aside, those doing mostly creative work, also agree to the relative overstimulation of burdensome, dangerous, heavy work, unworthy to human beings, for they voluntarily sell their labour cheaper. However, this modesty may have its drawback on the side of efficiency. Namely, this one-sidedness of the market entails not only the devaluation of creative labour as expressed in terms of economic goods but also that those who carry out creative work, to a certain extent underestimate the economic results relative to the non-economic one. The more creative the labour, the more significant is its extra-economic utility and greater the chance for such underestimation. Everyone knows the figure of the shivering and hungry scientist and inventor who is absorbed in his work to the extent that has neither time, nor energy to assert his material interests in the market. Plundering the creative man by the market may reach a degree when it comes to impeding his work itself. Here we need not only think about those cases—which we hope have come to be rare by today—when he is in want of some physical needs, i.e. cold, hunger, unable to cure physical or mental troubles, but first of all about situations where creative man is deprived of the means which would enable him to completely unfold his creative power. If we accept the self-evident supposition that human labour is the more efficient the more creative it is, this means that the market, by under-estimating creative labour, itself confines the source which is most suitable to nourish the increase of economic efficiency, i.e. creative human contribution.

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КРЕАТИВНАЯ РАБОТА — ВОСПРОИЗВОДСТВЕННАЯ РАБОТА И РЫНОК

Ю. РИМЛЕР

По учению неоклассической теории экономическая деятельность не что иное, как вынужденная жертва в интересах потребления, и индивидуум стремится к минимизации этой жертвы в сравнении с потребительским удовольствием. Употребляя более широкое толкование работы, можно попробовать распространение теории при следующих условиях: 1. Работу могут стимулировать не только экономическая польза, но и различные не экономические выгоды; 2. Всякая работа состоится из двух элемента, из воспроизводственной и креативной деятельности.

Статья анализирует то, что при перечисленных условиях как оптимизирует человек свои трудовые затраты, и полученные так результаты в чем отличаются от выводов неоклассической модели.

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THE CHARACTERISTIC BEHAVIOUR OF HUNGARIAN COMMERCIAL BANKS

Z. SPÉDER

The study analyses the events, causes and consequences in the commercial banking sector in 1990. The monetary sector could not reach the goals which justified the creation of the two-tier banking system even in 1990. Capital allocation by banks is not characterized by market motivation yet. The inherited concentration of credits continues to persist. The accumulation and rolling-on of doubtful and failed claims paralises the capital allocation system of commercial banks. "Queuing"—the mutual debts of firms—of about Ft100 thousand million indicates demonetization of the economy. The intertwining of ownership among actors of the economy has continued to strengthen.

The credit policy and practice of the commercial banks

A stagnating economy and rising inflation notwithstanding, the commercial banks in Hungary are still fundamentally engaged in *classical active banking operations* (credit granting, discounting of bills, etc.); their credit activities have been increasing despite a restrictive monetary policy.[1]

The credits granted to the entrepreneurial sector in the first seven months of 1990 grew by Ft55 thousand million, i.e. by 12 percent. This is well over increment of 6 thousand million in 1989. From another aspect this means that barely 2 percent growth in real terms followed the 10 percent decrease in real terms of the previous year.

As for the structure of the banks' placements, it followed the earlier years' tendencies. *The investment credit stock was gradually decreasing, while the ratio of working capital credits was rising within the credit stock.*

Investment credits rose by Ft11 thousand million in the first eight months of 1990 i.e. nominally by 8 percent. This equalled a nearly 2 percent decrease in real terms. On the other hand, *working capital credits* increased by Ft57 thousand million — i.e. 19.3 percent — during the same period, which equalled a considerable,

[1] The monetary policy of the central bank (National Bank of Hungary) was restrictive in 1990, as had been the tendency in previous years. It was restrictive in the sense that the real value of the central bank's placements (refinancing credit, rediscounting of bills) to the banking sector diminished, due to the combined effect of the 6.9 percent nominal increase of placements, and the 9.5 percent rise in the producer price index. Within the changes the stock of refinancing credit shows a 3 percent growth in real terms, while bill-of-exchange holdings show a nearly 30 percent decrease in real value

namely 10 percent, growth in real terms. Most of this growth can be attributed to the sudden rise in short-term placements. The slow yet incessant restructuring of the loans portfolio of the banks, and the advantageous changes in the structure by expiry can be considered as a rational response to the changes taking place in the economy.

What is mainly responsible for the falling share of the *investment credits* (stock reduced in real terms decreasing share in the banks' balance sums) is that banks see their medium- and long-term placements as facing increased risk because of the continuously accelerating inflation. Also, they cannot compensate for this with a radical rise of interest rates, since the clients already regard these as being very high. This is not only because — as a consequence of the further deteriorating conditions of the development credits that are burdening the assets — the granting of loans of longer than a years's term is close to hitting the demand constraint. It is also due to the fact that today's accelerating rate of inflation already excludes the possibility of rational banking and business calculations. This is also proved, beside a stagnating stock, by the fact that some of the banks disposed of a considerable surplus of permanent sources over longer or shorter periods during the year, while the number of applications for loans increased, as did the number of loans actually granted.

The *other* factor which accounts for a relative decrease in investment credits can be traced in the changes in the economy that have taken place due to the changes in the political system. The "class struggle" over property not only shook the enterprise managers' positions, but also the situation of enterprises. The reason for this was the lack of a clearly stated property and privatization conception. Under such conditions, the postponing of planned developments by enterprises may be considered rational, if the recession is disregarded. What gives the only ground for optimism in this situation is the fact that the stock of the investment credits of small enterprises grew considerably, i.e. nearly threefold. While this no doubt expresses a highly dynamic development, the result obtained has to be handled with reserve: not only because of the low level of the initial base, but also because of the increased number of formally independent small enterprises which are in fact in some way dependent on a large enterprise centre.

As for the increase in working capital credits, the relatively advantageous situation in sources played a part *on the supply side*; the changes in the economic circumstances of the enterprises that constitute the clientele of the banks played a part *on the demand side*. The increase in enterprises' demand for short-term credits is the consequence of the following factors:

— The lagging behind of the modernization of the product pattern, and the decreasing demand on the domestic and the rouble markets led to the deteriorating income position of enterprises and to increased stocks. Decreased incomes and increased stocks led to a growing demand for credit among enterprises incapable of being self-financing.

— The increased amount of short-term credits in 1990 was also partly due to the seasonal demand which usually arises at the time of purchasing agricultural products. As compared with earlier years, the intensity of this demand was somewhat lessened by the dispute that broke out over the damage caused by the drought, and the state purchase prices. However, a part of the seasonal credit demand reduction still appeared for this reason, albeit indirectly: the drought-stricken farms tried to finance their seed-grain purchases from credit, because of their loss of income.

— The demand for short-term credits was further increased by the fact that the enterprises in which there was no settlement of working capital in 1968 (e.g. mechanical engineering, food processing industry) financed their durable stocks partly from short-term bank credits. From the aspect of the bank this means that granting credits to this sphere of enterprises infers a rising credit demand, such as follows the producer price index. This is true even in case of physically unchanged stocks. Although certain steps had already been taken with a view to transforming the bank credits that function as capital (e.g. medium-term capital substituting credits), a genuine solution to the problem has not yet been found.

The credit constructions of the central bank (NBH)[2] *intended to promote priority economic policy targets* served to ease the pressure on the short-term sources of the commercial banks.

These were attractive because they were made available to the banks above the "normative" sources, and they were advertised at more favourable conditions than the normal market interest conditions. Of the three basic constructions, although it was only the pre-financing of exports that proved to be practicable in 1989, the banks' clientele made use of this financing possibility, such that it totalled nearly Ft30 thousand million. This growth followed in spite of the fact that as a consequence of the 1989 December expansion, the bank of issue introduced new regulations in 1990 for the pre-financing of exports: it was no longer content with a promise of usual bank guarantees (such as letter of credit, bank guarantee, bill of exchange, etc.) for these were prescribed as a condition of the construction. The stipulation of bank guarantees was, however, bitterly disadvantageous for the exporting companies. On the one hand, because of the bureaucratic procedure of acquiring the guarantees, quite a large number of enterprises were excluded from obtaining the credits. This was because, by the time they could get the guarantee, the motive for wanting the credit had already disappeared. On the other hand, the requirement of bank guarantees bred distrust — especially in clients who had always duly made their payments; consequently there was the possibility of a loss of market. Third, the bank guarantees demanded for long term added to the burdens on Hungarian exports, because of the favourable position of the foreign buyers, which is by no means desirable.

[2] These are the following: export pre-financing construction, credit construction for the promotion of privatization, and credit construction for the promotion of private enterprise.

The bank's tendency of credit distribution, i.e. the practice of credit granting has followed the same line for nearly four years. In the portfolios of the three large banks (the Hungarian Credit Bank Ltd., the Commercial and Credit Bank Ltd., and the Budapest Bank Ltd.) *the company and sectoral concentration of credits has remained.*

Not quite 1 percent of the total clientele of the banks disposes on average of 40–50 percent of the banks' total placements. The *concentration* of each bank's credit portfolio *by companies* is further shown by the fact that the share of credits over Ft500 million ("big credits") in each bank's loan portfolio amounts to 50–80 percent. This is indicative of a highly dangerous state of "creditor's" dependence. The latter point is further supported by the circumstance that nearly two-thirds of the *potential creditor's loss* (doubtful and irrecoverable claims) are ascribable to about 50 large debtors of the three large banks.

Sectoral concentration is another important criterion of the individual bank's credit portfolio: this is partly the consequence of the original distribution of the clientele, and partly of the scarcity of sources that has been prevailing lately. 60 percent of the total amount of credits granted to the engineering industry are concentrated at the Hungarian Credit Bank, and the credits granted to the said industry attain 16 percent of the total claims of the Bank. The Bank faces a particularly serious situation because of the reduced export prospects of the CMEA. The Commercial and Credit Bank is the main financier of the food processing economy: 50 percent of the credits granted to this sector come from this bank. On the other hand, the food industry and agriculture have a 47 percent share in the bank's total placements. Natural catastrophes (such as draught), and the battles over land ownership may drive this bank, too, to the brink of ruin. Finally, the Budapest Bank is practically the only financier of the shattered coal mining industry, whose share in the Bank's credit portfolio reaches 40 percent. It is obvious that the enterprise and sectoral concentration has remained and is reflective of the conditions established at the time of the bank reform.

Some change in the banks' loan portfolio ensued due to two methods, not generally used by banks. Against the enterprises with which the banks wished to reduce, but not completely wind up, commercial relationships, they applied a strategy of slow and gradual withdrawal. *The banks reduced their outstanding claims simply* by taking out all receipts entered on the debtor company's account immediately and without approval of the company. This was the strategy used by one of the banks to reduce its huge credit stock with the metallurgical industry. It thus made use of the transitory boom in the basic material sector.

Another method of withdrawal, not typically used by banks, was the *conversion of enterprise debts into shares.* This brought some change also with respect to the concentration of the credit stock, since after a long or short period, the banks' outstanding claims towards some of the large debtors were converted into shares (see TUNGSRAM). In the short run, these processes brought advantages on both sides, but in the long run negative consequences may still follow.

In the final account, the distribution of credits between sectors and enterprises on the one hand, and banks on the other, was not changed by allowing *free choice of a bank*. During the longer or shorter periods of restriction none of the banks disposed of promising, free sources for enterprises looking for large amounts of credit. Therefore, in the three years that have passed since the bank reform, hardly any fluctuation has followed among banks, and that which has was rather linked to the fluctuation among banks, of bank clerks financing the firm in question, i.e. with *their* "choice of bank."

The concentrated distribution of the bank credits also involves high risks, rendering the Hungarian banks vulnerable. *Concentration rates over 15–20 percent* reduce a given bank's creditworthiness, i.e. its value on the capital market, even under normal economic conditions. This holds even stronger if the economy is suffering under a general recession. Another problem beside the high rates is the *combined presence of enterprise and sectoral concentration*. For example, each of the above-mentioned three banks has debtors whose debts go individually beyond 15 percent of the bank's capital stock. The financial ruin of a few large enterprises jeopardizes the production of not just the given enterprise but also that of the entire sector. Against such a high degree of concentration, banking instruments are also powerless.

Commercial banks and financial discipline

The banks have also failed to produce good results in improving financial discipline. Demonetization of the economy went on. Although the pressure of monetary restriction somewhat lessened, the nominally increased short-term credit supply of banks could not satisfy the enterprises' growing demand for money — this being partly a result of inflation. The additional demand flowing into the inter-enterprise money market elicited a sudden lengthening of "queues" waiting for due payments[3] which involved at the end of 1989 already more than Ft127 thousand million of unsettled debts. This figure rose further during the first seven months of 1990. Its exact size, however, is impossible to state. According to some estimations, it may be two- or threefold the above-mentioned sum since, with the obligatory registration of banks abolished, the payment (collection) orders are returned in an increasing number. Because of the worsening financial discipline and the mutual defencelessness of the enterprises, it frequently occurs that the payment (collection) order is not even forwarded by those concerned. One factor that in-

[3] The term "queuing" also implies that claims have to be satisfied in an order prescribed by decrees. — Ed. note.

creases the registered size of the "queues", while decreasing their real size is the separate "queue" that arises because of the parallel accounts: while a company has uncovered accounts with one bank, it may have substantial reserves with another.

Apart from their size, *"queues" are basically characterized by concentration.* Over one third of the registered uncovered payment orders are concentrated in hardly 1 percent of the enterprises concerned, i.e. in about 25–30 enterprises; whereas the phenomenon covers a much wider field. Enterprise concentration is accompanied by sectoral concentration: most of the payment difficulties are concentrated in the fields of the engineering industry, light industry, mining and metallurgy — among these the main role is played by the engineering industry. The concentration is, however, by no means a matter of chance. The enterprises that enjoy monopolistic positions and are incapable of structural adjustment react to reduced liquidity with this peculiar way of money creation.[4]

However, it would be wrong to draw the conclusion from this fact that a concentrated attack on the focal points is enough to root out the "queues". Thus, in the proliferation of the "queues" an important role is played by the sphere of small entrepreneurs whose market position is characteristically that of suppliers to the previously mentioned large enterprises. The situation of this sphere is not only determined by the monopsony of their customers, but also by the latter's lack of adaptability, which is rooted in outdated equipment and poor work culture.

While the lengthening "queues" are signs of an economy, that is increasingly becoming 'physical' and, money is being driven out from it an at accelerated rate, as well as its financial mediating institutions, are given less attention, the attitude of commercial banks continues to be characterized by passive resistance. This can hardly be understood, even if some rational arguments can be brought up in its support. As a matter of fact, three short-term interests underlie the banks' reluctance to put an end to the "queues".

First. It can be said that one part of the "queues", small but representing large sums and of long-term duration, also contain a high rate of expired credits: those enterprises also owe the commercial banks large amounts, which on average reach a third or quarter of the concentrated stock. The fear of writing off the loss of credits granted and of mass wind-ups also accounts for the banks' reluctant attitude towards "queues". Banks would first like to discuss the *division* of the losses and burdens that did not come about exclusively as a consequence of their business activity, and only then to take steps.

Second. The banks are not interested in a genuine settlement of the question also because, as keepers of accounts, they can closely follow the money turnover

[4] The means of payment brought into being by the "queues" is already "almost as good as money": in other words, it is just as good for inter-enterprise payments as for wages and tax payments within the enterprise; its loss of value is just as expressive of inflationary tendencies as is customary in the case of the legal means of payment. (Cf. Éva *Várhegyi* 1990)

of enterprises, as well as their receipts. Thus they can have priority in having their demands satisfied. If, however, the bank's outstanding claims are guaranteed by another bank — which, in general, is the practice in times of recession — the "queuing up" of enterprises is not of great consequence for the bank.

Third. Furthermore, the banks lack interest in a short-term settlement of the "queues" because the greater part — between two-thirds and three-quarters — of the uncovered payment orders do not contain any obligation to pay instalments to banks, or to pay expired credits.

For these reasons the reserved attitude of the banks can be well understood: they sought a solution to their problems by using various methods — such as leaving the outdated economic structure unaffected — which carried inflationary pressure but improved money supply. This form of attitude was not helped in any way by the steps taken by the bank of issue.

The failure of the credit construction introduced by the central bank in May 1989 can be ascribed to the commercial banks' inability at the time to fulfil the conditions (elimination of the production of losses, of the centres of "queuing up") which would have enabled the use of loans at favourable rates (18 percent), as advertised by the bank of issue. The banks could not guarantee — knowing the peculiarities of the enterprises' money circulation — that Ft1 credit could eliminate Ft2 of the "queue"; nor could they document the reduction of the "queues" (i.e. of the amounts involved) as a result of the credit construction, which was another factor that caused the failure of the bank of issue's "solution." For all these reasons, the banks did not use this possibility, and the "queues" went on growing.

The strategy of switching over from the financing of the centres of "queuing up" to eliminating them failed. This was not only because the commercial banks adopted a passive attitude, but also because a full and final settlement of the problem would have to go far beyond the scope of the monetary sector. With the present size of the "queues" and the existing degree of concentration, the individual actions of the commercial banks, as well as the *ad hoc* interventions on the part of the government, may become insignificant. Only such versions of solutions may be considered which link the matter of settling the "queues" with that of the now pressing privatization and ownership reform.

Commercial banks and the settlement of doubtful claims

At present, the unsettled state of the doubtful claims is one of the most serious, inherited problems of the banking system. The fundamental cause of the three-year stalemate is that neither the state that has left, nor the commercial banks that have received, this legacy are willing to take the consequences of unpleasant decisions. To start a massive winding up of loss-making enterprises, and to consistently write off credit losses would most probably lead, under today's institutional conditions (such as the monopolistic position enjoyed by large banks and large enterprises, the cross-ownership between banks and enterprises, and the lack of credit and deposit insurance), to the banking system and in due course the entire economy going down like ninepins. This is not to mention the fact that, for a partial or total writing off of the doubtful claims now estimated at a minimum of Ft50 thousand million[5] — the total capital stock of all the banks would not suffice. Thus in the short run, the attitude of all actors is directed more at preserving the *status quo* rather than at creating new conditions of operation.

Its permanently restrictive monetary policy notwithstanding, the *central bank* is compelled to grant additional refinancing credit (such as forced credit, liquidity credit) to the commercial banks struggling with liquidity troubles. This is not only because of the absolute shortage of sources, but also as a consequence of the increasingly frequent refusals of payment and delayed payments. Besides, it has to undertake to establish special refinancing credit quotas for the enterprises that the banks consider unmanageable but which, if they collapsed, would jeopardize also a bank's existence. Thus the bank of issue need not shoulder, even indirectly, the accumulated bad consequences (losses, unemployment, shortage) of the bankruptcy proceedings. Of course, the monetary policy is still centred, at least as far as intentions go, on preserving the purchasing power of the home currency and on keeping under control external and internal monetary processes. The new managers of the bank of issue, who took office in summer 1990, also committed themselves to a strict monetary policy. But the question remains whether the central bank will be able, with legal guarantees missing, to resist the political and economic interest groups who expect a solution to the crisis from a less strict monetary policy, and who wish to find financial cover for uncovered political promises with the commercial banks and through them with the bank of issue.

The *commercial banks* are also reluctant to take the initiative in wind-ups, and the writing-off of losses. They still hold the view that they have inherited most of such claims,[6] and therefore are unwilling to bear alone the burden of the losses

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[5] The "consolidated" balance of the commercial banks does not even contain, of course, half of that amount.

[6] Today it is possible to estimate the size of such inheritances. Recent screenings in the three large commercial banks have produced good approximate results. They showed that more than 30 percent of the three banks' credit stock can be considered as *directly* inherited credit. As against this, of the total of doubtful and irrecoverable credits representing the potential loss, those *directly* inherited reach 35 percent. What the figures show is that the stock of "bad" credits within the "new" credits has not decreased much. The reasons for this have been given above in the discussion of the interests attached to maintenance of the *status quo*. A better picture is obtained from the point of view of the commercial banks *if the two elements are separately viewed*. While the *inherited doubtful credits* have a 21 percent share in the total doubtful credits, the *inherited irrecoverable credits* have a 41 percent share in the total of the irrecoverable credits. Finally, for a true judgement of the situation it has to be stated that nearly *half* of the "new"

arising. This is not only because the banking instruments required for settling the doubtful claims are missing (such as reserves, an adequate apparatus), but also due the fact that the maintenance of the *status quo* in the short run is more comfortable as well as more profitable: substantial profit can be earned, even though this is partly fictitious on account of the rolling of loans and the accumulation of interest. On the other hand, the starting of massive settlements would lead to big losses because of the lengthy processes and the devaluation of the enterprises' assets.

Finally, another important factor in the banks' reluctance to eliminate loss-making production is that many banks would have to start the wind-up proceedings against exactly those debtor companies which are also owners of the bank and whose main representatives are members of the boards of directors and supervisory committees. And, even though the banking functions of the proprietary institutions are going through a process of "clarification", a clearly outlined and diversified proprietary structure in which the roles (debtor–owner) are clearly defined is still quite far from realization.

The Ministry of Finance is the third main actor and it represents the *state*, which is also not urging an acceleration of the processes. As owner and income regulator, it could only lose in the short run by the banks' assumed doubtful assets becoming in fact really doubtful. As owner of the banks it taps the fictitious profit not only by means of tax, but also through dividends, whereas in the short run only the burdens of the loss would be felt. Thus, in addition to the government's "shifting" policy — which is of doubtful value — there are weightier practical reasons for the stonewalling tactics.

After all this it may be surprising that, at the end of 1989, the five leading commercial banks listed a total of about Ft3 thousand million credit losses among their inputs. This is, at least in comparison with earlier years' practice, rather high. This does not indicated, however, increased activity on the part of the commercial banks: the statement of credit losses higher by an order of magnitude is due to the rule changed by the State Bank Supervision. It says that the commercial banks are obliged to write off 10 percent of their doubtful assets.[7] as credit loss to the debit of their risk fund. Although the action was demonstrative enough, clearly indicating the government's intentions, there remains a weak point to be mentioned. When

credits were just hidden or open reschedulings of the old ones. In other words, knowing the distribution of the doubtful and irrecoverable credits, hardly more than a third of the credits involving potential loss can be considered as new.

[7]Doubtful claims are:

— claims qualified as doubtful by the financial institution;

— claims against debtors loss-making in the two years preceding the drawing up of the balance sheet;

— outstanding debts with debtors against whom winding up or refloating proceedings have been instituted;

— debts on the part of debtors who are in more than 60 days' delay of payment of interest or instalments on principal.

credit losses were written off, the financial situation of the enterprises concerned was not settled, there was no real account made with the enterprises. Also, the banks' outstanding debts were not actually recovered and, as for the companies concerned, they did not even know of the "cancelling" of their debts to the banks. That is to say, credit loss showed on one side, while everything went on as usual on the other.

Moreover, a few measures have been taken recently which were intended to settle the matter of the doubtful claims and which have not had much success, either, with those concerned. Such are: elimination of the tax-free accumulation of the obligatory risk fund; the drawing up of a list of fifty enterprises to be "sentenced to death" by the banks; and the starting of the winding-up proceedings by the banks.

These experiments could not be expected to be very successful, either. The reason for this is that the solutions, which centred on financial techniques, had neither an adequate conception nor the sufficient energy to upset the earlier outlined *status quo* and to establish a new equilibrium. In addition, no radical change occurred in the interest relations of the banks, or in those of the state, and there were no propositions for a solution based on the equal sacrifice theory of taxation. The state keeps pointing to the banks, and the banks keep pointing to the state.

The *banks* ought to recognize that the demonstration of the doubtful claims, and their accounting to the debit of the profit, together form an indispensable element of a bank's attitude conforming to the market, and to the protection of the depositors' interests. Since part of the doubtful and irrecoverable claims of the banks are the consequence of the banks' autonomous business attitude, the banks have to bear the burdens which arise. This, however, against the commonly held view, would not necessarily lead to their worsening position: tax saved on account of the lower profit stated, and a more realistic picture that clearly reflects their income-producing ability, may prove more advantageous than an explosion. The latter may come as a consequence of accumulated fictitious claims and incomes.

Of course, the *state* should also take an active part in any settlement. This is not only because the greater part of the doubtful and irrecoverable claims owe their existence to "inheritance", but also because the decision sphere covering the enterprises concerned extends far beyond the banks' competence. With several enterprises, the starting of the winding-up proceedings may well lead to employment troubles, export losses, and shortage situations — all of which have impacts on the national economy as a whole. The banks cannot, and neither want to, take the responsibility for these impacts. Besides, the solution of employment difficulties and the provision of social security are not tasks of the banks, but those of the state.

The fact must also be accepted that part of the doubtful and irrecoverable claims which falls to the state will add to the state debt, independent of the propositions for solution. However, the price to be paid would be reasonable: the state debt would grow by hardly 3 percent and the monetary sphere would get rid of the huge dead weight which hampers its functioning on the market. The advantages to be gained are enormous.

If, however, the settlement of the doubtful and irrecoverable claims is further postponed, it will have unfavourable consequences for the functioning of the whole capital market and for the creation of a uniform capital market.

— Because of the huge stock of doubtful claims and the deficiencies in the accounting system, the commercial banks are *impossible to regulate and control* with due strictness. This puts them into an advantageous bargaining position even against the state administration. From another aspect this means that there is only a slight possibility of introducing a monetary and supervisory regulation which is neutral to competition and which conforms to the market.

— The delayed settlement of the doubtful claims is harmful, because *refinancing on the part of the central bank* (special refinancing credit quotas, earmarked refinancing), coming as a forced substitution of their settlement, *elicits an unfavourable tendency of capital allocation.* Within the monetary sphere, economic units of low potential (but "sentenced" to survive) will get into a favourable position. An additional consequence is the preference for *administrative means of monetary regulation.*

— The unsettled state of the doubtful debts also causes disturbance *in the channels of income distribution*: the accumulation of interests, financed from credit, and the punitive interest rate, in fact bring fictitious profit for both the bank "producing" the income and the owners "distributing" it (state, enterprise).

— As a consequence of the unsettled doubtful claims *the capital market does not function properly, either.* Because of the unclear financial situation of the banks and of the enterprises that form their clientele, the differences in guarantees provided by the investors are not seen distinctly. The situation is the same with regard to the size of the risks as against the promised returns, and this is likely to arouse prudence in the savers.

— Finally, from all this it follows that the large commercial banks do not come up to the requirements of market conformity. Therefore, in their present state, to lay them open to foreign privatization would much more likely to attract profiteers, rather than genuine professionals who think in long perspectives. Such a state of affairs would certainly be undesirable.

Investments of the banking sector

The investment activities of the commercial banks and of the specialized banking institutions have been growing dynamically. The banking sector's capital interests were nearly Ft9 thousand million greater at the end of 1989 than the corresponding figure for 1988, which equals a 50 percent growth. Within this amount, investments were unevenly divided between the banking sector and the real sphere. The growth of banks' investments into the banking sector was a little more than Ft4.2 thousand million, i.e. 73.5 percent. On the other hand, the growth of the banks' investments into the real sphere came near to 110 percent — its absolute value stood at Ft4.7 thousand million. Altogether, the ratio of investments into the banking sector (banking institutions' cross ownership) reached 51.8 percent, which is to say that, in spite of the decrease, it still surpassed the share of the real sphere. In 1989, the five main commercial banks' share grew further as compared with the preceding business year: they made 83.1 percent of the investments into the banking sphere, 73.8 percent of those into the real sphere, and 81.9 percent of the total amount of investments — i.e. concentration also intensified in this field.

The expansion of the investments over traditional banking business is, however, not the consequence of the banks' autonomous business policy decisions. The investment boom of the commercial banks (relying on a temporary restructuring of savings) was partly forced out: the financing of enterprises which, for various reasons, have become loss-making and insolvent, may eventually become risks for the banks because of their "multiplier" effect. This could even reach a point where the odium of the concentrated debt stock will be borne not by the debtor but by the credit-granting bank. In order to counterbalance such growth of the risk on the portfolio, the commercial banks have resorted to the construction of the *debt/share* conversion.

With regard to the market share, the individual commercial banks judged the prospects of the business differently. In the field of investments the Hungarian Credit Bank was in a leading position over the years 1988–1990: its share in the total amount of investments was more than 46 percent at the end of 1989. Far behind the frontrunner we find the Commercial and Credit Bank (15 percent), the Hungarian Foreign Trade Bank (13 percent), and the Budapest Bank (6 percent).[8]

The situation we have outlined in the analysis of the credit business is perfectly reflected by the figures. The banks in which a large part of the credit stock is concentrated, and where a high share of the doubtful claims is stuck also hold the leading positions in investments. Of course, even though force does play a part in it, the business may be advantageous for all parties: banks can "get rid of" those irrecoverable claims that have weighed on them heavily and try to assert their profit interests by means of influence exerted through capital. The enterprises, on the other hand, freed from the burdens of interest may improve their financial position and thereby also the chance of an eventual privatization (see the case of TUNGSRAM).

[8] Unfortunately, the above figures distort the real situation quite badly, since they do not come from consolidated balances; they do not cover the banks' investments through their own concerns. With some of them these concerns are substantial.

This is, however, also not without problems. On the one hand, factors jeopardizing a secure functioning of the banking business emerge. Cross ownership between the commercial banks, dominant owners among banks' own clients, and the clientele who control the banks through ownership of the banks' shares — all these could hamper — beyond a critical point — the development of an optimum capital flow. In an even worse scenario, bankruptcies could occur on a large scale, and thus cause the economy to collapse. On the other hand, the position of the banks with regard to expiries will deteriorate even further because of the general scarcity of resources as they are anyway not sufficiently liquid. Finally, the lack of well-functioning markets with abundant capital makes it impossible to convert into money, without a considerable loss, even the realistically estimated assets embodied in securities. The danger was already perceivable in the liquidity troubles of the preceding year.

On the other hand, it can be seen that a drastic limitation of the banks' investment activities (made with a view to counteracting cross-ownership) or the limitation of their own activities by themselves, would not only slow down the desirable process of privatization, but would also retard the cleansing of the banks' loan portfolio. Banks are special actors on the capital market because they have the capital indispensable for the efficient restructuring of enterprises and/or privatization. Also, they have sufficient information on the sphere of enterprises concerned, and knowledge of the financial constructions required for solving problems. Not to make use of all this would be more than a mistake, it would be a sin. What is more, other methods available for cleansing the banks' portfolio are of only limited efficiency.

At the same time, some of the banks are rather cautious: taking into consideration the higher risks involved, the prescriptions of superior authorities which limit the banks' investment activities, and the lack of a well-trained staff they tend to opt for a slow reduction of the credits and/or a continuance of financing. This attitude is supported by the fact that in 1989 the income (dividend) brought by the various investments fluctuated between 8 and 12 percent which remains far beyond the prevailing interest rates even at a pre-tax calculation.

The proprietary relations of the commercial banks

From their beginnings, the proprietary pattern of the commercial banks has been determined by the predominance of the state: this first became obvious in the absolute majority of the government shares and later, after the additional issue of shares, in a relative majority of state ownership. At the end of 1990, the state share was in most cases below 50 percent. However, the state's predominance in the ownership in fact represents nonexistent property and the lack of real owners, in spite of the formal exercise of proprietary rights and frequent operative interventions. The state was as interested in tapping incomes and in the depletion of the banks as were the owner enterprises.

The year 1989 saw a series of attempts at loosening the distorted ownership structure of banks. One of the possible solutions seemed to be the *issuing of shares to the public*: the involvement of households as real owners seemed to be sensible. The only such action, which was initiated by the Commercial and Credit Bank, proved unsuccessful. The limited interest in these shares is basically the consequence of distrust towards the large commercial banks on the part of households. This distrust emerges from the muddled financial relations and the large amounts of doubtful assets held by the banks. Low dividends (looking at them from the households' point of view), the 20 percent source tax levied on them, and the impossibility of realizing the (potential) profit of a rise in share prices because of the lack of a stock market, all play their part in the limited demand. For all these reasons, the quotation prices of these bank shares have fluctuated about, and even below, the nominal values. This made several banks request the suspension of the sale of their shares on the market, so as to avoid a worsening of their reputation. All this, however, should not be considered as a manifestation of an overall distrust on the part of households. The "short-term success" of the shares issued by IBUSZ, SKÁLA, FOTEX, etc. clearly showed that the investor group of households are able to select carefully among the shares, even if only with short-term considerations.

Another series of attempts to find a solution turned to the *foreign* privatization of banks — at least on the level of intentions. *Commercial banks* saw a way of escape in contracting "mixed marriages". In this way they hoped to acquire *additional sources in foreign exchange*, as well as advanced banking technologies and well trained bank specialists. *Tax allowances granted to joint ventures* also provide a weighty argument in this aspiration of the banks, since such allowances would let them earn considerable additional profit without having to show any significant improvement of performance. Finally, with such a scarcity of experts the higher than average wages and incomes — which the joint banks could offer — would also give these banks advantage in competitive terms. What would be disadvantageous for the banks in such a transaction is that the profit-motivated foreign partners would not only contribute to the development of an income-oriented economy but, with repatriation of profit being allowed, would also take out the income produced from the banks. Considering the banks' present situation with regard to sources and liquid capital, this is not desirable.

The other party to the transaction, the *Hungarian state*, is also interested, in the short-run, in the success of possible privatization. The national economy could *earn a considerable amount of convertible currency* by selling the shares abroad, and could obtain *additional credit lines* and export financing lines through the participating foreign banks. Besides, participation of foreign parties would be a *guarantee* for genuine banking business, for the replenishing of reserves, that is, for safe banking transactions. Finally, *profit-motivated owners* would appear and they are regarded as the potential boosters of the Hungarian economy. Of course, the privatization also has its drawbacks for the state. The tax allowances granted to joint enterprises would deprive the budget of a substantial revenue, the extended foreign exchange rights would further lessen the efficiency of the monetary regulation, and the property share acquired by the foreign banks when government shares are sold would put them into such a position of control that there would be a limitation of the domestic control of this strategically important sector.

The mutual interest of the parties notwithstanding, the negotiations stalled. Several factors had a part in this. The initial enthusiasm of the negotiating parties was dampened when it became apparent that the negotiations were being carried on behind closed doors and without competition, and when public opinion was expressed against privatization. This made the actors more cautious. What gave further cause for hesitation was the now more strongly expressed opinion which said, referring to previous experiences[9] of the joint bank companies, that tax allowances and repatriation of profit should be abolished. It seems that such opinions are now shared by some of the government officials taking part in the negotiations. The third factor in the stalled negotiations is the hesitation of the foreign partners. Beside the extra advantages which the establishment of the joint bank companies may produce, risk factors become manifest also in this interest sphere. While Hungarian public opinion expresses fear that domestic property will be "sold out", the foreign partner is worried, having taken a close look at the banks, by the hardly manageable and extremely big stock of doubtful assets.

Therefore it seems that the breaking of the state's proprietary predominance, i.e. the diversification of the ownership pattern by means of foreign privatization, still remains a task of the future. The banks' foreign privatization is not to be prevented, however. Instead, such conditions have to be established which would make privatization serve the national economy's interests. Privatization must be preceded by a settlement of the doubtful claims, decentralization of the foreign exchange management, and abolishment of the allowances granted to joint enterprises. An "additional cost" of the foreign privatization of the banks is also the development of a new issuing bank regulation, since the breaking of the foreign exchange monopoly renders a regulation centred on refinancing credits inefficient. Also, time is pressing: not only because a fast privatization of the large commercial banks is indispensable for a sound reorganization of the banks, but also because the foreign investor can make its way into the banking sector "anonymously", too. This would involve high risks. Because of the failure of the privatization of banks with the aid of *households*, or with the aid of *foreign partners, a lack of real own-*

[9] As for the facts: making use of the excess demand on the money market, and of the allowances granted to joint bank companies, the joint banks could syphon off a multiple of the invested capital in a few years.

ers, and constraints due to cross-ownership between banks and enterprises, are still characteristic of the banking sector.

The *enterprises* which form the major proprietary group of the bank, with representatives in the bodies of the joint stock company, still do not display a proprietary attitude. They are interested in the highest realizable dividend, in an immediate realization of the profit, and in keeping reserves at the lowest possible level. In their capacity as "proprietors", the most important element of their functioning consists in fighting for an advantageous position in the *distribution of credits*, and in making use of their right of control over the bank. The success of this fight is proved not only by the credit qualification (judgement) systems used by the banks (preference for shareholders independent of their creditworthiness), but also by the size of the credit allotted. Surprisingly, however, this has not led to an unfavourable turn in the banks' capital allocation. Although nearly half of the credits of the bank go to the banks' shareholders, and the greatest part of these is composed of large credits reaching over 5 percent of the banks' share capital, this has not led to a sudden rise in credit losses. According to estimations, the ratio of "bad" credits in the total amount of credits granted to shareholders is lower than the average: as for *doubtful assets*, their share is a little more than 50 percent, and as for irrecoverable credits — i.e. those that cause actual loss — the ratio is only 25 percent. All this means that the banks' *dependence, in their capacity as owners*, is gradually being replaced by their *dependence as creditors*, i.e. dependence of the banks on the enterprises to which they granted large credits.

The other aspect of the banks' dependence, i.e. proprietary control over the enterprises, is shown by the banks' behaviour in the course of *winding up loss-making production*. So far the banks have not had the strength to start a winding-up procedure, even if perfectly justified, against enterprises that are tied to them through important credit relations and which have a proprietary share in the banks. Yet it can be seen that the elements of the owner's and the creditor's dependence are largely mixed.

Although the enterprises' proprietary share in the banks has mixed consequences from the aspect of the banks' capital allocation, it must not be ignored, even in a medium perspective. Disinterest on the part of households, the lack of real institutional investors, and discouraging factors in the eyes of foreign investors, together create a situation in which, in the short run, only a rise in the enterprises' proprietary share in the banks can reduce the state's predominance as "proprietor." This is necessary even if this temporarily augments the cross-ownership between banks and enterprises (privatization, settlement of enterprises' debts): the enterprises' shareholding in the banks, based on a subsequent privatization of the enterprises, may represent an intermediate phase of the privatization of banks.

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ОСОБЕННОСТИ ВЕНГЕРСКИХ ТОРГОВЫХ БАНКОВ

З. ШПЕДЕР

Монетарный сектор, рассматриваемый в Венгрии как одна из опорных отраслей рыночной экономики, и в 1990 г. не смог выполнить те цели, которыми обосновывалось создание двухуровневой банковской системы. Механизм банковского распределения капитала и сегодня все еще определяется не рыночными мотивами. Хотя имело место постепенное приспособление портфелей банковских кредитов к росту инфляции, продолжает сохраняться существовавшая в момент начала банковской реформы и характерная для консервации распределения капиталов отраслевая концентрация кредитов по отраслям и предприятиям. Накопившиеся и воздействующие по цепной реакции сомнительные и невыполненные кредитные задолженности парализуют систему распределения капитала торговых банков. Наличие очередности по кредитам в размере 100 миллиардов форинтов свиделельствует о демонетаризации экономики. Вынужденной альтернативой ликвидации убыточного производства и в прошлом году для банков было образование компаний, передача долговых акций. Тем самым, однако, круговая порука собственников среди отдельных действующих лиц хозяйства продолжала укрепляться, ставя заслон формированию механизмов рыночной селекции и ликвидации очагов создания убытков. В статье анализируется состояние сектора торговых банков, его причины и следствия.

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PROBLEMS OF THE FINANCIAL INFORMATION SYSTEM IN HUNGARY

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In a monetized economy the main instrument of economic management is monetary policy. The operation of an adequate financial information system is crucial. It not only provides the foundation for government policy decisions and the banking system, but also influences the whole of the economic life.

This background is missing now in Hungary, and has become an obstacle to the rational operation of economy. This article reviews the history of the financial information system and the current situation, and proposes changes deemed most important by the author.

The compilation, publication of and accessibility to data and databases has become one of the most profitable businesses in the developed industrial community. Wide publicity and a competitive market—the existence of several sources independent of each other—are in themselves a guaranty for the relative reliability of information. Reliable and broad based sources are also supported in most of the developed western countries by several legal rules and institutions.

The dumping of information relates, of course, also to the existence of financial information. Enterprises produce data on their operation and financial position: summary informations are produced about the situation of individual market segments, within them a leading role is played by statistics describing money and capital markets. And last but not least, at the macrolevel data systems are called upon to help survey the economy as a whole and are now compiled in every developed country.

Presently, such an information infrastructure is essentially missing in Hungary. This does not mean that certain financial data are not available, the Ministry of Finance, the National Bank of Hungary (NBH) and also the Central Statistical Office (CSO) do produce financial data. But the data system currently in operation does not withstand the requirements undertaken by the same financial information systems found in market economies. It is thus not suited to provide a foundation for decisions to be taken in the government sphere and banking system.

In this study a financial information system is defined as the data describing the income processes taking place in the economy as well as those showing the position and development of the assets and liabilites. Due to limited space, this analysis does not extend to price and profitability data, though these also are an integral part of the financial information system. Beyond them, the analysis of some special financial indicators, characterizing individual fields will also be omitted.

The Hungarian financial information system

The Hungarian system of financial information fails to meet the internationally accepted requirements in almost all respects. The place and role of the financial data in contemporary Hungarian economy is well illustrated by the fact that the annually published Statistical Yearbook which sums up the most important information about Hungary—as against international practice—did not contain any chapter on finances up to the mid-eighties.

Until quite recently, economic organizations have not supplied any kind of public information on their economic and financial position. For the Ministry of Finance financial reports were, of course, prepared for strictly official purposes, mainly taxation and, in addition to not being published, they did not answer the internationally accepted requirements raised towards such data.

In respect of the fiscal data the situation is even graver. Although the government regularly and publicly reported on the state budget, precisely because of the political importance of the budget, published data were falsified in most cases. This procedure was made possible, among other things, given the lack of institution for auditing the budget data. The publication of data not suited for interpretation was also facilitated by the absence of an accepted and publicly known methodology for the compilation of the data. Also, the frequent modifications of "methodology" provided an opportunity for the distortion of data.

The unreliability of data on settlements with foreign countries follows from the above situation. The saving propensity of the population is for several reasons low in Hungary, and the budget deficit is to a considerable extent financed by the raising of foreign loans. Thus, falsification of the budget data naturally leads to the distortion of data related to the stock of foreign credits. But this causal relationship was frequently reversed: in order to show a credit position or a balance of payments better than the real one, the data of the other income holders were "corrected".

In the course of past decades such practice developed in Hungary that the various institutions and, not infrequently, departments within individual institutions, did not pry into the secrets of others in order that their own secrets shall not come to light. Nevertheless, to ward off possible inquisitive persons, the legal regulations of classification allowed to classify one's "own" data as top secret. It is natural that all data suppliers made efforts to exploit the possibilities of such a distorted information system. This influenced the quality of the data not only of government organs, but also that of the enterprises and financial institutions.

Consequently, it is not surprising that for more than one and a half decades no such comprehensive statistics has been compiled in our country which would have summed up the income, outlay and the capital finance of the four main institutional sectors (corporations, households, general government and the rest of the world). Beside presenting a survey of the financial transactions taking place in the country, this would have created a possibility for checking data of individual sectors and their data systems. The aforementioned data system has to be consistent in several respects. For instance, the capital outlay of any transactor of the economy should be equal to the sum of his savings and net borrowing or lending adjusted to the balance of his capital transfers. A further possibility for checking is a summation of data of the four sectors relating to redistribution of income; the result must be zero since what is income for one sector should be an outlay for another.

Although a closed information system satisfying the above requirements does not prevent a harmonized effectuation of distortions, it provides a chance for exposing mistakes and deficiencies coming about either as consequences of separate institutional interests or deficiencies inherent in the system.

Short history of the development of the Hungarian financial information system

Up to 1945

A *stock exchange* operated in Hungary since 1864 with one of its most important activities being official quotations. The first official sheet of quotations of the Budapest Commodity and Stock Exchange was published in 1868 and continued up to 1948 without interruption. At the start 28 kinds of shares were quoted. After Hungary's compromise with Austria in 1867, the turnover took an upswing and the number of shares quoted exceeded 80 by 1869. Beginning with the second half of the 19th century, several annual data compilations were published on the Hungarian joint stock companies. The diversely edited and published *Compasses* (1872–1944) contained the data of financial institutions and joint stock companies as well as of other enterprises in separate volumes. The *Magyar Pénzügyi Compass* (Hungarian Financial Compass) published all public data of the enterprises under obligation to render public their accounts (balance sheet, profit and loss account, division of profit). The most detailed financial informations were comprised in the yearbook of financial institutions, because the regulations relating to financial institutions were the strictest.

The first Hungarian law ordering the checking of financial statements was enacted in 1916 and prescribed a compulsory revision for the member institutes of the Pénzintézeti Központ (Center of Financial Institutions). The Kamarai Hites Revizorok Egyesülete (Association of Chartered Auditors) was formed in 1926.

The first *State Audit Office* was set up in Hungary in 1870, and its formation and operation were regulated by law. The law dealt with in detail the scope of authority and independence of the Audit Office; it determined the order of accounting (book-keeping) of the government institutions, the budget, and the mode in which state property, funds and the state-subsidized institutions should be checked: it also ruled on the checking of state debts, and prescribed the rules according to which the balance of state property and the budget report had to be compiled.

The first independent organization of Hungarian statistics was established in 1848, as an association of the ministry of internal affairs of the first independent responsible Hungarian government; it was short lived. Previously, as of 1829, the Austrian statistics were also engaged in collecting Hungarian data. In 1867 a Hungarian statistical section was once again created which then became an independent office in 1871. In 1874 the operation of this office was regulated by law. The first proper modern law on statistics was legislated only in 1897. With this law data collections carried out earlier by other authorities were henceforth included in the scope of the Statistical Office. In order to be able to successfully address the increased tasks, the qualified staff was enlarged. For the purposes of smooth data collection the law stated that data supply was compulsory. To promote the reliability of the data, the office was given the right to spot check data. To protect the interest of the data suppliers and aiming to increase the reliability of the data, the law subordinated the data collections of the office to control by Parliament. The above listed rights of the office could be exercised if the data collection was ordered by Parliament. The law prohibited the publication of individual data while obliging the office to prepare "annual reports on general public life and on the results of government activity" which, of course, also had to comprise the figures of the state budget.

The statistical yearbooks of the early 20th century devoted significant space to financial informations. One could find in them data on assets and liabilities of industrial and commercial joint stock companies, limited liability companies including their profit and loss accounts as well as the distribution of profit. The chapter on the budget showed in a detailed breakdown of income and outlays. A separate table presented the stock of credits raised by the state and itemized. The chapter on money and credit listed balance-sheet, profit and loss accounts as well as the distribution of profit according to types of financial institutions. Separate tables reflected the particulars of credits, securities and deposits of outstanding importance. The insurance institutes indicated not only their profit and loss, their assets and liabilities but also the value of capital insured. Additionally the yearbook provided information about prices, insolvent firms and the number of protested bills of exchange.

In the years preceding World War II, Hungarian statistics were up to world standards, also in respect of comprehensive computations. Data series estimating the country's national income and national wealth were prepared by the Economic Research Institute of the Statistical Office by the thirties.

1945–1968

After 1945 the financial information system practically collapsed. In the course of nationalization of enterprises and the emergence of a centrally planned economy the earlier autonomous control institutions were abolished (association of chartered accountants, audit office). Moreover, the state organizations could decide at their discretion the publication of information. Formerly, actual and potential shareholders, creditors, business partners as well as the state were all interested in getting a reliable picture of the assets, liabilities, operation and financial position of the enterprise, and one audited by an independent expert. The same held true for members of Parliament who were interested in judging the position of public finances on the basis of information checked by the state audit office. By the late forties, in consequence of the establishment of the socialist institutional framework, this interest practically ceased to exist.

The situation further deteriorated as a result of the "physical" approach coming to the fore and the central determination of prices. Therefore, instead of the observation of income processes, interest became centred on balances drawn up in physical units of measurement.

In this period no kind of information gave insight into the operation of economic organizations, their financial position and net wealth. Though certain data were actually published about the income and outlays of the general government, they reflected political expectations rather than the real situation.

Throughout this period there was a single element of the financial information system in which development could be found, and this was the system of national accounts—on the agenda at this time in other parts of the world both in the East and the West. Thus, previous national income computations by the Hungarian Economic Research Institute became official and indicators calculated according to the MPS system were built into the regular annual data publications. In the same period there existed published data on fixed assets and inventories of economic organizations—which in fact substituted for the matching of assets with liabilities. In both cases, the goal was a comprehensive presentation of quantitative, physical processes. The only reason for the presentation in monetary terms was that this was the only way to sum up the data.

1968–1982

Preparation and introduction of the economic reform of 1968 brought significant changes in the financial information system as well.

With the development of enterprise interest in profit the financial statements of enterprises obtained a more significant role. Although a major part of capital allocations continued to be performed by the general government, a part of after-tax profit and depreciation allowance remained with the firm for the purpose of implementing investments "maintaining the standards". It is from that time that credits began to play a major role in the financing of capital formation. Though the financial statements of enterprises were still not published due to their new role, the substance and structure of the reports had somewhat approximated Western norms of accounting.

The system of national accounts underwent total transformation; its heyday had arrived. As the first socialist country, Hungary devised a system of accounting in which there was a possibility to produce data systems approximating the recommendations of both the MPS and the SNA. One of the main advantages of the SNA system employed in capitalist countries as distinct from the MPS used in socialist countries, is the significant level of effort placed in presenting income processes.

Using the recommendations of the SNA and MPS, the Central Statistical Office worked out a closed system of accounts which comprised:

— production; these present the value of production in the country in a given year by sources (origin of the product) and uses (consumption, accumulation, balance of exports and imports);

— the total income distribution among the main institutional sectors (corporations, households, general government and the rest of the world)—the development of incomes and outlays, capital finance and financial transactions.

Beside data on flows, the system also comprises stock data. Traditional data on fixed assets and inventories is complemented by data on stocks of credits and deposits broken down by type and institutional sectors. The main deficiency of the accounting system was that—as against the SNA requirements—it did not show the development of assets and liabilities in a unified structure. Although, in the final analysis, the side of assets was almost complete, as separate data were produced on assets, inventories and claims, on the liabilities side only debts appeared, and no information was given on the development of the own equity. Also the inclusion of intangible assets was missing. Nevertheless, the system could be regarded as closed from several respects, as the interrelations among income processes could also be depicted as numerical identities.

Compilation of the system was facilitated in this period by the fact that merely four banks and a single insurance company existed in Hungary. However, as it will be argued later, this not only promoted but also hindered the compilation and publication of the data system. The publication summarizing income distribution of the national economy was not made public, either. It was classified as "for official use". The publication comprising the credit relations of the national economy was considered "top secret".

The above data system referred to was compiled and published by the economic department of the CSO only for a few years. Conjectures can be made why this activity ceased. At that time the importance of financial informations had not been recognized in Hungary and the progression of the data system was a product of the zeal of those working in said department rather than a general intention to satisfy demand for information that was determinant. Furthermore, the compilation of the data system violated several interests, as the annual publication of a closed data system provided the possibility of outside checking and interference into the affairs of the data suppliers otherwise enjoying a monopolistic position and exempt from every kind of public control (Ministry of Finance, National Bank of Hungary, General Development Bank, Ministry of Foreign Trade etc.).

Since 1982

The complete dissolution of the data system was completed upon the demand by Hungary for IMF membership. Simultaneously with submitting the demand for accession, detailed information had to be compiled regarding the external credit position of Hungary. Those tabulating the data were motivated partly by conflicting interests. On the one hand, they intended to show a relatively low net stock of debts, since the main reason for entering into the organization was to raise further loans. But a great part of the then existing debts were raised from exactly those markets in which the IMF also had access to information. Thus, the opportunity to show a more advantageous net debt was available not so much by window dressing the gross sum of credits raised but rather by fictitiously increasing the sum of credits placed.

A further important position held was that the amount of net debt of the general government must not be higher than the sum of the annual budget deficits appearing in the published budget reports of the general government. However, the "correction" of the net foreign debt was smaller than the "adjustment" of the budget deficit. Otherwise, the two corrections could have cancelled each other, since in the national credit balance statement drawn up by the National Bank of Hungary—a summary of credit transactions according to the financial institutions—placed the claims of the financial institutions and thus the stock of debts of the general government on the assets side, while the debts of the financial institutions mostly consisting of foreign ones appeared on the liability side.

Because of the numerical deviation between the two corrections the producers of the data were forced to distort the data of further institutional sectors. Finally, the data of the corporations was also tampered with. The "task" was to increase the net debts of this sector. This was solved in two steps: the stock of credits of the economic units was increased by a part of the unrevealed general government debt on the one hand, and the deposits of the economic organizations were reduced on the other hand.

A "curiosity" of the Hungarian data stock was that for organizational reasons, the loans raised by public finances in the traditional sense (also deficits) did not appear as parts of the stock of credits of the general government. Namely, beginning with the early seventies, the financing of the capital formation of the general government was transacted by the Állami Fejlesztési Bank (ÁFB—State Development Bank—henceforth SDB). The SDB raised the loans from the NBH and made available state development loans to the enterprises, and the sums paid out for big investment projects and to other state funds were recorded among its claims as well. The harmful and misleading impacts of this system will be analyzed later in detail.

It was accordingly with the accession to IMF that the second era of secrecy and gross falsification of data occurred in socialist Hungary. In the fifties and sixties no adequate role was given to financial information and data published was adjusted to the "theses" of the socialist political economy (e.g. the budget deficits were conjured away). From the beginning of the eighties the main justification for falsifying data was preservation of the country's creditworthiness. It cannot be assumed that when presenting this distorted stock of data the policy makers and banking experts were aware how decisively this step of theirs would influence the development of economic life in Hungary, even in the long run.

The size of "corrections" was startling from the outset. The net stock of debts of the general government exceeded the published figure manyfold even if we do not reckon with the methodological distortions. In constructing the data stock the initial assumption was that in the course of several years the falsified data on stock would gradually approach genuine credit positions. This concept conceals in itself huge dangers, since the distortions affected almost each institutional sector. Although, in principle, with the adjustment process the data of stocks could have indeed come nearer to reality. With this in mind drastic distortions ought to have been introduced into the data indicating annual changes, as the net credit position of a given year reacts much more sensitively to a correction of a given magnitude than does the corresponding data on stock. The problem was further aggravated insofar that in the analysis of processes occurring in a given year the annual changes are really decisive. The economic situation of the country had worsened more than one had foreseen. As against initial beliefs, not only the deviations could not be reduced in the course of years, but in individual years further distortions became necessary in order to produce a "politically acceptable" balance of payments and/or general government budget deficit.

Separate institutional interests and disruption of the information system

In the early eighties there was still a single-tier banking system and thus the main actors of financial life created oligopoly of great influence. These institutions were the exclusive proprietors of information (the Ministry of Finance—MF, the

National Bank of Hungary, the State Development Bank, the Ministry of Foreign Trade). For various reasons, it was not in the interest of any of them to allow others to have a look into their data systems. The National Planning Office and the Central Statistical Office could not or did not actually want to collect adequate data from the institutions listed. As a result, the information system built up in the early seventies collapsed completely by the early eighties.

The creation and maintenance of an integrated data system built on several sources is a task requiring serious cooperation on methodological and technical levels. But as underlined, the above listed institutions had no interest in this cooperation involving sacrifices.

It was the international department of the NBH that maintained direct contacts with the IMF. This department was also responsible for the domestic publications of information by the NBH. The international department used as starting point the top secret national credit balance compiled by the credit policy department of the Bank and carried out on it the corrections deemed necessary. It was this data system which had to answer the control criteria of the IMF experts. The data system satisfying the IMF criteria could frequently be constructed only after several trials.

The credit policy department of the NBH compiled the national credit balance from informations received from the other departments of the Bank, from the SDB, the Foreign Trade Bank (FTB), the General Securites Bank, the National Savings Bank (NSB), in addition to the balance sheet of some small banks and the State Insurance Company. This depicted the credit relations between financial institutions and the other sectors.

The accounts of the government and of the SDB were managed by the credit policy department. The government data had to be presented not only at the IMF negotiations, but also to Parliament. In order that the annual budget deficit should be of an "adequate" magnitude, each year a number of methodological changes and corrections were performed. The changes necessary to achieve this were made jointly by the credit policy department, together with the SDB and the MF already when compiling the credit balance (and the balance-sheets). These included, e.g., the bringing about of a *special "reserve" fund* in order to eliminate the budget surplus. By hiding a part of the budget deficit the closing stock of general government credits did not agree with the opening stock of the following year and in this respect the growth in the stock of credits did not burden the current annual budget.

The differences between the closing and opening stocks of credit, and the changes in the stock of other items that were not assigned to any of the four main sectors had attained every year proportions equal to the changes in the net credit position of the individual sectors; this in itself challenges the interpretation of the data system.

The classification of a part of foreign trade data as "top secret" can only partially be explained with the above detailed reasons. In this realm the classification may also be traced back to problems related to the re-export of Soviet oil. But the ever growing difference between the data of the Ministry of Foreign Trade and the NBH regarding the balance of trade transacted in convertible currencies cannot be regarded as a mere accident. The ministry and the enterprises supplying data for the ministry were interested in showing the smallest possible deficit and the greatest possible surplus, while for the NBH it was advantageous to show a smaller surplus or a greater deficit than the actual one, since in this case only smaller "corrections" had to be carried out with the other items in order to show smaller interest expenses than the actual ones. (Publication of the genuine outlays on interest would have demonstrated the real size of the stock of foreign credits.)

It follows from above that the organizations mentioned were not interested in handing over data and networking with institutions outside the circle, thus e.g. with the CSO. Although the CSO had access to top secret documents as well, even to the national credit balance and the balance of payments, it did not know the information used for compiling the data, nor the methodology applied. Thus it could not interpret the data (documents) received in the framework of its own information system.

Manipulations with the capital transfers from the government

The history of the development of a special capital transfer system is a good example of the ways in which the consequences of wilful economic decisions, causing immeasurable damage, can be hidden in a segmented information system. State development loans frequently financed government-supported big investment projects or capital formation of less profitable firms. The enterprise obtaining a state development loan *ab ovo* received state support along with favourable conditions of these loans. It was in the early eighties when—as could be reckoned with in advance—it occurred that several enterprises which had earlier received development loans could not pay the due instalments. The experts, however, had a "successful" saving idea which gave the firms further advantages without showing the loans as budget expenditures. The earlier development loans were transformed, with a single stroke of the pen, into special capital transfers from the government.

The curiosity of these capital transfers was that the obligation of the repayment was not abolished but after transforming the loan to "special" capital transfer the instalment became tax deductible what significantly reduced the profit tax commitment of the entitled enterprise. Of course, the tax revenues of the government were reduced by the same amount, but in the course of devising the system of this special capital transfer; nobody had reckoned with its impact on tax revenues. At the same time some enterprise obtained further tax reliefs (e.g. it could deduct from the profit tax a part of the instalment, computed as a percentage relative to the rate of profit tax). In the case of a 50 percent profit tax rate this meant that the firm became practically exempted from any instalment obligation. The SDB received the total amortization instalment, but the tax revenues were reduced by the amortization revenues of the SDB.

Another advantage of the enterprise was that the structure of its liabilities changed immediately. The capital transfer increases the value of own equity. Subsequently, the recorded indebtedness of the enterprise was significantly diminished and this contributed, among other things, to an improvement of creditworthiness, frequently examined also by the World Bank.

The solution had several advantages of presentation from a general government budget perspective and, particularly, the SDB. The latter could continue to treat the special capital transfers as its outstanding claim. In the case when the enterprises paid their instalment according to contract, the SDB could also meet its instalment commitments towards the NBH and the change in construction did not cause any complications. Although the decline of tax revenues had an unfavourable impact on the budget, the above solution still involved a smaller burden for the annual current budget than if the credits had been written off and the credit losses of the SDB had been financed by the budget—or if the capital transfer received by enterprises had been accounted among the budget expenses.

This solution was not consistent as the balance sheets of the SDB showed outstanding loans which were not included in the liabilities of the firms, and the enterprises received investment allocations which did not appear among the expenditure items of the budget. In this phase the problem still appeared to be of a technical nature, because there would have been several possibilities to restore consistency of the data system. At the time the goal aimed at devising this construction was to avoid consistency. The task was to ease the burdens of enterprises struggling with difficulties in amortizing the development loans, and thus putting the smallest possible burden on the budget, and so that the causes of the increase in outlays (or reduction of revenues) still appearing could not be detected (i.e. should not be shown as a credit loss of the SDB).

But the "special" dividend of enterprises which received "special" capital transfer did not cover the interest and principal amortization liabilities due to the NBH after the credits raised by the SDB. To mask the problem the dividend received was used to pay the interest becoming due, thus, the SDB needed no state support. At the same time the state fund allocations recorded as claims gradually "became empty" and were no longer covered by any kind of debt. As a result of this process it became obvious that the problem was clearly not one of accounting techniques: the fictitious claims of the SDB on the budget could no longer be regarded anything else but as unaccounted budget deficit. (Similar problems arose in connection with the other special funds managed by the SDB. This holds particularly true for the funds financing the major investment projects, such as the Bős–Nagymaros hydroelectric project or the Yamburg pipeline project). In short, outstanding due to "special" capital transfer should unambiguously be regarded as debt to the general government.

Though the SDB also provides characteristic services of financial institutions it cannot be classified in the same category as other credit institutions since it is one controlled by the general government. In my opinion, the correct way of accounting is when all debts of the SDB are recorded as debts of the general government which is then re-lent to the SDB. This solution would correspond with the actual situation in which the SDP is commissioned by the state to transact placement of state monetary assets and to collect the claims having become due.

A further delicate problem of the transformation of development loans into special capital transfer is that during the accounting of the transaction, concurrently several billions of forint were lost. If, namely, the sum of state development loans figuring in the 1984 closing balance sheet of the SDB is compared with the sum of state fund allocations in the 1985 opening balance sheet, a difference of such order of magnitude appears.

Asynchronous development of the financial institutional and information systems

In the early eighties several changes occurred which created the possibility for issuing long-term securities, i.e. bonds. Complementary to this also the obligation and practice to provide information ought to have developed. Initially, the lack of these was covered by state guaranty, but this expired before the law on securities entered into force. Compared to other countries, this law prescribes smaller duties in respect of providing information for those wishing the sale (or already having sold) securities issued by them to other agents in the economy.

In 1987 a two-tier banking system was established in Hungary. At that time the information system was practically non-existent, and the appearance of the new commercial banks further deteriorated the situation. In principle, the setting up of the two-tier banking system could have improved the flow of information, since the monopoly positions of the NBH and the SDB were broken, but in practice just the contrary occurred.

The newly established commercial banks exploited the situation, namely, lacking a functioning data system, almost no possibility existed for checking informations supplied by them.

It may thus occur that the financial institutions publish data different from those figuring in their reports submitted to the Ministry of Finance, while also those given to the NBH can differ and even these latter do not coincide with the data stored in the computerized data base at the NBH itself. (Because of their backward technological equipment, the greater part of the database of the commercial banks is treated in the computer centre of the NBH.) A part of the deviations may, of course, be traced back to methodological causes. The flow of information among the various institutions is, namely, occasional and thus there is no real chance for the comparison of methods. Further, it cannot be traced at all how the individual banks interpret the different instructions.

The interpretation of data published by the commercial banks is difficult not only because of methodological pitfalls, since, lacking adequate policy parameters, or evading them, the banks also use their data supplied as an instrument for the assertion of their own interests; this practice leads to a significant distortion of information. Bank managements have well defined interests also in the capitalist world but, quite naturally, these interests cannot be asserted through negotiations with the issuing bank and other government institutions, as is the case in Hungary. Yet, in the developed world such methods and procedures became established which serve the demand for information of those interested in or showing interest for the unit in question (norms and obligations related to accounting, valuation and publication, financial reports authenticated by independent auditing firms, and, last but not least, special and strict prescriptions relating to the information system). The latter are taken so seriously that e.g. the Hungarian commercial banks would be closed down if they were in Germany in a few days because of their poorly operating information systems.

The fact that information systems and data published by commercial banks leave much to be desired may be related not only to the interest of banking executives and the obsolete technical possibilities, but also the particular structure of the financial sector and various internal conflicts in the banking system have a role. As a consequence, in Hungary today the bank executives as well as those of enterprises do not possess a realistic picture about their financial position. The confusion is well illustrated by the case which frequently occurs at the end of each quarter: the management of the bank generally prescribe that by a given date the leaders should reduce the stock of outstanding short-term credits. This is usually carried out, but at the same time the value of other assets regularly increases, clearly indicating that a part of credits has simply been transferred to another account.

Several attempts have been made recently to do away with this absurd situation. If not in the short run, later improvement in the financial information system is hoped for. The Act on business associations prescribes that financial reports of joint stock companies and of one-person limited liability companies have to be audited by chartered accountants and the most important data must be published at least once a year. Also the law on securities obliges the firms issuing securities to publish their data. In the autumn of 1989 a law was enacted on the State Audit Office. When preparing for the free Parliamentary elections, the outgoing government corrected the data on foreign debts and on the government debt—earlier published in a falsified form—on several occasions. The Stock Exchange has been reopened in Budapest, and the new rules of operation raise further requirements in respect of providing information towards the institutions wishing to have their securities quoted. Also, reliable data are regularly published about the quotations and the turnover of securities.

Tasks outstanding

A part of the economic organizations are already obliged by law to publish financial information related to their operation. This group will hopefully further expand in consequence of overall growth, change in the form of associations, issuance of securities, and a growing number of economic units will be obliged to provide information. Considering, however, the large proportion of state enterprises operating in forms other than association, expansion of the scope of the law should be contemplated.

It is also necessary to adapt the accounting rules and financial reports to the European standards and, at the same time, the activity of chartered accountants should be re-standardized.

The obligation of financial institutions to supply data should be given particular importance. The financial information system in Hungary is not treated with the seriousness it deserves. In the developed capitalist countries, data published by financial institutions are focussed upon not only because the activity of these institutions has a great impact on the financial position of the other economic organizations, but also in general, these institutions supply a great part of information relating to the economic sphere. In some countries, e.g. in Germany, the bank of issue publishes detailed informations about the development of the assets and sources of the economic sphere. Elsewhere the provision of information is the task of the statistical office (e.g. in Great Britain), but it can perform this task only by relying on data supplied by the issuing bank.

The central bank collects data from the financial institutions in Hungary, but they are not reliable because as already mentioned, the financial institutions themselves do not operate within a satisfactory information system. Therefore, given the disintegration of the national economic information system, they can manipulate the data.

For settling the problems previously listed it is absolutely necessary to regulate, by act of Parliament, the information system and data supply requirements of the financial institutions (banks, insurance companies, security agencies etc.) and, within this framework, separately those of the NBH. Due to the growing autonomy of the latter, enactment of these obligations is particularly topical.

The position of the fiscal information system has unfortunately not been improved by the creation of the State Audit Office (SAO) as of January 1st, 1990.

As a result of haste, not only is the law regulating the operation of the Office deficient and full of contradictions, but also the staff recruited in haste does not consist of veritable experts. The criteria for incompatibility is very weak in the law and almost no condition is prescribed concerning aptitude. A further dilemma was that officials were appointed by the former Parliament.

The law vested in the Audit Office provided with a wide area of authority and following western examples also set as a task to check the activity related to the preservation and rise in value of enterprise property and institutions operating with state property. Concurrently, even elementary conditions were not secured for the Office. The primary task of the Office would be to check the implementation of the budget and the validity of published informations. Initially, the information system that would have been indispensable for its work is still not available. This was demonstrated when the outgoing Németh government handed over the financial affairs of the country to the new leadership without even raising the idea of controlling the State Audit Office.

For these reasons it is necessary to debate once more the law on the State Audit Office. The first task should be to work out the new, closed accounting (bookkeeping) and data publication system of the budget. (The closed nature of the system—as has been repeatedly emphasized—serves the possibility of checking, eliminates the various mistakes and intentional distortions.) The system thus established would comprise informations from the aspects of both results and money turnover; one could see a unified structure, of all income and outlays, assets and liabilities of the general government (e.g. also debt of the general government), together with their annual changes. The data registered and published would, of course, also comprise "special" capital transfers and loans earlier financed by the SDB, claims of other funds brought about to finance state investments as well as the income and outlays, claims and debts of the artificial financial institution created for the issuing of state bonds, the Központi Váltó és Hitelbank Rt. (Central Bill of Exchange and Credit Bank, Co.Ltd.) The data of the central and those of the local governments as well as of the state-owned enterprises should be calculated on separate data tables, so that there should be a possibility for matching data of the government and those of other institutional sectors.

After the creation of the data system the Ministry of Finance should work out the data of the past period in the given structure, since the accuracy of the data system at the start can be secured only in this manner. The SAO would check the correctness of these computations and the "regular" activity of the Office could only start thereafter.

Many factors hinder the creation of a comprehensive financial information system describing the national economy. The most important of these have been already discussed. I should like to draw attention to some further obstacles not yet mentioned.

The organizational setup of the Central Statistical Office has not changed much since the fifties. In spite of several smaller changes in organization, the staff of the section for financial statistics does not amount to more than ten people. This section processes financial data, but its task would be to coordinate the data systems of various institutions and departments. However, the conditions are missing for that. It would be the task of Parliament to enact a statistical law defining the tasks of the CSO, while simultaneously creating the conditions for attending to these tasks (prescribing e.g. the data supply obligations of individual institutions). It would make the duties of the Office unambiguous: which data systems it should produce and publish.

An important and as yet unsolved goal is the urgent regulation of the rules governing secrecy and classification of the data. The scope of the data and its publication which violates the interests of the state should be defined by law and not some internal, unpublished regulation. When this law enters into force, all earlier classifications are subsequently superseded.

In a period when democratic Hungary is emerging, a mistake must not be committed: presumed or momentary interests should not prevent us from giving a chance for completely learning the confusion of data about the past and the present. Such a step would again, and for a long time, suppress the hope for the creation of a reliable and comprehensive data system. The danger of a new wave of secrecy is indicated by the fact that "protection" of the latest data system compiled for the IMF and the World Bank again becoming a "national" interest. It seems that those competent for the matter are still not willing to face the fact that there exists no comprehensive information system in Hungary today. And in the long run it is not in the interest of the country that the data structure which is acceptable by the IMF be simulated by a department of the NBH. Hungary should try to clear up what happened in the past and try to create (and not only simulate) an information system that would show a reliable picture of the economy and the financial situation of the country.

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НЕПОЛАДКИ В ДАННЫХ ПРОБЛЕМЫ ФИНАНСОВОЙ ИНФОРМАЦИОННОЙ СИСТЕМЫ ВО ВЕНГРИИ

А. ТАРДОШ

В монетарном хозяйстве, где участники экономической жизни мотивированы прежде всего достигаемым доходом, и главным средством управления хозяйством является образование монетарной политики, основное значение имеет работа соответственной финансовой информационной системы. Монетарная информационная система обосновывает не только решения правительственной сферы и банковской системы, она повлияет и на всю экономическую жизнь.

Такого информационного фонда сегодня во Венгрии нет, и это непосредственно мешает рациональному функционированию экономической жизни. Статья коротко показывает историю создания домашней финансовой информационной системы, анализирует настоящее положение и наконец, суммирует важнейшие по мнению автора направления изменения.

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NOTES

DEFENCE OF THE REALM

A. BRÓDY

The official estimates of defence spending in Hungary amounted to 3 to 8 percent of the GDP in the past. Yet the actual burden may have been as high as 20–30 or more percent. Various checks corroborate the much higher findings. The author proposes a radical departure from the war- and shortage-economy.

Similarly to other items of the budget, defence expenditures can be correctly judged only by considering costs and benefits. What is needed for this is public, clear and authentic accounting which is, however, still not at hand.

General staff orders covered all walks of our life, causing significant changes and costs even at places where no trace of soldier could be seen by the unsuspecting citizen. As the eminent specialist of welfare economics and the theory of war economy *Pigou* well saw: war casts its shadow on peace. (Pigou 1940)

How long and deep is this shadow in Hungary? Today, the appropriations of the Ministry of Defense are seemingly public, although the details are made known only to the exclusive committee of the Parliament.[1] But already the sum total itself gives ground for doubt, since it is but a fragment of the presumable costs.

According to *Leontief and Duchin*'s results (1983), the world's military appropriations exceed 10 percent of the GDP even *on average*. In Hungary these costs are shown to be less than half of that rate and this extremely large deviation suggests that the state wants to make MPs, as well as the general public, believe highly improbable and hardly or not at all believable proportions.

The official estimate must be, therefore, incomplete. As it is the custom in Soviet-type budgets, large items of defence expenditures are hidden under other, seemingly neutral, headings of expenses, if at all mentioned. No lesser authority on the subject than Gorbachev himself called attention[2] to the circumstance that great chunks of war supplies and national defence investments, research and development procurement are kept well hidden. However, even the revealing of these substantial additional items would not make the picture complete, since there are

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[1] This is, however, "...useless not only because military expenditures show also under other headings, but further because it is impossible on the whole to form a picture of the real content of the budget on the basis of the items without a sufficient breakdown, under the pretext of "secrecy."—as István *Gyarmati* stated. (Gyarmati 1990b)

[2] *Izvestiya*, Moscow, August 27, 1987.

other burdens, externalities, not taken into account (often difficult to be expressed numerically). Nevertheless these are also integral parts of our particular socio-economic system.

For example, there is the concealed and never mentioned burden of universal conscription. Two age-groups fall out of production because of the call-ups.

Since an average of 40 years pass from entering the workforce to retirement, it is easy to compute that the Ministry disposes of more than 5 percent of male labour in consequence. However, the real burden is not represented by the cost item actually shown, i.e. the ridiculously low pay-roll but by the loss of the national income that goes unproduced. and this one item is already greater than the entire declared, official estimate of the Ministry.

An attempt to come clean

We shall try to exhibit the official and the actual military burden of a given year, for example, of 1980. According to the published data,[3] the Ministry spent Ft17.7 thousand million i.e. 2.5 percent of the Ft721 thousand million GDP. Take a look at the input-output table which gives a more detailed account of the values produced and distributed. The majority of the Ft58 thousand million for "communal, administrative, and other services" i.e. Ft40 thousand million is to be considered as police and local government expenditure, i.e. home affairs costs. National defence costs seem to be thus less than a third of the costs of maintaining order.

National defence costs are also dwarfed by Ft78 thousand million of social-cultural expenses as well as by Ft60 thousand million of personal and economic services. National defence costs amount seemingly to only about 10 percent of the total costs of services. These are but misleading proportions, deceptive appearances. There is, namely, a peculiar blank spot in the balance. Subtracting the households' Ft470 thousand million consumption from the Ft515 thousand million of total final consumption (including there all grants and services in kind, too, since the wages paid amount to no more than Ft313 thousand million), a remainder of Ft45 thousand million represents such "communal (public) consumption" of which no open statement is made.

I do not claim that this amount is the exact equivalent of the concealed national defence expenditure, since there may be such knots in the accounts as can well get over me. That is to know: the financial authorities' "redistributive activities" or rather, redistributive manoeuvres subsidize final consumption by Ft55 thousand million while taxing away Ft69 thousand million. This entails, for each

[3]Published, of course, not in Hungary; such data would be in vain sought in the official yearbooks of the Statistical Office. Data supply to the foreign countries was, if not more sincere, but more detailed even then.

item and for each service, widely different and not traceable effects. As for the size of our previous estimate, it again corroborates its size of magnitude. Redistribution is carried on in the first place to cover up the traces of a war economy. It covers the costs of the quite substantial part of production, separated for military purposes, and it compensates for the losses caused by unprofitable production, ordered on general staff considerations.

There may be further concealed items. The input-output table does not use the criterion of national defence, therefore, schools and hospitals, cultural and welfare expenses, pensions, etc. of the armed forces are shown (or rather concealed) among the corresponding public services. Probably, also the costs of barracks and of officers' housing and mess are listed with the general and seemingly civilian costs. These amounts are difficult to quantify. But, even if they are left out of consideration, and only the official 17.7 thousand million, the concealed burden of 25–35 thousand million of the universal conscription, and the 45 thousand million of the above-mentioned blank spot are added up, the result will be already Ft88–98 thousand million. And this still represents only the *current* opportunity costs of activities *strictly* in the nature of national defence.

Yet there were investments made as well: armament factories and arsenals established, strategic stock build-up (raw materials and fuels, equipment, ammunition, food),[4] and finally, participation in military development and research work.

If all this investment and stock building input is charged to the current costs in proportion to the capital-intensity of civilian industries, then the true outlays will certainly be underestimated. It is general knowledge that military engineering is much more capital-intensive than the average of industry, already on account of the priorities constantly asserted and of the lack of sufficiently explained investment which lacks any criterion for appraisal. Capital-intensity of military engineering is probably double that of the civilian industries. Therefore, the lowest estimate here is an additional 132–147 thousand million, and the highest an additional 176–198 thousand million for investments. The total expenditure thus amounts to at least 20–25 percent of the GDP. A breathtakingly high proportion—but, as it will become clear in the sequel this figure still contains only the direct, and not the total, burdens.

Cross-checking the estimate

So far we have sought answer to the question where our statisticians could and did hide the actual expenses, amounting to 8–10fold of the official 2.5 percent,

[4] As we were not long ago informed, in the case of the Soviet army now pulling out, the dispensable part of such stocks, i.e. what can be left behind, was estimated at Ft40 thousand million—which means our own stocks must be many times that amount.

which ought to be openly considered when determining the share and total burden of defense outlays. Other checks indicate, however, an even greater indirect burden.

Data of the war economy of the First World War show (*Hardach* 1978) that to provide one armed soldier with food, clothing and arms 8–10 workers are needed in the domestic "hinterland". Although in peacetime less ammunition is shot and weapons go out of use only because of the fast technical obsolescence, the generally rising costs of military engineering (ever bigger and more complicated tanks, aeroplanes, rockets and space stations) and the need to learn the handling of the fast changing weaponry cannot have allowed this empirical ratio to fall considerably. Starting from an army of two-hundred thousand, the number of those directly or indirectly working for the defence is thus estimated at 1.8–2.2 million, which reaches 34–44 percent of the full employment number and almost doubles our former assessment.

Our third check is based on the highest eigen-value of the Leontief inverse. This yields an estimate of the final bill of goods—total production multiplier. In this case we start from the final bill of goods, because, as against other state services and individual consumption, military hardware cannot be recirculated, it is input to no other productive activity.

From the economic point of view, this is the decisive, qualitative difference between expenses of the Defence Ministry and those of other ministries: that the former, as important and necessary as they may be judged, drop out of the circulation of production *once and for all* as soon as the countervalue is spent.

The eigen-value of the input-output matrix of the current inputs (including reproduction of labour) is approximately equal to 0.9. This leads to an eigen-value of about 10 for the inverse matrix. Thus we have arrived again at a similar multiplier and at an approximately 45 percent burden on the GDP, showing an index number similar to that of the former estimate, but now derived from an average computation based on the process of value generation.

For a final check, we can also exploit the Soviet general staff computations after the Second World War.[5] In the early 1950s, Hungary's full war potential was estimated as an army of 850 thousand men, and at the very extreme and only temporarily, as a one million-men army. This means that in case of an all-out war effort, a force of 850 thousand men was seen as mobilizable. In such a case *everybody* works for war and the only result of the economy (beside the "maintenance" of the population and of the productive forces) is the army itself, going to war.

In an *exceptional* case, when the tear and wear of productive capital is not made up for (enabling a further, say, 5 percent increase of production) and households' consumption is temporarily driven below the subsistence level (a further

[5]The data are found in *Bencze* 1990. I took only the totals that seemed perfectly authentic, and relied on these to draw my final conclusions, so as to answer all doubts, justified or unjustified.

10–15 percent "saving" on food and clothing), one million men, i.e. an additional 150 thousand, were considered to be mobilizable.

I think that this is an overestimate, since not even the total mobilization during the Second World War garnered more than 600 thousand men.[6] If, however, lower numbers than these were used, the burden indicated would be even heavier.

Thus the mobilization of a force of 264 thousand men (this had been the task Hungary was charged with and fulfilled in the fifties) corresponded, according to the data of the general staff, to about 31 percent of our maximum potential. Since then the costs of keeping armed forces have risen all over the world,[7] therefore the real burden represented by defence in 1980 can be estimated, on the basis of the foregoing, at 35 ± 10 percent.

The Hungarian economy was and has remained thus basically a war economy. This is also indicated by the fact that since the 1950s and even since the so-called Győr-programme of 1938 (when Prime Minister Darányi announced overall war preparations), the investment proportions determined by general staff considerations have not, or hardly, changed. These proportions did suppress agriculture, neglected residential construction, trade and services, whereas gave constant preference and priority to industries, mainly to the "heavy" industries (electric power, metallurgy, engineering and chemical industry).

Imre Nagy, recognizing the country's economic impasse, tried in 1954 to diminish the burden and suggested—in vain—new proportions of distribution. This experiment was thwarted by the resistance put up by the Hungarian industrial-military complex (organized by István Friss and István Kovács) and, politically, because of the pressure exerted by the group representing the same interests in the Soviet Union.

It is not my task to dwell on the political background of the question. I mention it only to make it clear that the storm could not have been raised by wanting to change that "tiny" item of 2.5 percent. The hidden and relentlessly asserted central motive of Hungarian economic policy has been militarism and armaments, now for more than fifty years going. Perhaps the period is even longer if we consider the oversize military establishment inherited from the Hapsburg monarchy.

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[6] The number of the population was then several millions more because of the increased area of the country. This area (and the number of the population) was reduced by the Paris peace-treaty once more to its Trianon size. Besides, because of the masses of Jews and gypsies annihilated in the concentration camps and the large number of the prisoners-of-war and of those carried off to labour camps, the age groups liable to military service suffered huge losses.

[7] One of the causes of this growth is exactly the unbridled arms race, which generates selfish and corrupt overspending. "Insensitivity to costs" is the object of constant attacks also in the Western countries, even though it is accompanied by higher competence and better technical results. See for example *Kaldor* 1982.

Efforts to further increase military potential necessarily lead to the emergence of a shortage economy, redistribution, and dictatorial planning. It is the permanent taxing away of more than one third of the national product that creates permanent shortages on the markets of civilian consumption. To cover the military expenses (since these can never be recovered), financial means have to be constantly reallocated. Finally, all this must be made obligatory, i.e. laid down in the form of plans, lest the remaining force of the market should drive production towards personal consumption.[8]

If our economy is held tight by uncontrolled and uncontrollable, over-large military expenditure, then our leaders must unflinchingly tell us that the "next year will be the decisive one", that the country's capacities "unfortunately" do not allow as yet the satisfaction of otherwise "justified" demands (acceptable living standards and pensions, comfortable housing, telephones, education, arts etc.). And, as the armed bodies increase in number, they too begin to express discontent, because they are permanently short of equipment and supplies. Not only the war economy, but the inflated staff of the armed body, itself of a weak and inconsistent performance, made the country's situation worse, clearly indicating the nation's unwillingness and unpreparedness.

What to get rid of

In an atmosphere in which the military and political leaderships barricaded themselves behind the Warsaw Pact and CMEA decisions, everything became state interest and national defence interest and thus strictly top secret. This made assessment even more difficult and, in some respects, it is impossible to this day to give correct and detailed analysis of the situation.

The hidden military idea often left its stylistic marks on the massive investment projects: the ever growing number of industrial and technical "works" of impossible names which never referred to the object of their production activity (our biggest factories fabricate ordnance, from time to time throwing out some "spin-off products" for the civilian market), the "higher" motives making their presence felt behind bauxite mining and nuclear technology, the transfer of "autarkic" metallurgy from Mohács to Pentele upon "political" considerations after beginning the construction works (with huge losses), just as the deep underground tube to connect Eastern and Western railway heads in a bomb-proof manner, the oil pipes of large and unutilized capacity, the all too obviously deep riverbed demanded by the Bős–Nagymaros "hydroelectric plant" (and its sluices to be of a size suiting so far unknown oil tankers), the primacy of the Transdanubian military

[8] Any increase in personal consumption is considered as a catastrophe by economic leaders who have up to this day successfully fought against it.

roads and railways, the growing number of valuable nature areas closed down by the armed forces, and the military reserve areas now expanding even over the past hiking areas around the capital. Everything, everywhere breathed war.

Maybe I see ghosts even where there is nothing to fear. But I shall find peace only if the Statistical Office stops mystery-making and gives account, correctly and without distortions. That is to say, if it is at all able and allowed to do so.

The picture completed

My attempt is the first try to break a vicious circle and I readily admit its partial failure. I have failed to nail down exactly whether 25, 35 or 45 percent of the Hungarian GDP have been spent on national defence and armaments. In any case, a multiple of the confessed 2.5 percent.

As I see it, the total expenditure always exceeded a third of the maximum permanent inputs allowed in total war. István *Nemeskürty* fully documented his statement (Nemeskürty 1972) to the effect that, in the middle of the Second World War (January 1943), not even one third of the approximately 600 thousand soldiers—those sent to the front-line, the Second Army that came to such tragic end at the Don—were sufficiently armed. Expertise and staff numbers were as insufficient as winter clothing, food, fuel, arms and ammunition. Modern weapons (anti-tank-guns etc.) were never seen at the Don Bend. It follows that even with the greatest "total" efforts, Hungary is unable to arm itself with modern weapons and keep an army of more than half a million men. A changing share of this half a million—usually over one third—has been kept under arms in Hungary.

A more detailed assessment will be the subject of further investigations, which the new general staff promised to support. As Ferenc *Szombathelyi* declared,[9] these will reveal, with the help of experts, the veritable relationship between army and nation.

By all means, Hungary has been spending more on national defence in the last fifty years than what could be invested into the economy serving civilian needs. And the only result that is worth mentioning of all those investments is the temporary occupation of the Venceslaw Square: the assistance given to suppress the Spring of Prague. For that, however, Hungary had to apologize later. Thus even this one and only military success is of adverse value, augmenting rather than reducing the burden weighing on Hungary.

[9] *Magyar Nemzet*, February 24, 1990.

Proposal for a turn

Ever since King Matthias' victorious battle of Vienna—of which he did not profit much himself—Hungary has been a regular loser of wars. Lacking sufficient armed forces, unity and perseverance, we would be better off if, instead of going to and losing the war, we made peace right from the start.

The developments that followed the Second World War carry the same warning. As a "punishment" for their defeat, Germany and Japan were not allowed to spend a penny on national defence. With the money thus released they created thriving economies at an extremely fast rate. This "miraculous" rate of their economic growth slowed down, however, as soon as they were strong enough to walk into the trap of militarism once again. (Japan being more prudent in this field, its economic development slowed down to a lesser extent.)

Such punishment was not inflicted on the countries in the "socialist camp" (including losers and winners). They could soon further increase their military preparedness, ignoring peace altogether, since the slogan issued in Moscow said: "we have won the war." Even Hungary—a loser—was cherishing such illusions because it was too unpleasant to face the fact that it had fought the war not on the side of democracy. (We still do not like to be reminded.)

Hungarian militarism was last dissected effectively by the Galilei Circle toward the end of the First World War. After the Second World War, not even the most obvious conclusions were allowed to be drawn. The prohibition of "pacifism" was concomitant, however, with wasting away peace.

All these facts demand a fundamental change of strategy, a real turn, a deliberate and as fast as possible conversion to a peaceful economy. *Lack of aggressiveness* has, of course, its risks just as sabre-rattling has. In today's world situation, however, and in the case of such a small country, the risk is smaller and decreasing. No territorial demand has so far been made against Hungary and if we were to commit aggression, it would not be just expensive and hopeless: it would be catastrophic.

The remaining tasks of national defence could be more efficiently fulfilled by a small and professional force, armed and trained exclusively for territorial defence, than by the present system based on universal conscription. Our neighbours as well as the wider world would have more trust and respect for us if it is clear that we do not prepare for attack, nor are capable of it, whereas we can bloody any invading army supported by no matter how many tanks and aeroplanes, in a zone of the first 20 kms. With today's conditions of military technology, this is by no means impossible, while it is considerably cheaper than the existing complicated, clumsy and old-fashioned, multipurpose war machine.

I may be trying to force an open door by this suggestion.[10] The Ministry of Defence and the general staff itself stress the necessity of a turn. Yet the answer to the Hungarian version of my paper has been a staunch reiteration of the old and falsified data, beside a lengthy article to the effect that the living standards of the middle level military deteriorate (Kozma Tóth 1991). I suspect that it deteriorates slower than that of the productive workers and creative intelligentsia.

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[10] The proposal of István Gyarmati put forward in his work mentioned above and in his study (Gyarmati 1990b) are similar. Tanks and aeroplanes have become by now easily destroyable, "lazy" targets, and if he deems a force of 30 thousand as sufficient (50 thousand would be nearer to the general international proportions), the maintenance of universal conscription would be totally unjustified.

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COMMENTS AND CRITICISM

EVALUATION OF THE IMF ACTIVITY IN HUNGARY (COMMENT ON THE STUDY BY B. CSIKÓS-NAGY)

I. SZALKAI

In a recent article in Acta Oeconomica Béla *Csikós-Nagy* (1990) gives a careful evaluation of the activity of the IMF in Hungary. His critical remarks stem basically from the recognition that Hungary had no analytically tractable market in a regular open economy framework during most of the period of financial co-operation between the IMF and Hungary. Due to this condition the conventional macroeconomic analysis with straightforward adjustment suggestions was hardly applicable. One of the main conclusions of his paper is that to overcome structural impediments originating from inheritances of a Soviet-type planning system with a rigid regional trade arrangement, Hungary needs medium term structural adjustment programmes. He also implies that shorter term arrangements with the IMF, which focus on financial policies suitable for "genuine" open economies, may result in failures. Consequently, there is a necessity for new understandings on the Fund's programme objectives and policies.

From the outset there was little doubt that the nature of centrally planned economies would give rise to several serious problems concerning financial arrangements with the IMF. The economic literature on these issues gives clear evidence that western analysts of Soviet type systems, including the Fund's staff, were properly aware of the specific risk (see Allen 1982, Wolf 1985). Recorded minutes of negotiations bear testimony to the fact that such issues were frequently the subject of discussions between IMF staff teams and the national authorities, too.

Csikós-Nagy touches on several major questions that bear directly upon this issue. His views on individual issues are mostly correct. However, his findings about the general effectiveness of the IMF-supported adjustment policies in the 80's in Hungary do not show evidence of favourable results. My own comments, therefore seek to help to estimate the difficulty which emerges in the evaluation of Hungarian adjustment programmes under IMF standby arrangements. I focus my remarks on the efficiency and length of programmes, the speed of transition and the question of debt relief.

Legacies of central planning

Csikós-Nagy refers to the legacies of Soviet type planning and points out that "under such conditions all kinds of recommendations pre-supposing an open economy with a market system will fail to work." (p. 255) This is a fairly strong exaggeration of the difficulties anticipated during the formulation and realization of the Fund's supported adjustments programmes in centrally planned economies. In Hungary the relationship between the domestic macroeconomic imbalance and the external imbalance was closer than in some other centrally planned economies at the beginning of the 1980's. The system of controls over the functioning markets, however, had serious distorting effects. The IMF programmes in the first half of the 1980's had a basic objective of reducing external imbalances, without exacerbating internal imbalances. While external imbalances actually eased under the effects of these programmes, one cannot be sure about their final impact on internal imbalances. Certain restrictions were discontinued and the domestic liquidity overhang was considerably reduced. However, simultaneously, other restrictions emerged (some of these were collectively referred to as "manual control"). These emerging restrictions, however, were not reflected in an immediate negative impact on growth performance. Among major debtor countries the Hungarian growth performance—with 2.0 percent average annual growth rate of GDP in the period 1982–84—was satisfactory. The initial liberalization of private and semi-private activities, encouraged by IMF programmes, significantly contributed to this outcome. Broadly speaking, emerging restrictions strengthened the inappropriate sectoral allocation of resources with a concomitant, but somewhat delayed effect on the productive base (the Hungarian growth performance became fairly poor in Eastern European and broader international comparison, mainly in 1985–86 when IMF arrangements were not in force.)

The revival of IMF programmes in the second half of the 1980's was preceded by major structural reforms that affected financial intermediation, taxation and enterprise management. More instruments became available for market oriented economic policy purposes. IMF programmes called for continued implementation of structural reforms. Requirements relating to structural policies were built into standby arrangements as specific performance criterion.

Performance of IMF programmes during this period improved in the field of structural reforms and weakened in the area of stabilization. IMF programmes treated structural reforms in a pragmatic way until the political transition: this required an improvement in incentive schemes that would provide the possibility of a better allocation of resources, while accommodating the slow increase in private ownership and the untouchable regional trade arrangement. Despite these constraints, structural policies under the auspices of the IMF met with considerable success. These policies were aimed at reducing distortions in the price system and wage determination, liberalization of trade, establishment of money and capital markets and the liberalization of financial intermediation.

Faltering stabilization was mostly reflected in frequent slippages in fiscal policy implementation (1988/89) and loss of control over the money supply (1990). Slippages in policy implementation led mainly to the acceleration of domestic inflation and further deterioration of growth performance, while the balance of payments on current account registered improvement in IMF programme periods. (This improvement fell behind the target in 1988, but it was better than the target in 1990. Large deterioration of the current account in convertible currencies occurred by the end of 1989, when an IMF programme was not in operation.)

This outcome, however, cannot be regarded as country specific. IMF programmes in market economies often led to dismal stagflation with little or no success in the attempt to reduce inflation. Not surprisingly Hungary—where exogeneous developments also proved to be disastrous—arrived at a similar position. The prospective danger of this situation was that the lack of stability in the macroeconomic environment would eventually hinder the successful implementation of structural policies.

Need for a medium term programme

The need for medium term programmes was recognized fairly early by the Hungarian authorities as well as the IMF staff. However, a medium term programme was not approved for Hungary until 1991. Nonetheless, there were several reasonable considerations behind the annual short term standby arrangements:

— Practically all standby arrangements in the 1980's were preceded by rapidly growing external imbalance in Hungary. Balance of payments difficulties centred to a large extent on the current account and on the reduction of external capital inflows. These reflected sharp declines in voluntary lending of foreign banks to Hungary. Due to these circumstances, policies had to be developed to address the immediate task of improving the balance of payments. It was always a great risk not knowing how foreign creditors would respond, or how the market sentiment would change towards Hungary. Under these conditions it was thought that the best way to restore the confidence of financial markets was to choose a prompt adjustment, with a considerable amount of demand restraint, which could be accomplished efficiently in a short term framework.

— Detailed and appropriate policy packages, with an efficient combination of demand management and structural reform measures were not available for medium term periods. This raised the risk that a medium term programme might be off track within a relatively short period. As a result, confidence problems could emerge again, and the immediate task of stabilization might require the replacement of the medium term arrangement with a short term standby programme.

— The IMF staff was not very supportive of medium term programmes because of several unfavourable experiences in other countries. Since IMF programmes with Hungary in the second half of the 1980's included a variety of structural policy elements, calendar years could not be strictly separated. The IMF staff and the Hungarian authorities agreed at that time that policies,— without programme details—had to be described for a medium term period. The Executive Board of the IMF gave its general support as to the authorities' medium term programme. However, the IMF financial resources were committed only for one year in advance. The medium term programme period was supposed to be covered by consecutive annual standby arrangements. This overbridging solution seemed to be satisfactory for both sides. The major drawback was the lack of a longer term commitment of IMF financial resources. The uncertainties surrounding the financing of the balance of payments at that time, however, were basically temporary. There was little doubt that fairly soon private financial markets would provide the bulk of necessary external funds to Hungary. However, this assumption changed dramatically and led—among other things—to the introduction of a formal multiyear arrangement (1991).

Speed of transition

Csikós-Nagy suggests a step by step transition as opposed to shock therapy. In fact, this became the official position in Hungary and only a few economists argued for shock treatment. Csikós-Nagy's explanation goes as follows: "...the problem in question is so very complex, the time demanding nature of the issues are so very different and the linkage among them so very specific, that shock therapy could hardly bring any hope of a solution." (p. 260) If this is correct, it can be used also as an argument for shock therapy. If issues are so complex and interrelated, then extension of a transition period would increase the risk of the inappropriate sequencing of measures. The faster the transition, the less critical is the problem of sequencing, since correct measures introduced during a short period will probably be mutually supportive. I am also inclined to accept the suggestion of gradual transition but my reasoning is somewhat different. If a country reaches a stage when dismal performance can be explained mostly by inertia, and expectations tend to drive economic conditions to an even worse level, there is no other choice than shock therapy. Shock therapy is basically an instrument of stabilization, the main purpose of which is to consolidate expectations and increase confidence immediately. Such therapy can inspire the reform of institutions, the rewriting of contracts etc. All of these changes serve to dramatize the end of the "previous policy period". A significant amount of initial demand management efforts would be one of the preconditions for subsequent success. Consequently, these measures inevitably bring about serious social tensions. Although the Hungarian economic situation is quite unfavourable, it is not a likely candidate for shock therapy. Participants in the system have some hope at least that the continuation of government policies can eventually bring about success. Therefore, they may behave supportively. The explanation for this can be derived from past developments, which clearly show that demand and structural policies have brought—at least partly—appropriate results in Hungary.

Question of debt relief

Csikós-Nagy hesitates when making his final conclusion on debt relief, although he suggests that the policy of the continuous debt service, according to the original contractual conditions, could work in Hungary. Debt and debt service reduction can be justified as part of a medium term structural adjustment if they can serve the longer term interests of both debtors and creditors. One or more of the following conditions can contribute to a consensus:

— the political sustainability of a reasonable structural adjustment programme cannot be ensured on a given debt repayment schedule;

— even with a reasonable adjustment programme, new money from private markets is not forthcoming;

— debt overhang is so large that the growing out of the debt option cannot be defended by regular economic policy considerations.

I think that Csikós-Nagy is absolutely right if we evaluate the issue of debt overhang in Hungary. We have recently experienced, however, warning signs of a deterioration of the political sustainability of adjustment and a recurrent worsening of available market financing to Hungary. If these developments persist, the question of debt relief in the framework of a medium term structural adjustment programme may need to be reconsidered.

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REVIEWS

PROFESSIONALS IN HUNGARY: IS THEIR NUMBER TOO HIGH OR TOO LOW?

A. RÉVÉSZ

I have examined the statistical figures on professionals in eighteen countries—*Austria*, *Belgium*, Czechoslovakia, Denmark, *Finland*, *France*, the Netherlands, Ireland, Canada, Poland, *Hungary*, *Great Britain*, *the GFR*, Italy, Portugal, Spain, Sweden and the *United States*—regarding the period between 1970 and 1985. From the countries printed in italics I also managed to obtain data about the educational level of the employees. Henceforward, "other countries" or the "rest of the countries" refer to the above listed countries or to the majority of them.

For an international comparison of changes in the number of professionals, an 1966 ISCO classification offered the most convenient tool. It groups this most comprehensive occupational category under the heading: "Professional, Technical and Related Workers". The heading includes technical workers, the group of people working in administrative jobs, related to the economy, in transport management, traffic management, in health and cultural jobs, i.e. the entire group of white collar workers, with the exception of accountants, clerks and trade employees who are working in subordinate posts and whose educational level is not higher than secondary. The former account for 60 percent of the 1,500,000 white collar workers registered in Hungary in 1980, i.e. approximately 940,000 persons (KSH[1] 1981). The ILO figures (1980–1985) put the number of Hungarian "professionals" more than 20 percent lower than this figure. Although the reason for the divergence between the two figures could not be traced back to any definite reason, the explanation probably is that foremen, dispatchers and traffic controllers are grouped in ILO statistics under headings different from those in KSH statistics. This, however, could not be established for sure.

If we compare the number of professionals with the total number of people employed in Hungary, or with the economically active population, we can clearly see that relative to the European average, Hungary is in a fairly good position in this respect. Based on the figures published by ILO, Hungary is 14th among the 18 countries listed in *Table 1*; Hungary comes in front of the Federal Republic of Germany and Austria, lags behind the United States and Canada only by a narrow margin and is well ahead of the southern European countries. If we based our ranking on KSH census figures instead of the ILO figures, then Hungary would be

[1]KSH= Central Statistical Office (of Hungary)

ranked near the top: it would be placed 4th. On the basis of KSH figures, Hungary has comparatively more professionals than Great Britain, Belgium, Denmark, Finland, the United States, Canada and of course, more than the rest of the countries mentioned above.

Table 1

Economic development level and the number of professionals around 1980

	GDP/capita*		Ratio of professionals per 1000**		Economic efficiency of the number of profess.	
	dollar	ranking	percent	ranking	dollar/capita	ranking
United States	11,500	1	15.7	10	738	1
Canada	10,120	2	15.9	9	636	2
Austria	6,990	9	11.5	15	608	3
Federal Rep. of Germany (FRG)	8,240	6	14.0	12	589	4
Finland	8,500	4	16.9	7	503	5
Belgium	8,140	7	17.7	4	460	6
Spain	4,100	15	9.2	17	446	7
Denmark	6,970	10	16.3	8	428	8
France	8,500	5	20.8	2	409	9
The Netherlands	7,000	8	17.2	6	407	10
Portugal	2,270	18	5.6	18	405	11
Italy	4,990	12	12.6	14	396	12
Great Britain	6,680	11	17.6	5	380	13
Sweden	9,000	3	26.3	1	342	14
Ireland	4,200	14	13.1	13	320	15
Poland	3,160	17	11.4	16	277	16
Czechoslovakia	4,900	13	19.4	3	252	17
Hungary (ILO)	3,670	16	16.7	11	220	18
Hungary (KSH)	3,670		18.5	4	198	19

* *Source: Ehrlich* (1989)

** Ratio of professionals within total employment, according to ILO publications (1981–1986)

Comparison of the indicators of the number of professionals and those of economic developments shows astonishing results. The ratio of these two figures yields an indicator that is not found among those used in general practice. Although its concrete contents can be interpreted, it is not a standard indicator. Its dimension is dollar/capita and it indicates the relationship between the number of professionals and the specific (per capita) total output of the economy. It can be interpreted as an indicator of the global economic efficiency of the activity of professionals, and it primarily shows the relative ranking of the countries examined. In this respect, the outcome is disastrous for Hungary, as it is last among the 18 countries listed.

Hungary's serious backwardness regarding the global efficiency of its professionals can be interpreted in more than one way. It may be supposed that this backwardness can be blamed on the composition of the group of Hungarian professionals, i.e. their composition according to professional fields or the level of their professional training. Their distribution according to economic branches and subbranches may also be a reason: maybe they are not working at places appropriate to their qualifications. Another explanation can be that they attend to their tasks unsatisfactorily because they do not know what they should know. The system and contents of the training can also be blamed. (The standards of the evening and correspondence courses in Hungary, for example, have been much criticized.) A view generally accepted in Hungary probably brings us closer to the truth, namely that the socio-economic conditions of the country do not allow the professionals to adequately utilize their knowledge. The Hungarian system of incentives and interests as a whole leads to the wasting of labour and the group of professional workers is no exception, either.

One thing is certain, however: in no way can it be claimed that there are not enough professionals in Hungary or that the problems can be traced back to a low number of professionals.

If we examine the number of professionals by considering the various sectors of the economy, it can be seen that their number is high in the *primary* sector in comparison with their total number in Hungary, and is outstanding when compared with any of the other market economies under scrutiny. We are also among the top countries if we examine the *secondary* sector and we also have a good placing in the tertiary sector. At the same time, it can also be seen that in the developed capitalist countries that were examined the concentration of professionals in the tertiary sector is much higher than in Hungary. The fact that teachers, health workers, administrative and trade professional workers are employed in the tertiary sector and that their number and proportion increases proportionately with the growing share in the economy of this sector, is not the only explanation for this. There is another factor that plays a role here.

There is a phenomenon that vigorously manifests itself in the tertiary sector—although in Hungary it is in an embryonic state only—namely that the computer specialists, accounting, agricultural and other specialists have been quitting their jobs in enterprises. This is especially the case in the small and medium-size establishments, which they leave in order to offer their services to the public in a "self-employed" capacity.

The terminology: professional—if we continue to consider this category as an *occupation*—fails to indicate the composition of this group according to educational level. As a consequence, we must also examine the concept of *professional* from another angle, namely from that of *educational level.* This, however, turns out to be a complicated task because the countries included in our survey have different educational systems and, as a consequence, the names of the educational levels, their scale of values and their relationships to one another, also greatly differ. Higher education in certain countries is differentiated according to two, others to three levels, while their delimitation is often dubious. There are even cases when it is difficult to tell where secondary education ends and where higher education starts.

The majority of the countries, including Hungary, distinguish three levels in higher education. Post-graduate training is not considered to be a separate level. In Hungary, the highest educational level, henceforward HE-I, is called university level. This means at least four but often five or even more years of studying, following graduation from secondary level institutions. The HE-II levels or "high-school" (or college) educational level in Hungary means somewhat less time of study than at university level and the training itself is usually more practice-oriented.[2] In many of the countries, and in part also in Hungary, the system of higher education is organized in such a way that the HE-I level is built upon the HE-II level, while in many other countries the two levels are not interlinked. The third level, HE-III—often described as post-secondary or sub-university training—means that while it is also based on graduation from secondary schools and provides professional qualifications, it is a closed form of training and it is a supplementary training following secondary education. As such, it is not an integrated part of the higher education. In many countries this type of training is given to higher-trained technicians, to teachers, vocational teachers, kindergarten teachers, paramedicals, as well as to medium-rank administration, management and accountant specialists, etc.

For some summary data, see *Table 2*. We must emphasize, however, that one or two percentage point differences are not sufficient for comparisons and that the differences of statistical recordings and the methods of survey limit the comparability of these figures from the outset.

As is shown by the figures in *Table 2*, Hungary is more or less in her due place when it comes to the proportion of those employed with a higher level education. It is somewhat surprising that Hungary ranks equal with the FRG, is behind Finland only by a narrow margin and is ahead of Austria and Italy—yet the situation shown by *Table 1* justifies this. One thing is certain: concerning the ratio of active wage earners with higher educational qualifications we cannot speak of Hungary's lagging behind at all.

If we continue to break down the higher educational levels according to the levels mentioned above—which we managed to do in the case of eight countries—we receive more complex information, better suited for judging the situation.

The picture reflected by *Table 2* radically changes and Hungary climbs upward on the list. On the basis of the above-mentioned aspects, Hungary is ahead of France, Britain and Finland!

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[2] The terms high-school and college denote *in the USA* (as against European terminology) secondary level of education.—Ed.note.

Table 2

Number of professionals with higher educational training per 1,000 employed

Country	around 1980	around 1987
The Netherlands	n.a.*	164
Norway	157	n.a.
Belgium	156	145
United Kingdom	126	n.a.
France	114	148
Finland	102	n.a.
Spain	n.a.	107
GFR	85	99
Hungary	82	99
Czechoslovakia	73	n.a.
Yugoslavia	n.a.	82
Poland	n.a.	79
Bulgaria	n.a.	74
Austria	48	58
Italy	n.a.	57
Romania	n.a.	48
Portugal	n.a.	43

*not available

Source: Data from around 1980: (Révész 1990)
Data from around 1987: (*Ladányi* 1989)

Table 3

Number of professionals per 1,000 employed according to educational levels Around 1980

Coutry	University and "high school" (college)	Other higher education	Higher education total	Proportion of professionals with "other higher" education (percent, first column=100)
United states	177	176	353	100
Belgium	104	52	156	50
Hungary	74	8	82	11
France	73	58	114	76
Great Britain	70	57	127	74
Finland	58	44	102	76
FRG	56	29	85	52
Austria	48	-	48	-

These figures too, seem to support the assumption according to which people in Hungary with HE-I and HE-II levels are working in jobs which in many countries are filled by people with HE-III levels. At the same time, the low number of people with HE-III (post-secondary or sub-university) levels also indicates the probability that tasks, which in other countries' practice are performed by HE-III level people, are done in Hungary by people with secondary level education. Both cases involve losses for Hungary. In the first case, time, money and energy spent on training will be lost; in the second, Hungarian professionals may lack ability to receive, to learn and to apply new technologies.

I made a comparison of the professionals with higher qualifications also on the basis of their specialization. This comparison showed that a markedly high proportion of professionals in Hungary have specialized training in the agricultural branches, a fairly high proportion in education and also a fairly high proportion in engineering branches: e.g. mining engineering, and metallurgical and chemical engineers. At the same time, the proportion of professionals with liberal arts degrees and social science degrees is strikingly low. As concerns the rest of the branches, Hungary's situation is more or less the same as that of the rest of the countries included in the study. The picture thus received supports everyday experience: in Hungary, a very large number of professionals with teachers' qualifications are working in public administration and in other fields requiring a liberal arts education. Besides, the large-scale agricultural units and the central managements of these employ a very high number of agricultural professionals.

Data about the groups of professionals

I have examined the data of eight occupational categories of professionals as separate groups. These are: technical workers, senior officials and managers, specialists in agronomics, legal professionals, teachers, health workers, economic and trade experts and the other professionals not listed above.

About technical workers

As seen in *Table 4*, the ratio of engineers and technical staff is fairly high in Hungary. At the same time, the ratio of engineers with higher level education could be higher. Besides, a comparison between the number of engineers and technicians reveals that the proportion of the latter is rather low. Around 1980, the ratio of engineers in Hungary was higher than in any of the other countries examined, including the United States, Britain, the FRG and France. Since 1980, this number has increased further.

This, in fact, means that, regarding the relative number of engineers, Hungary rivals countries where the per capita national product is at least two or three

Table 4

Distribution of technical workers

	engineers	technicians	foremen	technical workers total	out of 100 engineers, those with higher education	technicians per 100 engineers
	per 100 employees					
Hungary 1980	2.21	2.77	1.38	6.35	55	125
Great Britain 1981	1.96	1.69	2.68	6.33	63	86
FRG 1980	1.75	3.15	0.47	5.37	76	180
France 1982	1.73	2.79	2.15	6.68	56	161
Finland 1980	1.22	2.94	n.a.*	4.16	77	241
United States 1982	1.19	1.48	n.a.	2.66	n.a.	125
Belgium 1981	1.04	2.59	1.72	5.35	92	249
Austria 1981	n.a.	n.a.	n.a.	3.52	n.a.	n.a.
Hungary 1984	2.95	2.76	1.44	7.16	61	94

*not available

times higher than in Hungary. This leads us to one conclusion only—namely that in Hungary a considerable proportion of all engineers are underemployed; more precisely, a considerable amount of their working hours is taken up doing tasks that require lower qualifications than theirs, such as administrative tasks, lower quality management work or "manual" or "foot"-work to substitute for the lack of modern office and computer technical equipment. Due to the absence of genuine challenges and incentives there is no stimulus for the engineers to do creative work. Besides, the wage-system has also contributed to this nonsensical situation. Relative wages provide no incentive for the efficient management of qualified labour. Another explanation for the high proportion of engineers is the embryonic state of engineering services in Hungary. The economic units are forced to employ people in full-time jobs for such functions which, with a more rational organization of work, could be provided as limited-time services. Because of this "lack of outward openness", the economic units are deprived of the chances of market bargaining and of making their own choice and also of the necessarily wide experience of the servicing organization. The *"many engineers—few technicians"* situation in Hungary has another obvious explanation. Earlier, money, prestige and self-esteem were, and still are more dependent on the position held than on the actual performance of the individual holding the position. Therefore, the interested parties were guided, and continue to be guided, by a common interest: to increase the number of engineers both in training institutions and at workplaces, at the expense of the number of technicians. The actual outcome, however, has been contrary to intentions: due to the lack of chances for creative work, frustration rather than prestige increased among those involved.

The category of the senior officials and managers, i.e. people in charge, must also be reinterpreted. Otherwise, any comparison based on the Hungarian interpretation of the *leading, management* positions, would give us a completely false picture.

According to the ISCO manpower statistics or other statistics using methods similar to ISCO, only those people are classified as senior officials and managers whose main job is to make decisions of *strategic* importance, and to shoulder the subsequent responsibilities. The Hungarian term is "leaders" and its interpretation is much wider than ISCO's. Therefore, here again, we are forced to reinterpret and transform Hungarian data (without going into the details of this exercise because of the lack of space).

The proportion of Hungarian *leaders* and *managers*, if we use the ISCO classifications, compares well with the European average. As a matter of fact, it is somewhat lower than the European average. It is probably lower because Hungary has a very high number of big companies—so much so that not even the very high number of people working in the government apparatus can make up for the difference.

In Hungary there is a widespread belief that people in leading positions are of a low educational level. The international comparison, however, firmly contradicts this belief. In the rest of the countries I examined (the United States, the FRG, France, England, Belgium, Finland and Austria), only one quarter or one third of the people in leading positions have HE-I level qualifications. In Hungary, this proportion is about 40 percent! The erroneous belief about the low qualifications of Hungarian leaders can probably be traced back to the fact that the KSH's *leader-manager* category is much wider than ISCO's. Hungarian statistics classify under the heading of leader-manager the foremen, the workshop managers, the traffic controllers, and all leaders in the retail trade, in servicing shops, and in the catering industry, etc., i.e. all those people who climbed over the lowest grade of the hierarchy and are authorized to give instructions to others. In the light of the above, it is not surprising that the educational level of people in "leading" positions adds up to a low average level.

Concerning agricultural professionals

Hungary's labour force structure in agriculture in the period between 1960 and 1990 cannot be compared to countries where agriculture is based on a farmer-type management. Farms usually do not employ accountants, bricklayers, electrical fitters, telephone exchange operators, drivers, agricultural experts, soil biologists, or veterinarians—nor do they include the people engaged in "branch-alien" activities. The tasks listed above are done either by the farmer or his family or by service personnel.

If, on the basis of *occupational* categories, we compare the number of professionals having agricultural qualifications with the number of people working in agriculture in the developed countries, we will see that the specific figures are much lower than in Hungary, i.e. only half or one third of the Hungarian figures. However, the difference is much bigger if we compare the number and proportion of professionals actually working in agriculture as a branch of the economy. This value is many times higher in Hungary than in any of the other countries mentioned: in Hungary seven out of 100 people working in agriculture are professionals, while in other countries this ratio is usually one or even lower.

In many of the western countries, people with university degrees in their pockets are working in agriculture. Their occupational title is farmer! The specialists with agricultural qualifications: agricultural experts, plant-protection specialists, strain-improvement specialists, viticulturists, hydrobiologists, irrigation specialists, garden designers—are engaged in activities other than agriculture (their occupation is different): they are doing research work, they are teaching, they are consultants, or they are working in offices, or are doing control or planning work. Therefore, they do not belong to the agricultural branch, but to education, research, servicing trades or administration.

Legal professionals

In the countries examined, the mean value of the number of people in legal professions (judges, attorneys, lawyers) as a proportion of the economically active population was 0.25. In Belgium and the FRG, this value was higher, while in England, Austria and Hungary it was lower. The number of people with law degrees is 50–100 percent higher than that of people actually working in branches of law. It has been a widely-known phenomenon for a long time now that in Central Europe law degrees are either a precondition for, or a promoting factor in, obtaining positions in the economy, in the civil service or in politics. As reflected by the statistical data (see *Table 5*), this must also be true in the case of Western European countries, since there is an increase in the number of people with law degrees working in jobs other than the legal profession.

Concerning teachers and the teaching profession

Hungary's supply of teachers may be considered to be satisfactory, since in this regards, Hungary practically equals countries producing at least two or three times higher incomes per capita. *Table 6.* To obtain precise information about teacher training or, more exactly, about the number of people *trained to be teachers*,

Table 5

Distribution of people with law degrees and people working in legal branches per 10,000 economically active employed people

Country / year	Legal occupation	Legal quálification
Austria 1971	21	n.a.*
Austria 1981	25	54
Belgium	38	n.a.
FRG 1970	28	n.a.
FRG 1980	39	42
FRG 1987	46	51
France 1975	33	n.a.
France 1982	36	n.a.
Great Britain 1966	15	20
Great Britain 1971	16	24
Great Britain 1981	22	36
Hungary 1970	18	24
Hungary 1980	20	39
Hungary 1984	21	40
Finland 1980	25	n.a.
Finland 1985	28	n.a.

*not available

Table 6

Some figures showing the distribution of teachers around 1980

Country	Teachers per 1,000 actives or employed	Country	Primary and secondary school teachers Total, per 1,000 students (6–17 age bracket)
Belgium	68	Belgium	100
France	38	France	69
Austria	38	Finland	64
Finland	34	Great Britain	60
Hungary	32	Hungary	54
Great Britain	31	Austria	53
FRG	31	FRG	40

or about their overall proportion and distribution according to specialization, is not an easy task. This is because the Hungarian training methods and the methods of registration are based on an approach which is different from that in many other countries. In Hungary, a graduate with teaching qualifications specializing in mathematics is considered to be a teacher with a specialist diploma in mathematics. In other countries, the same person is a mathematician with teaching qualifications. In the statistics of other countries this approach means that mathematics teachers are classified as teachers by their occupation while as mathematicians by their qualification. This is the form in England, Finland, Austria, and is partly also true in France and other countries. The separation of people who are teachers by occupation but mathematicians by qualification, could be done with the help of fully detailed cross-tables only, but the only case in which I found such cross-table was Finland's. None of the other countries' statistical surveys are elaborate enough for this purpose. In the statistical surveys of most of the countries, the "teacher" heading includes only the primary school teachers or nursery school teachers and vocational teachers without university degrees. When referred to in the context of higher education, the term "qualified in pedagogy" usually refers to a person involved in the pedagogical sciences, educational psychology or history of education and similar areas. Thus the possibilities for any correct comparison of teacher training on the basis of specialization are very limited!

About health workers

Hungary's supply of physicians is excellent (*Table 7*). Consequently, in this regards, Hungary is placed among the most advanced countries. However, if we also include in our statistics the second line of personnel, i.e. the nursing personnel, the situation changes radically.

Figures in *Table 8* reveal that Hungary has the lowest number of nurses and assistants and that hardly any of them have higher educational qualifications. As compared to the developed countries listed in the tables, Hungary has a comparatively low total number of health workers. At the same time, health as a branch also has a small total number of employees as compared to other branches (*Table 9*).

With regard to economic and trade experts and economists, I can only say that, according to my experiences, it is in this field that the categories and nomenclatures are the least clearly defined and where our terminologies in comparison to other countries are misleading. Consequently, the interpretation of the statistical figures is almost always dubious. Despite the great number of uncertainties, however, it can be stated that the proportion of this type of professional in Hungary more or less equals the advanced western European countries, save the smaller or bigger shifts in particulars, of course.

Table 7

Number of physicians and dentists per 1,000 people

Country / year	Physicians and densits per 1,000
France 1975	3.03
Austria 1971	1.93
Hungary 1970	2.16
Great Britain 1971	1.44
France 1982	3.10
Austria 1981	2.70
Belgium 1981	2.52
Hungary 1980	2.33
Finland 1980	2.19
FRG 1980	2.07
Great Britain 1981	1.79
Hungary 1984	2.93
Finland 1985	2.87
FRG 1987	2.67

Table 8

Number of nurses and assistants per doctor (The countries are ranked on the basis of the values "together")

Country / year	Nurses / doctor	Assistans / doctors	Nurses and assistans/doctor	
			number	with higher educational degrees
Great Britain 1981	6.07	0.41	6.48	3.70
Finland 1980	5.45	0.83	6.28	n.a.*
FRG 1980	3.01	3.25	6.26	n.a.
Belgium	3.61	0.39	4.00	1.46
France 1982	3.04	0.53	3.57	1.48
Austria 1981	2.37	0.70	3.07	0.70
Hungary 1970	1.33	0.83	2.16	n.a.
Hungary 1980	1.63	1.08	2.71	n.a.
Hungary 1984	1.72	1.06	2.78	0.17

*not available

Stock of professionals—professional training

On the strength of a few remarks, I must touch upon the relations between the actual number of active professionals and the training of professionals, first of

Table 9

Number of health workers and the proportion of people working in the health branch

Country / year	Health workers per 10,000 employed
Finland 1986	432
France 1982	392
Belgium 1983	384
FRG 1980	370
Great Britain 1981	314
Austria 1981	298
Hungary 1980	218
France 1982	530
Finland 1981	523
Austria 1981	515
Great Britain 1981	502
FRG 1981	428
Belgium 1981	398
Hungary 1980	314

all in order to be able to the answer a question warranted here: what explains the fact that I am talking about a relative and, in many regards absolute, abundance in professionals while the press complains about a shortage and often catastrophic lag in this field.[3] Do these statements contradict one another? If the answer to the question posed above is yes, what explains the two conflicting statements? Could it be that the stock of professionals and the supply of professionals is markedly high and, at the same time, the number of people receiving higher educational training is low—moreover, dangerously low as many people would claim?

It is obvious that the stock of professionals is, for the most part, the result of training. Yet, the interrelation is not as simple as this. In other words, the relationship is not a direct one.

The period of time examined in this study covers roughly 15 years. As a result, the survey presents not only a static picture but it indicates the trends of development as well. The dynamics of the Hungarian stock of professionals shows no marked deviation in the period between 1970 and 1984, especially if compared to the trend of development in other countries. Although I had no opportunity to make any detailed analysis of the Hungarian stock of professionals on the basis of age groups, it is likely that the composition of the stock of professionals reflects continuous ageing in certain branches. One of the explanations for this is the fact

[3]Regarding the number of students in higher level institutions as compared to the country's population, Hungary ranks 18th among twenty European countries. (Ladányi 1989)

that the large number of graduates who left the universities in the early 1950s—chiefly technical universities—are reaching their retirement age now. Therefore, it can happen that with the approaching turn of the century, the situation reflected by the study will undergo some change and certain indicators will deteriorate.

However, it is not only ageing that we must take into consideration here. There are losses due to other reasons as well, such as massive emigration, the changes in vocations or leaving a profession because of motherhood or simply becoming housewives. Assuming that the stock remains unchanged, the above losses will necessitate additional supply of trained personnel. On the basis of international comparison, the trends in the changes and also their magnitude can be easily forecast: the number of chemical, metallurgical and mining engineers and agricultural experts is expected to decline, while the number of professionals in liberal arts, communications, computer technology, social welfare, legal and administration branches as well as the number of financial and monetary experts is expected to increase, or at least there will be a demand for an increase of their number.

Consequently, on the demand side, one can forecast significant future changes in the stock of professionals, changes that are expedient and predictable.

As regards the other side of the balance, the majority of the supply, i.e. the positive part of the flow, will continue to come from professional training—that is, primarily from higher educational institutions. Although this is self-apparent, it still needs some elucidation.

Firstly, it is obvious that it is not the number of university students, but the number of *graduates* released by the universities that result in changes in the stock of diploma holding people. In this regard, I would like to emphatically call attention to the differences between the rigid Hungarian type, or we might say Prussian-type, higher educational institutions and the more open, Anglo-Saxon type institutions in the western countries. This is because the differences between the number of students and the number of graduates are essential. Their relative proportion shows significant differences depending on whether the universities are organized on the basis of a more rigid system or on the basis of an open-system.[4] Depending on the system of enrolment, the subject of studies, the number of courses, the environment of the university and the traditions, the number of university students per graduate in one country may surpass others by as much as 50–100 percent. In the 1986/87 school year, this value was 3.99 in Hungary, while in Austria, Spain and Italy, it was over 10. (Ladányi 1989). By ranking the 20 countries on the basis of graduates

[4] At the time I graduated from university, 600 out of the 650 students enrolled four years earlier received their diplomas. The number of "dropouts" or students advised to repeat the term was negligible. Not only the students but the teachers as well did their best to avoid such cases. As a consequence, considering these relations to be more or less continuous, for each graduate we can count 4.33 university students. (650/600x4 = 4.33)

instead of the number of university students, Hungary climbs up the list and can be found among the most advanced countries with her 10th place (ibid).

A significant proportion of women receiving higher educational training—even those graduating from the universities or 'colleges'—are in active employment only while they are single. Furthermore, some of the graduates become immediately unemployed—although they would like to take a job or are forced to take up jobs that are entirely different from their qualifications. In the same way as the number of students is not always relevant, the number of graduates is not relevant either when it comes to calculating how many of them will actually increase the number of professionals.

Secondly, it should not be neglected either—as can also be seen from international comparison—that, although the training of the new generation of professionals is obviously the task of higher educational institutions (such as the training of doctors, lawyers, natural and social science experts) an increasing share is taken by the forms of training provided by various courses, as can be observed in the practice of a number of advanced countries.

The intellectual potential of a country is not simply an aggregate of people holding university diplomas. The category *professional* has a much wider interpretation. The narrowing down of the concept of professionals to university graduates is a mistaken approach and might lead to an unacceptable waste of human resources. As can be clearly seen from the figures quoted here, the danger of wasting human resources is, beyond doubt, a real one in Hungary.

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BOOK REVIEWS

MIZSEI, K.: *Lengyelország. Válságok, reformpótlékok és reformok* (Poland. Crises, reformsubstitues and reforms). Közgazdasági és Jogi Könyvkiadó, Budapest 1990.

The book makes a very easy reading and far from only for economists or those interested only in the Central European region. Public opinion sensitive to social and political questions often draws a parallel between Hungary and Poland in the course of examining crucial Hungarian issues, by probing the question of "how did we get here and why". As for the author, he does not conceal his intention in seeing and showing up to the reader a particular case of the Stalinist socio-economic model. This is justified, as the Polish developments of the 80s keep repeating themselves, almost like a ghost appears, in another medium between 1989 and 1991, in the ascending and then descending phase of Soviet reform policy.

In the first third of the 80s when demand for publishing this monograph arose, the then managers of the publishing house shied away from the idea by insisting that Poland did not show a good example of socialism and, indeed, there was some truth to that. The model of total submission of society and the economy to the state administration could never take a root under Polish circumstances, and could only be implemented with rather peculiar features even in the stages of utmost "socialist unification". Still, the very fact of raising the question, the conflict, the twist and turns and the events themselves—and the lasting consequences of how the regime operated are familiar to the Hungarian reader, too. "Still, what a difference" one could note at every major turn.

Mizsei's work, summing up the research of a decade, fits into the best trend of Hungarian empirical and comparative economic research that had produced a summary of the reform debates of the 60s hallmarked by Sándor *Ausch*'s Comecon reform book (1972). This performance was followed up in the 70s by a work by András *Köves* (1985) examining the Soviet foreign economic opening and its impact on Hungary. In the 80s this process was completed by a monograph of Tamás *Bauer* proving the impossibility of macro-economic planning (1981) and a book by Károly Attila *Soós* (1986) criticizing the role money plays in a planned economy, deploring the insufficient and limited nature of socialist reforms. Mizsei's work, completed in the spring of 1989, formulates the issues in a system of values and conditions marking systemic change and its answers depicting the fiasco of the socialist attempt. It may be seen as a sign of the new era that the publishing house could be persuaded last year to bring out—as a swan song—a scholary analysis of an economist still living in Hungary, and to incur some of the losses of an activity that constitute its 'raison d'être' and goal. Our sincere thanks are due to the publishers for this last effort.

Mizsei uses a well tested option of cinematic art when the line of images starts with the protagonist dying, with his whole life once more relived. This enhances our empatic and sympathetic abilities what is really needed as we do not follow the events with the supercilious attitude of an outsider who is always wiser in the hindsight. This is some adventage while reading the study, but also somewhat of a drawback in setting a balance because—as it appears—the contemporary "spectacles", the order of measures and values often stamp their mark on the ways in which the individual issues are treated. And then the reader may feel the same way as when he saw Andrzej Wajda's "Iron Man" on Hungarian Television in the week between Christmas and New Year's Eve 1990; the lofty pictures ending with the pathetic victory march by workers in Gdansk were lent a particularly absurd tone by the fact that the protagonists figuring live in the film, including Walesa and Geremek, looked back at us the following morningh from the pages of the daily press ten years older, fatter and as each other's main rivals in the struggle for power.

Mizsei's book represents a piece of comparative analysis in a single country study because, aside from the constant Hungarian parallel, the role played by the Soviet Union and the one-time peace camp are at the center of his analysis. The unfolding of socialism would have been inconceivable without the power and geopolitical realities defined by the deal struck at Yalta, as the disintegration of the regime was without a weakening of the Soviet economic potential, and a re-interpretation of the military and foreign policy priorities stemming from that factor. Only a combination of the external and internal conditions, and the decisive nature of being determined from the outside can explain the fact that, and how, the state socialist structure had been introduced with only a few weeks of difference, and than was simultaneously eliminated in a matter of a few weeks or months virtually throughout the region. This may serve as an explanation from the questions "why simultaneously" and "why so late". (Csaba 1990 and 1991).

Thus Mizsei—while practically exclusively relying on primary sources, and writing with extraordinary empathy—places Poland throughout in an international context. This may be the key momentum, without which nothing is understood—ranging from the prolongued bad conscience of the West to the relatively benevolent, indulgent basic position adopted by the all time Soviet leadership. Nevertheless, it may still be regarded more as an exception than as a rule in the relevant literature where emphasis is usually placed on the personal qualities of the individual party leaders and other superficial phenomena. Mizsei's overall scientific approval may justify our misgivings against his interpreting particular events and concepts in modern Polish history. For instance, can the adoption of the Stalinist model, and particularly the practice of the fifties, *in any sense* be regarded in a Central European country as modernisation as this involved elimination of the system of market institution already established in former decades or the former century and of a relatively advanced civic society as well as the introduction of a primitive order of war economic management? (p. 26) By the same token, can the "leftist" turn of 1957 be understood from the insufficient economic foundation of the contemporary reform proposals? Or can the sudden turn in the mid-seventies, the strenghtening of party control, the amalgamation of the functions of municipal council chairmen with those of party secretaries, be really explained from purely Polish power dynamics? The latter two cases were pearls, of a model value, showing up the direct impact of the "international labour movement". (pp. 47 and 107) Similarly, the author is the victim of an optical delusion through primary sources, when he writes on p. 76 that in the first half of the seventies it had been Poland that opened to the West the most powerfully.

In a cultural sense—including tourism—this can hardly be disputed, in fact this stands even to a certain extent as far as foreign policy is concerned, but this cannot be supported in the sphere of the economy by statistical data. In fact, one must make mention not only of trade proportions but also of measures, because Poland, both institutionally and quantitatively was and has remained one of the most seclusive economies within the Comecon. (p. 168) This probably explains the alarming contradiction—justifiably criticized by the author in many places—that Polish economists had mostly neglected foreign trade, and right up to the Balcerowicz plan, treated it as a mere supplementary issue, even in the course of the ever renewed reform debates.

The consequent use of a contemporary pair of spectacles that is apparently distorting today, is the most disturbing aspect in the author's treatment of the seventies and in the excessive discussion of the draft reforms of the early eighties. Completely lacking any formulation, the author lends credence to the pledges and promises made by Gierek when coming to power—and, as Mizsei stresses himself, mostly forced by the pressure of the circumstances—notably that he was a reformer, and wanted to liberalise both politics and the economy, only conditions would not let him do it (hardliners, shortages and, of course, the Soviet comrades). This stereotype, so well-known in Hungary, was apparently catering to western public opinion, the church and the otherwise closely censored professionals. The Gierek programme called "expert" on pages 68 and 69: the process of forming trusts described as "the WOG reform", the unheard-of increase in investment rate without introducing a market economy and export orientation, the agrarian policy that ultimately viewed private farming as retrograde (particularly after 1974), but even the legalisation of the black market emerged on the whole as one of the most incompetent—if not the most unprofessional—economic policy lines in the whole socialist economic history. These errors did have—just as every error has—some core of truth as no obviously lunatic concept has any chance of being put into practice. These partial truths, however, never formed one policy line, but the improvisations became permanent trends that—according to analyses made in the middle of the seventies (KICS 1977 and Fallenbuchl 1977)—could only lead to a fiasco unprecedented in economic history.

From a hindsight, it is clear particularly from the analysis of the investment policy of the Gierek years (Bauer 1981 pp. 185–198) that the economy was ruled by parochial-minded party cadres, misunderstanding the essential issues of economic management, where the point was that they were totally incapable of assessing the consequences of any of their deeds, particularly not in advance. Gierek failed to realise even toward the end of his rule what the electrician from Gdansk did realise the day after his election to the Presidency, notably, that it is quite different to act as a spokesman for an interest group from ruling an entire country responsibly, because the two aspects may coincide only by accident. Gierek ruled all the way as he had learned during the time of acting as a successful provincial party secretary in Katowice. This meant that he pursued some partial objectives, in his line, at any price, while in cases viewed as "the business of others" he shifted responsibility onto others (in the best of cases), or he simply ignored problems or did not even recognise them in the worst of cases.

This lack of any systemic approach stemming from his inherent limitations and lack of incompetence made Gierek the gravedigger of socialism in Poland, as his successors could only afford to manage the crisis, from the outset and avowedly, or to ward off the Soviet invasion, then considered something even worse. One could mostly say about the economic visions of the Balcanic and Asian state socialist despots that they were nonsense, but they added up to some system (how the latter statement is right, is evidenced by the tenacity with which the systems outlive the despots. However, Gierek grabbed here and there, just to please the next in the line. And in this instance not the excessive overspending on investment projects or the indebtedness criticised with predilection on the basis of anti-western ideologies are the decisive factors. Mizsei proves with full right (p. 131) that the Poles did not use up their credits in an easygoing manner, but invested them (for mistaken objectives), and therefore they have to face bigger troubles than if they had merely squandered the funds away (the same applies to Hungary as well). The western credits helped establish and spread an—even twenty years ago—outdated and uncompetitive economic structure and a related structure of society and incomes feeding on extended reproduction. True, operating this structure entails even bigger losses, but its phaseout has been hampered by a comprehensive network of interests even for a decade. In his book, Mizsei gives a plastic picture of the incredible rigidity in this peculiar pattern of the socialist economy that stagnates in real terms, unlike any textbook, which softens any major reform on the system through the ability of vested interests to articulate and get through their own priorities at any rate, as all efficient socio-economic feedsack is institutionally suppressed.

And we have reached an extremely important issue which makes Mizsei's mode of treatment characteristically different from that of regular analysis of planned economies: his placing the second or irregular economy, commonly known as moonlighting, having jobs on the side, in the centre of his attention. It is a logical step to move from the above way of reasoning—although by no means inevitable—in a direction that if the bureaucratic economy is so overwhelming, then anything breaking up its closed logic is only welcome and will certainly move the economy in the direction of a market. This is how private farmers, citizens acting as occasional taxi drivers in Moscow, or the personnel selling products from under the counter at exorbitant prices, or the workers mutually helping out fellow workers in extra-factory grievances at the weekend will together elevated to being bastion of free entrepreneurship under state socialism. This school of thought is particularly fashionable in North America, but has mustered quite a following in Hungary in recent years. (Gábor R. 1986; Mizsei 1987; Kornai 1990)

In this approach it is only right that Mizsei will assess any move promoting the underground economy, ranging from black money exchange to doing shady business abroad as a positive reform move. It is only in dealing with the socio-pathological phenomena of the second half of the eighties that he raises—as a subordinate question—that these processes have eroded not only the bureaucratic framework of state socialism, but also centrain elementary norms of civilised human behaviour. Well, it appears to me precisely due to the final outcome of this process—because of its full blossom in Poland—that this is a rather contradictory process which, to a certain extent, becomes in itself an obstacle to systemic change. When analysing the 80s, or more precisely the domestic deadlock from 1983 to 1988, Mizsei writes himself (p. 244) that the second economy had mostly not put up any competition to the large-scale industry, and it was precisely this fact that prompted the authorities to adopt a tolerant attitude towards it. Apparently, there is a peculiar coexistence between the state and private profits, where the quasi-private activity mostly preys on the "socialised one": it siphons off profit as a leech, but does not pay taxes, which remains a fact even if an overwhelming part of the citizens have become alienated from the public purpose. Therefore, even after the redefinition of public priorities—following the systemic change—it would be foolishness to expect these harbingers of the market to become more interested in competition (in the apperance of new market factors), and to better contribute to bearing public burdens, making in the final analysis the institutionalisation of differences in incomes and properties a socially accepted fact, which is a pillar in the process of transition. Conversely, right and left-wing populism may equally reckon with the fact that this sector may provide an inexhaustible thesaurus of examples for violating elementary norms, with which not only the immediate loosers can be mobilised against a truly pluralistic, modern market system. Because of these Janus-faced features—easy to understand under our conditions—it is retroactively doubtful for me and also from theoretical aspects to what extent the eulogising of the role played by the irregular economy is well founded, while its role in making up for shortage and even its pedagogical one can certainly not be called into question.

In addition to the spread of the underground economy, another feature of Poland of the 80s is the trade union form of social resistance, which has at the same time resulted in an anticommunist and egalitarian diretion of the campaign, and in a preponderance of "third road" concepts in the economy and of self-management ideas (and practice) in administration. (p. 132) This has led—as amply shown and throughly proven by the author—to the acceptance and rigid insistance by the Polish opposition on a number of economically self-conflicting positions. This is true to the extent that—as he stresses in the epilogue—Balcerowicz, during his first and second tenures as finance minister, implemented his comprehensive and successful reforms not in compliance with the accepted views of the coalition that helped him power, but rather in opposition to them.

The social clashes in 1980 and 1982 had a stimulating effect on Poland's intellectual life, resulting in a number of brand new concepts. Mizsei gives a very detailed account of the contemporary ideas that were presented by the press-campaign—commanded by Suslov—of the era, as overly courageous and in fact adventurous in Hungary, too. It appears well from Mizsei's book that the Balcerowicz of 1980 had been far from what he became by 1990: fixing of prices based on average costs, acceptance of a centralised allocation of inputs and neglect of agriculture and the ever expanding shadow economy stand out through the contemporary ideas, i.e. concepts lagging behind the Hungarian reform ideas of the mid-fifties (Szamuely 1982). Mizsei also stresses that Solidarity had been unable to commit itself to any clear-cut economic programme during its legal operation (p. 195), and could only afford to criticise—without any conceptual alternative—moves by the authorities during the era Solidarity had been outlawed (p. 204). It becomes clear from the above that the one-time general-president, now out of public life, cannot bear all responsibility for the protracted crisis of the Polish economy.

It is an important aspect of the book to show that no "Latin American regime" was established when the state of emergency was imposed on Poland, but at the same time began the profanisation and ultimate dissolution of the party structure and the ideology sanctioning it.

The author draws attention to a major interrelation on pages 252 and 296 when he says that the western credit embargo imposed on Poland in response to the declaration of martial law—as against statements made by the contemporary propaganda—actually helped ease Polish problems. Poland had suspended payment of state debts onesidedly, and commercial banks rescheduled 92 percent of the debts maturing in the period between 1981–87. Despite this, Mizsei—justifiably—describes the Polish economy as struggling in a debt trap. Well, in point of fact this is the real yardstick by which the bankruptcy in the wake of the innovations made by Gierek can be measured: a country indebted due mainly to its investments is unable to pay back even a fraction of its interests and debts to its creditors. At the same it cannot be doubted from what has been said that a certain write-off of the debts was actually a basic precondition to the re-start of any payments under Polish conditions, because the debt service after the remaining part of debts was a hitherto neglected sum (associated with the commercial credits and the rescheduled, although interest bearing maturities). This constitutes a new burden for the Polish economy, and not at a neglectable level. So there is nothing to envy about the fact that less than 2.5 billion, four-fifths of three billion, out of 48 billion dollars of debt had been written off by the U.S. President in a spectacular manner, because this happened in a structure that considerably increased the current and prospective burdens of the Polish economy.

It is an interesting part of the book that presents Jaruzelski's attempt to imitate Kádár's style in the years between 1986 and 1988 in its own absurdity. Jaruzelski attempted to copy the Kádár-type of consolidation, then praised to the point of boredom, without a stick (executions and the crushing of Budapest) and in the absence of a carrot (curbing the terror of the state security service and, last but not least, abstaining from irking the population, while providing an ever improving supply with consumer goods).

In vain was the Polish general Kádár's best disciple, in vain did the refuse to promote his own personality as Gorbachev, in vain he tried to win over the opposition intelligentsia, in vain did he give in to them on every single issue—something that had led to the consolidation of the official rule in Hungary in the late 50's was too little to stop the catastrophe in Poland three decades later.

The description of the last Polish socialist attempts at reform also serve with a good moral. Visibly, the economic and political battlelines did not cover each other at all. While some of the pro-government camp around national bank president Baka worked out a programme for stabilising the Polish currency, described by Mizsei as socialist monetarism in noble simplicity (p. 311), the leftist demagogue and anti-entrepreneurial platform represented by the official OPZZ trade union prompted the re-licenced Solidarity to adopt a more militant economic position (on account of competition, too).

The Polish reform attempts between 1987 and 1989 show up two major lessons. One is political: the issue of timing is of the same weight as the merit of the steps taken (it is now a fashion to call this in question, in the concept of the big bang). It is obvious that some of the moves taken by the Baka reform committee, or particularly the Rakowski cabinet, might have been the most radical socialist reforms of all times ten or, say, five years earlier. In those early days, however, the ruling power had nothing in common with the enlightened people—Rakowski had been practically to the very last moment, both in Moscow and within his own party, a barely tolerated fellow passanger, a substitute player shouting in from outside the basline. By the time Rakowski was added to the team, it had been disrupted, and soundly beaten, which was headed for the shower, not the adversary's goal. Not even Maradona can work miracles in the 119th minute of a match and, on top of that, Rakowski had not exactly proved to be a Maradona of the Polish economy and policy (see below).

The second lesson is economic: The socialist reforms were marked in general, and the belated Polish reforms in particular, by their being partial and by narrow instrumentalist concept of the market. This appeared clearly in the theoretical works of the leading reform economist of that era, Zdislaw *Sadowski* (1990), written around that time and became tangible in the so-called price–income operation resulting in the liberation and running away of prices thus causing the downfall of the regime. The essence of the latter move—voted dawn in the referendum of November, 1987, but nevertheless put into practice from 1988 on—is that it rattles the multiply distorted relative price and income proportions into position with one firm blow after a major decision by the central authorities. It thus seeks to centrally develop a system of standards to which entrepreneurs would adapt subsequently. Well, this basic position reminds much rather of Oskar Lange, the great Polish utopian of planned economy, than of any realistically operating market economy. Under market conditions, the "correct" proportions of prices and incomes develop only later, as a result of decisions by millions of entrepreneurs, and cannot be calculated in advance because of the intricate mutual interaction of such decisions. In addition, these proportions continuously change, i.e. they are not definitive once and for all, but develop as the final reasult of a spontaneous self-correcting process. Well, the price–income operation was proceeding in an order contrary to the logic of the price liberalization, and that was no error, it was inherent the whole approach. One can thus hardly share the view of Mizsei on p. 318 that the Polish reform measures planned for October 1987 could have been regarded as the then most radical blueprint in all of Eastern Europe.

It is however, doubtless, that then technocratic approach to prices had given the first decisive initial push to Polish inflation which was only aggravated by the wage indexing won by the trade union unity front at the round table talks of March 1989 (*Kolodko* 1989). The price–income operation thus became the last straw, overturning the deadlock that had lasted since 1983 and led, following the May strikes in August 1988, to allowing Solidarity to operate legally again, and to the round table talks that eventually have shaken the foundations of the regime.

To a certain extent Kálmán Mizsei can be called a lucky person, because at the time his book ends, an era has also been concluded, as from the partially free elections a straight road had led to the systemic change where the questions are raised in a new frame of reference. The policy of stabilization pursued by the Mazowiecki government (*Dabrowski* 1991), and the privatisation launched with a new line-up under the presidential term of Walesa (*Nuti* 1991) leads to such a different sphere of issues about which one can no longer speak with a historian's sobermindedness. One question remains unanswered: that of inflation, which has remained a three-digit figure despite several reports of victory. Today it is hard to decise what had lead to the hyper-inflation in Poland in 1989: a simpleton, deliberate damage, or preparation—not lacking a doctrinary flavour—of the shock therapy? What would favour the first answer is that Rakowski had liberalized food prices preserving the trade monopolies and before privatising retail trade, while incomes were almost completely indexed. Supporting the second answer is the fact that the outgoing reform-socialist government had left an empty state treasury behind, where the main task facing the staff members at the finance ministry was to bring about a cover for their own wages in October 1989. Finally, speaking for the third consideration is the fact that the main enemy of the transition is a single shoke and whithin that of price liberalization was the huge monetary overhang, due to savings partly by the population and partly held by companies. A hyperinflation afflicting everyone in its nondescript character is a politically more tolerable mode of neutralising them than the organisation of a bureaucratic confiscation—most recently attempted by Valentin Pavlov. Therefore I am far from condemning the third aspect without reservation as done by Kolodko (1991), who stresses the third item in interpreting inflation. He is of course right in that it is rather hard to press down a high level price increase at a time of indexing and slow privatisation, especially when monetary policy is accomodative and courage to accept bankruptcy proceedings is missing for political considerations. So—while it will continue to be a matter of dispute to what extent it is the legacy of socialism and to what extent the yield of the stabilization policy pursued by the new government—the major price increase, together with its gravely destructive economic and unjust social impacts, will continue to be a travelling companion in Polish society for quite a long time.

Thus the Polish democracy is carrying an awfully heavy legacy and, beside the expert programme of Balcerowicz, the long-term thinking of Walesa duly enjoys international recognition with which he keeps the ever less popular, but indispenable "Polish Erhard" at the helm. The comprehensive crisis analysed in Mizsei's book, the contradictions presented in connection with the second economy and the development of Solidarity, and the overt pauperisation due to inflation warn us that a long road leads from overcoming the shortage economy to a modern, European market economy. We should not believe the victory reports, nor should we expect any miracles, because recovery will be a slow and painful process.

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L.CSABA

MIHÁLYI, P.: *Az NSZK gazdaságpolitikája. Elmélet és gyakorlat* (Economic policy of the FRG. Theory and practice) Kossuth Kiadó. Budapest, 1989. 195 p.

In his introduction to his book, Péter Mihályi says it is useful to study the methods and mistakes of others. His intention is to draw lessons for Hungary, both in the positive and the negative sense. The most useful methods are summed up in the second part of the book, but the first part is also worth studying: it throws light on the circumstances and the grounds from which Germany's economic miracle sprang, then goes on to clarify the reasons for the slowdown of economic growth. For example, it dispels the fallacy according to which the German economy was rehabilitated by Marshall aid. Mihályi informs the reader that $1.5 thousand of the $25 thousand million of Marshall aid went to Germany, and $3.4 thousand million went to England, and yet economic miracle followed in Germany, and recession followed in England. Another fallacy, or better to say legend, is connected with the 1948 monetary reform, of which many of us have read that it was brought about by Erhard, later to become economic minister. However, Mihályi says that the monetary reform was planned as well as put into effect by the American occupants, who also abolished rationing without even asking for the Germans' opinion. Also the biggest concerns were wound up or broken up by the Americans, and this action on their part turned out to be one of the major factors of the German miracle. The third fallacy or rather myth is that of the social market economy. Mihályi knows well and describes well this conception, which he thinks is rather a muddled political ideology. He quotes Hayek's sarcastic words, saying that nobody knows what this expression means, and what is sure only that the social market economy is no market economy, just as the social constitutional state is no constitutional state, and the social conscience is no conscience, and social justice is no justice. Mihályi is also sarcastic, though not to the same extent as Hayek. Namely, he thinks that the social market economy is in fact a market economy; however, it is a rather flexible one, i.e. well tried in practice. He says: "The social market economy is practically based on the approval of the free competition capitalist system, which the ideologues wish to strengthen by a social security network, partly with a view to mitigating adverse side effects, and partly to buy the patience of individuals and groups who are losers in the competition. Under this conception, all kinds of social welfare expenditure are considered as a necessary evil, to be minimized as far as possible and to be strictly separated from the sound body of economy.

It is to be stressed that Germany spends a lot on social welfare purposes; Mihályi mentions that such expenditure exceeds 30 percent of the GNP. The sentences quoted are intended to present a certain way of thinking, about the social market economy which is basically different from that of the ideologues of the welfare state. The former has also been tested in practice and it showed it could operate efficiently. In the golden age of the social market economy—that is, in the two decades after 1948—a liberal economic policy was pursued. Another basic principle put into practice was concerned with the stability of the purchasing power of money—in other words, there was a horror of inflation. Closely related to this was the rejection of central management of the economy. The Hitlerist command economy taught this lesson, and neighbouring East Germany also served as a deterrent. The close relationship between the two principles: inflation and central intervention, is revealed by the cases of other Western countries. During the 1950s and 1960s it became a ruling idea in many countries that unemployment can and must be prevented by means of centrally planned inflation. During that period, West Germany held on to a stable currency and free economy.

Some change followed in the 1970s, this due to the influence of three factors: first, the slowdown of economic growth in the late 1960s; second, the social democrat-liberal coalition coming to government; and third, the oil crisis of 1973.

The ruling social democrats began to apply Keynes's recipes, with a due amount of prudence. Protectionism and inflation emerged. Nevertheless, the rate of inflation in Germany remained low and much below that of other countries. Mihályi stresses the point that the adoption of the interventionist principles was much hindered by the decentralized political structure that had been established by the Americans. In 1983 a new government under Helmut Kohl again promulgated a liberal economic policy, and even its "Reaganic" version, i.e. it promised substantial tax reductions. In its actual practice, however, this government also met with the above-mentioned difficulties. Obviously, in all these changes of economic policy, prudence was an important factor, as well as a fear of social experiments. Mihályi writes: "Seeking the middle course, Germany successfully avoided a situation in which a policital party (or, even worse, a political leader) was able to commit the country to a doctrine which in five, ten, or fifteen years would be held erronous by the majority of experts. Thus Germany avoided the wave of nationalization which swept through Western Europe in the 1950s; and in the 1960s it did not fall into the Anglo-Saxon illusion that Keynesian economic policy put at the government's disposal a simple instrument with which the rate and tendencies of economic growth are easy to steer. Finally, the governing circles of the FRG were not "fooled" by the new American economic policy doctrine either; this stated that massive tax cuts would lead to an economic boom which would result in increasing budget revenues."

I. KEMÉNY

Zur Transformation von Wirtschaftssystemen: von der Sozialistischen Planwirtschaft zur Sozialen Marktwirtschaft (Remarks on the transformation of socialist planned economy into social market economy). (Arbeitsberichte zum Systemvergleich, Nr. 15); Forschungsstelle zum Vergleich wirtschaftlicher Lenkungssysteme der Philipps-Universität Marburg. Marburg, Juli 1990. III + 170 p.

The Marburg research institute, which was founded by K. Paul *Hensel* in what used to be West Germany and which has been playing an outstanding role over the past decades in publishing comparative analyses of economic systems, brought out a high-standard volume of essays and studies in July 1990 on the theoretical issues and first practical conclusions of transition from a planned into a free market economy. The brief introductory note by Alfred *Schüller* and Hans-Georg *Krüsselberg* reveals that the volume was meant to greet Professor Hannelore *Hamel*, an outstanding contributor to the Marburg school's activity, on her 60th birthday. It also was to offer a solid scientific analysis of the problem in view of the "lack of an interdisciplinary and empirically backed up theory of the (ongoing) changes in the (political and economic) systems" in Easter Europe (p. I). To the slight disappointment of the Hungarian readers, neither the theoretical studies nor the writings assessing the first practical conclusions and tasks to be done go deeper into analyzing the peculiarities of the Hungarian economic mechanism. This tangential approach may well be considered deplorable if we consider that the economic reforms that were launched in Hungary in 1968 have brought about a markedly peculiar combination of the planned and the market-based economies. (It should also be noted here that the volume remains similarly sparing in its description of the other characteristically unique economic and political system in Eastern Europe, Yugoslavia. True enough, references to the country recur in the book, but mostly as a deterrent example for the "third road" policy.)

Accordingly, and following from the Marburg school's intellectual traditions, the studies in the volume concentrate primarily on those countries which had implemented and practiced centrally planned economy for the longest while and/or with the greatest consistency. Thus the volume focusses primarily on the changes that have been implemented in the economic systems of the Soviet Union and East Germany. There are only three studies in the volume which do not fit into this mould. Krüsselberg's essay is based on a theoretical–historical approach. Wladislaw W. *Jermakowicz* contributed a highly informative comparative analysis of the initial stages of the German and Polish "social market economies", and Helmut *Leipold* assessed the experiences of the privatization and deregulation policies of the Thatcher government.

The title of the volume gives a clear idea of how the majority of the contributors viewed the origins and projected conclusions of the on-going restructuring processes in Eastern Europe. The point of departure for the countries in the region intent on introducing new political and economic systems is the socialist planned economy. Hensel, who began his scientific career at the University of Freiburg, and also his adherents were bent on terming this phase as "Zentralverwaltungswirtschaft" (centrally directed/managed economy), while in the Hungarian economic terminology this is most often referred to as the (traditional) system of planned economy based on plan directives (instructions). According to the Marburg researchers, the countries at issue should ultimately develop social market economies patterned on the West German model. This economic formation has different readings in the countries of the region, but its popularity is clearly on the increase. The special feature of the social market economy, as the appendix to Schiller's study explains, is that it represents a kind of middle course between the American type of "capitalist market economy" and the Swedish "welfare state market economy", with a leaning for the latter (pp. 22–23). This projection by and large dovetails with the ideals of those politicians, economists and publicists who are considered the propagators of social market economy in Hungary. However, there is need to stress that the economic policy which West Germany implemented at the dawn of its social market economy in the late 1940s was marked by the prevalence of monetarist traits rather than by a pronounced enforcement of the social viewpoints. In his study referred to above, Jermakowicz dwells longer on this point.

In the first study of the volume (Probleme des Übergangs von der Staatswirtschaft zur Marktwirtschaft), Schüller points out that a precondition to the transformation into any of the above-mentioned forms of market economy is the elimination of the four basic pillars of the Soviet-type centrally planned system (democratic centralism, central planning, state ownership, state monopoly in foreign trade). In his analysis of the history of "perestroika", the Soviet reform process, Schüller rightly points out that the "transformation-illusionists" (p. 7) are wrong when they argue that the transformation into the market economy must be preceded by the stabilization of the economic situation, or else the price the society has to pay will be way too high. In fact, this reasoning sets a precondition to the transition which actually cannot be met. In Schüller's opinion, also those efforts do not yield any solution which the East European reformers have been trying to implement for decades now. With differing intensity and emphasis, these schemes were all designed to bring the economic systems to "perfection" (through the democratization of planning; combination of direct and indirect methods of macro-economic management and a simultaneous replacement of the direct methods with the indirect ones; phased reformation of the individual sectors of the economy; substitution of state orders for the central plans; free sale of the goods produced "above the plan"). Let us cite here another train of thoughts from Schüller's study, which focuses on the relationships that exist between the choice of an economic system and the operation of a pluralistic political system which replaces the one-party dictatorship/hegemony. According to Schüller, it is far more difficult to establish a promising parliamentary opposition in a system where the governing party exerts a determinative influence on the transformation of the economic processes and the economic structure. Consequently, those "third road" proposals that wish to combine political pluralism with a strong state control over the economy (either according to the traditional socialist pattern or in a way common in the welfare states) can justly be suspected of posing a potential threat to the parliamentary system.

Krüsselberg's study (Adam Smith und die Deutschen: Gedanken zu den ethischen Grundlagen von Wirtschaftssystemen) tries to establish ideological and theoretical-historical links between the first major wave of liberal economic thought—more specifically the economic philosophy of Adam *Smith*—and the world concept (Weltanschauung) of those German scholars with whom the conception of the social market economy originated. On the one hand, Krüsselberg points out that the "great simplifiers" are wrong when they attribute the speculation to Smith that "the (enlightened) selfinterest finds its own justification *quasi* in itself, as it increases general welfare amidst such a selection process where the stronger take the upper hand over the weaker, and where the care for the weaker is considered both inexpedient and morally unadvisable" (p. 31). In fact, the sequence of Smith's works also indicates that the focus of his interest had always been the mutual interrelationship among the system of values, the legal and state system and the economic system. On the other hand, Krüsselberg also delves deeper into the ideas of the German thinkers who belonged to the Freiburg school of the second third of the 20th century (*Eucken, Müller-Armack, Erhard* and *Röpke*, whom he also classifies with them), and finds that the moral foundations and moral justification of a free market economy were priority issues for them as well. As a result of the economic and political integration of the eastern provinces, millions of Germans are confronted with an unfamiliar institutional framework and with new systems of values. Krüsselberg is of the opinion that the digestion of these new experiences and the identification with the new institutions could be greatly facilitated by the comprehension and acceptance of the moral–philosophical foundations of the market economy.

In his study entitled "Zur Funktion der Zentralverwaltungswirtschaft als politisches Herrschaftsinstrument", Karl von *Delhaes* seeks an answer to the highly intriguing question of "how could a system so obviously incompatible (at least in retrospect) with the requirements of a modern national economy survive for such a long while?" (p. 41). Delhaes establishes that the hopes originally attached to the socialist economic systems—which in fact had a measure of legitimacy at the outset—had soon proved to be unfounded—except for the promised guarantees of job security. The author subscribes to the thesis that the drive to maintain the "administrative form of socialism" in the East European countries can be explained by the Soviets' pursuit of hegemony. In the Soviet Union, however, "this system must have offered such advantages to the decision-makers which could offset, over a longer period of time, the costs they had had to reckon with owing to the low economic efficiency of the system." (p. 42). Quoting excessively from the documents of the first decades of Soviet party and economic history, Delhaes concludes that the establishment, maintenance and even the recurrent reformation of the extremely centralized economic system served mere political goals. (The author finds confirmation in the changes that were introduced in the Polish and East German systems of macro-economic management in the 1950s and 1960s, and also in the "international socialist division of labour" in the frameworks of Comecon.) This way of reasoning is undeniably plausible for those readers who think in the hardly definable terms of the bolshevik/communist party, the nomenclature, or the political élite. However, the findings of those economic sociologists and political scientists who have undertaken the analysis of the past decades of socialism in Hungary lead us to conclude that the power structure was far too complex and multi-faceted to permit a simplified, schematic description based on the dichotomy of party members and non-party members, or leaders and subjects. There is no ground to presume that—apart from the years of extreme dictatorship—either the Soviet Union or the small East European countries with centrally planned systems have until recently lacked this kind of articulated interest and complex power structure, although of different extent. Consequently, we believe that Delhaes may well be right, in a first approximation, when he states that the centralized system of macro-economic management could endure for decades just because it was a means of maintaining political dictatorship/hegemony. And yet, we feel the need to learn more about the interest relations, the power structure and the formal and informal institutions of the "every-day" form of socialism if we want to understand the mechanism of the East European systems, and also the timing, extent and way of their collapse.

Professor Gernot *Gutmann* of Cologne, whose intellectual approach is far from alien to that of the Marburg school, bases his study (Euckens konstituierende Prinzipen der Wirtschaftspolitik und der ordnungspolitische Wandel Osteuropas) on the above-mentioned premiss that neither the West nor the East has developed yet a comprehensive theory on the ways and means of transition from a political dictatorship and a centrally planned economy into democracy and a market economy. And yet, Gutmann continues, the German economists at least have at their disposal (ordnungspolitische) recommendations on the ways in which an economic system should be organized. There were worked out first of all by Walter *Eucken* key principles of creating a market-based economic competition. Are these recommendations relevant to the ongoing transition process in Eastern Europe, or should we treat them as pertinent to the Germany of the late 1940s only? Seeking an answer to these questions, Gutmann finds that Eucken's comprehensive work, *Grundsätze der Wirtschaftspolitik*, which deals with the basic conditions of a market economy, spelled out the same principles of economic organization which the pioneer countries of the East European transition process are now striving to implement (free prices, private ownership, financial stability, freedom of contract and contractual responsibility, regulated competition, etc.)

From among the works published in this volume, the reviewer's interest was captivated the most by Jermakowicz's study entitled "The beginnings of social market economies in Germany and in Poland". The author, who is based in Evansville, USA, contrasts the experiences gathered by the Germans in the late 1940s during the introduction of a currency reform and elimination of controlled economy with those the Poles accumulated during the first months of their economic stabilization and restructuring drive in 1990. In his comparative study, Jermakowicz deals with the essential conditions, the international environment, the economic policy concepts and their effectuation, and also with the similarities and differences between the lessons from the two specific cases. One noteworthy conclusion of the author is that while in 1948 Ludwig *Erhard* and his colleagues introduced a system based largely on free market principles in an international, or more specifically European, environment which was highly sympathetic towards planning and state intervention, in 1990 Leszek *Balcerowicz* launched his similarly free market-based concept amidst a growing interest worldwide in liberalization and deregulation. (Let me just add here that prior to his appointment, Balcerowicz had spent a while in West Germany studying Erhard's economic policy.) The programmes of both Erhard and Balcerowicz included measures aimed at stabilizing the economy and restructuring the system. However, while the situations in Germany and in Poland were rather similar in that in both countries the (real) economy was highly disintegrated, there is no denying that Erhard was in a much more advantageous position as regards restructuring of the system of economic institutions. Germany had already had the basic institutions of a market economy at its disposal (private ownership, capital markets, banking system, etc.) and "all" Erhard had to do was to breathe new life into it, whereas in Poland these institutions had to be established simultaneously with the economic stabilization. As regards privatization, the situation in Poland (and in Eastern Europe in general) is without parallel in history. Among other things, Jermakowicz ascribes to this difference the fact that while Germany witnessed a boom in economic performance in the wake of the introduction of the currency reform, the Polish economy had to suffer an unprecedented recession during the first few months of the stabilization programme. In Germany, the cutting of the nominal money supply (i.e. a currency reform) was considered a remedy for braking inflation and for drawing excess money out of the economy. In Poland, the almost complete liberalization of prices (i.e. corrective inflation) was chosen while keeping the money supply unchanged. Neither Germany nor Poland attempted to remove the excessive money though selling out state property. Germany simply did not have enough state-owned assets for this purpose, while in Poland there were political and social considerations, as well as the protracted preparations, that prevented a serious consideration of this alternative. Jermakowicz considers this the major deficiency of the Polish programme. There are two more conclusions of the author worth quoting here. 1. It is indispensable for the successful execution of the economic reforms that the government work out a detailed, thoroughly-organized action-plan. 2. The Polish example shows that "it is easier to stabilize the financial situation than it is to make institutional changes" (p. 96). In view of the sympathy that surrounds the Balcerowicz programme in the international financial community, this conclusion also means that if those East European countries which can boast of a relatively stable economic situation procrastinate about answering the conceptional questions that come up in the course of the restructuring of their system, they are bound to lose the potential advantage which they had had in the region at the outset of the current reforms.

The peculiarity of the Bochum-based H. Jorg *Thieme*'s high-standard study (Währungsunion in Deutschland: Bedingungen, Chancen und Risiken) is that the author closed the manuscript prior to the introduction of the German currency union on July 1, 1990. The time that has elapsed since then enables us to subject Thieme's speculative ideas and recommendations to empirical tests. Thieme starts out from the question of whether the currency union, which was (to be) implemented hastily due primarily to political reasons, will facilitate the economic integration of the eastern provinces, or it should instead be seen as the "sacrifice of economic rationality on the ... altar of political pragmatism" (p. 114). Weighing the risks involved in the speedy currency union, Thieme attaches great importance to the exchange rate to be applied. (We should not forget that Thieme's work preceded the actual implementation of the currency union, only its date was known.) The author considers the idea economically wrong that the exchange rate should be adjusted to certain social considerations. He argues that such a move would—mistakenly—lay a social policy duty on the central bank, whereas it should rather watch over the country's financial stability. The accidental unfavourable social effects of the economic accommodation processes must be alleviated by the budget and not by the central bank. Should the Bundesbank retain its traditional role of providing monetary guarantees to economic stability, and should the economic and social unions be implemented as fast as the currency union was, then Thieme says the "introduction of the 'hard DM' in East Germany would surely amount to a major trump in prompting efficiency" (p. 115).

Ulrich *Fehl*'s paper deals with one of the major prospective consequences of the economic integration of the eastern provinces, namely with the already launched transformation of the size structure of the companies (Einige Überlegungen zur Betriebsgrossenstruktur der DDR-Wirtschaft angesichts des Übergangs von der Zentralverwaltungswirtschaft zur Marktwirtschaft). The message of Fehl's study is, of course, relevant not only for what used to be East Germany but also for all the other countries of Eastern Europe, since they all had planned economies and thus they all have had to cope with an extremely concentrated company size structure, with the relative lack of small and medium-sized companies, and with the so-called reversed company pyramid. Fehl devotes the first half of his paper to a search into the reasons for this situation, and also to the description of its East German variant. Then he gives an outline of two theories which try to explain the changes in the company size structures under market economy conditions. The first theory holds that there are certain causal relationships of "optimal" company size structures within each economic branch around which the actual structure fluctuates. The other theory rejects this *ex ante* definable optimum, arguing that the permanent changes in the market processes create an infinite variety of company size combinations. Subscribing to the latter opinion, Fehl establishes that in the transforming economies of Eastern Europe "transition ... to the market-based company structure can take place only on the basis of the operation of market forces. Accordingly, those preconditions must be created first which enable the operation of such a system" (p. 125). At the same time, the fact that the "withdrawal" of the state from the economies in Eastern Europe (and more specifically in the former East Germany) cannot be realized without the active participation of the state itself also means that a major role will be played by the state property agencies charged with the privatization of the state's assets, and also by the anti-trust authorities watching the fairness of competition, in shaping the (future) company size structures (as well). Moreover, Fehl stresses that the government departments may well play a major and positive role in this process, by appropriately supporting the small and medium-sized companies, and especially the new enterprises.

Leipold's study (Die Politik der Privatisierung und Deregulierung: Lehren für die Wirtschaftsreformen im Sozialismus) starts out from the premiss that the Eastern European countries can learn the most about "how the economy can be rid of state dominance and how private initiative can be strengthened" (p. 133), apart from the economic historical example of the establishment of social market economy in West Germany, from the privatization and deregulation policies that were pursued in the West, and especially in the United Kingdom, in the 1980s. Surveying the British experiences, Leipold dwells in detail on the aims, methods and achievements of privatization. He states that the British have managed to attain the goal of relieving the state budget of its burdens: between 1979 and 1989, the gross privatization-related proceeds of the British treasury amounted to 25 billion pounds (and there were an extra 15 billion pounds rolling in from the sale of council flats), and the net proceeds were just 2–9 percent lower. There were other advantages as well, which are impossible to quantify but are highly probable to occur: by way of example, let us mention the surplus tax receipts from the privatized (or just reorganized but still state-owned) companies and from the small enterprises, which are bound to mushroom as a result of the deregulation drive, or the savings resulting from cutting the subsidies to the loss-making state-owned companies. The British economic policy has been second to none in the international field: while the governments of most of the major western states accumulated sizeable debts in the 1980s in the UK the indebtedness perceptibly diminished. Simultaneously, they managed to reduce the proportion of the tax revenues relative to the GDP, and the structure of their tax system has become more of a stimulant to production. From among the less positive aspects of the British example, Leipold chose to highlight the fact that the marked drive to privatize the state-owned companies was not followed by likewise distinct deregulation measures which could have introduced new actors to the market competition.

The issue of the social tensions that inevitably accompany the economic transition in Eastern Europe is tangentially mentioned in a number of the studies in the volume. In his paper, Reinhard *Peterhoff* undertook a more detailed analysis (Die Bedeutung der Sozialpolitik im Systemwandel). To illustrate his point, the author cites examples primarily from East Germany, Poland and the Soviet Union. It clearly emerges from Peterhoff's study that the transition into free market economy in Easter Europe requires a completely new system of welfare policy institutions. This system equally entails new and untested organizations and methods (for example in managing mass unemployment), and also appropriately restructured forms of the already existing institutions (e.g. pension- and health insurance). Complementing these basic institutions are the "social ≪first aid measures≫" (p. 165), which are meant to sweeten the bitter pill of transition, and also to provide social policy buttresses to the economic reform. Quoting examples from East Germany and Poland, Peterhoff also points out that adoption of the values of a free market and of the welfare policy common in the market economies is a process replete with problems. After all, it is not easy for people accustomed to state directives and tutelage to adapt to a situation where they are responsible for their own fate, and where it is up to them to exercise their freedom and exploit a relatively wider scope of choice. Peterhoff believes that the state-owned institutions have to engage in an extensive explanatory campaign, and have to apply "political persuasion" (p. 165), if they want to make people understand and accept the operational peculiarities of the free market economy, and the connections between production and distribution.

Although not simultaneously, all the countries of Eastern Europe have already begun to move away from the socialist planned economy of yore. In most countries, the aim today is to establish (social) market economies similar to those of Western democracies. However, the studies in the volume rightly point out that there are no beaten tracks that lead from one social, economic, political and value system into another, and so those who want to make this transition will need patience and persistence to accomplish their historic goal.

L. G. TÓTH

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TWO APPROACHES TO THE TRANSFORMATION IN EASTERN EUROPE: THE "BIG BANG" VERSUS "SLOW BUT STEADY"

I. ÁBEL—J. P. BONIN

In this paper we focus on three aspects of stabilization and international integration, namely, the real wage, inflation, and the real effective exchange rate. Using empirical evidence on inflation and the real effective exchange rate, we evaluate the gradualist option represented by the Hungarian reforms. The prospects for continuing a program based on a real exchange rate anchor supported by a crawling peg tied to a basket of convertible currencies is assessed. These issues are compared with the experience of Poland, which is considered to be an example of shock therapy using a nominal anchor.

Introduction[1]

Full integration of the East European transforming countries into the global economy became even more immediate with the dissolution of the former CMEA agreements beginning in January 1991. The timing of convertibility and trade liberalization takes on new urgency. Yet a lack of consensus on major aspects of trade policy leaves these countries with but one more situation in which the waters embarked upon are currently uncharted. Like the stabilization debate, the options seem to be shock therapy or gradualism. Although the former is attractive if for no other reason than the demands of expediency, the latter may be preferable if lasting strides toward full liberalization are desired.

Convertibility is taken in its broadest sense to include currency convertibility, the exchange rate regime, and liberalization of foreign trade. An important initial task is establishing a precise definition of currency convertibility. *Williamson* (1991) discusses the difference between the Western and East European concepts. The former distinguishes unrestricted convertibility which allows unrestricted capital flows from *current account convertibility* which requires that no restrictions be placed on obtaining currency for current account transactions including tourism and the repatriation of foreign investment incomes. The latter distinguishes internal convertibility which is the right of domestic residents to exchange currency at official rates from external convertibility which gives the same right to foreigners.

[1] This paper is a summary of the joint research conducted under the auspices of CEPR's research project on *Economic transformation in Eastern Europe* and the MTA OTKA's research project on *Fiscal and monetary policy during the transition to market economy.* Financial support from the PEW Charitable Foundation and Wesleyan University is gratefully acknowledged.

In this paper we focus on three aspects of stabilization and international integration, namely, the real wage, inflation, and the real effective exchange rate. Our purpose is to analyze the Hungarian reforms, which is often called the slow but steady approach. Using empirical evidence on inflation and the real effective exchange rate, we evaluate the gradualist option. The prospect for continuing a program based on a real exchange rate anchor supported by a crawling peg tied to a basket of convertible currencies is assessed. These issues are compared with the experience of Poland, which is considered to be an example of shock therapy using a nominal anchor.[2]

The significance of stabilization and convertibility

Consensus and experience indicate that macroeconomic stabilization is a necessary first step along the road to transforming the previously bureaucratically managed economies of East Europe into (mixed) market economies (see *Blanchard et al.* 1990, *Blommestein and Marrese* 1991, *Greene and Isard* 1991, *Kornai* 1990, *Lipton and Sachs* 1990a, b, *Blue Ribbon Commission* 1990 and *Bridge Group* 1990 for overviews of the general issues). Does stabilization require shock therapy? What can we learn from Hungary, a country in which the macroeconomic imbalance never reached the crisis proportions found in Poland?[3]

The timing of currency convertibility remains an open question in the debate over the proper road to a market economy for the East European countries. Kornai (1990a) favors full liberalization of the private sector, a notion that approaches unrestricted convertibility. Yet Hungary's experience with opening up the travel account in 1989 led to the re-imposition of stringent controls on households.[4] Current account convertibility combined with a prohibition on capital outflows may require some limitations on households to prevent the circumvention of the capital account constraint. As Greene and Isard (1991) note such restrictions are hard to enforce and capital flight has sometimes occurred even in the absence of capital account convertibility. As Kornai (1991b) cautions, the imposition of a hard budget constraint is a precondition for allowing enterprises to purchase foreign currency.

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[2] The Balcerowicz-Sachs program started in January 1990 initially used a fixed exchange rate as a nominal anchor. In May 1991 the Zloty was devalued by 14.5 percent and the Polish exchange rate policy is now more similar to the Hungarian crawling peg approach.

[3] Williamson (1991) claims that: "The main lesson of the Hungarian experience seems to be that gradualism does not deserve the contemptuous dismissal that it has tended to receive in much recent discussion. Under certain circumstances it does provide a feasible road to reform." (p. 73)

[4] From a net surplus of \$41 million in 1988, the travel account in the convertible currency balance of payments deteriorated to a deficit of \$447 million. The government responded by suspending, on November 3, official foreign exchange allowances to households for travel purposes until November 20, 1989 at which time a new system of foreign exchange allocation was introduced limiting Hungarian residents to a foreign exchange allowance of \$300 for a four-year period.

After macroeconomic stabilization is attained and while restructuring accompanied by privatization is proceeding at a natural pace, what are the proper policies to adopt regarding the integration of these countries into the global economy? Most commentators agree on the importance of export-led growth as the primary engine of economic expansion and the necessity of direct foreign investment to revitalize industry. However, no consensus emerges concerning the appropriate exchange rate regime or the extent and timing of trade liberalization. Should an undervalued fixed exchange rate like the one used as the nominal anchor in the Polish stabilization program be retained during the interim (medium) term? Is Hungary's managed exchange rate and gradualist approach to convertibility a more appropriate strategy? Should protectionist policies be adopted to afford companies the opportunity to adjust to world market prices or is full liberalization accompanied by foreign competition for domestic markets necessary to insure the importation of the correct price structure? How quickly should foreing trade be liberalized?

McKinnon (1991) focuses on the irrationality of enterprise input choices based on price signals in the old system and claims that, if costs are calculated based on world market prices, many of the existing domestic producers are value-subtractors as the material used is worth more then the final product. Not only would these companies be vanquished quickly by foreign competition if trade were fully liberalized; they would also be unaided by currency devaluation because such a policy would increase the costs of the necessary inputs that they purchase from abroad. Consequently, McKinnon supports interim protectionist measures in the form of cascading tariffs to allow the more able of these companies to adjust to the new (world-market) prices for inputs. Then, he argues, Eastern Europe will avoid the immediate (and severe) foreign exchange shortage that would accompany instant liberalization and have deleterious effects on exchange rate policy.

According to *Portes* (1991), a commitment to early convertibility of the currency raises the stakes and enhances policy-makers' credibility. *Blommestein, Marrese and Zecchini* (1991) support current-account convertibility at an early stage in the transformation to expose domestic producers to foreign competition. Sachs and Lipton (1990a) based the Polish shock therapy on trade liberalization and a nominal exchange rate anchor designed to import such competition from abroad and blunt the monopoly power of producers in highly concentrated domestic industries. *Nuti* (1991) disagrees on both counts; he supports a real (rather than nominal) exchange rate anchor and slower progress toward liberalization. For Nuti, the sluggish domestic import and export price elasticities that are legacies of the old system constrain the speed with which currency convertibility and trade liberalization should be pursued. Nuti is also skeptical of these countries' ability to defend a nominal exchange rate for any reasonable period of time.

Several strong arguments have been advanced against a freely floating exchange rate for the transforming countries, at least in the medium term. *Bofinger* (1991) poses the following dilemma; a compatible monetary policy is a necessary condition for floating yet its basic components (e.g., demand for money, propensity to save) are extremely unstable in these countries. Williamson (1991) claims that a floating exchange rate can function effectively only in the presence of well-developed capital markets which these countries lack.

The argument in favor of a fixed exchange rate is often associated with the Polish stabilization program in which this nominal anchor was designed to import a rationale structure of relative prices. However, fixed exchange rates are credible only if they are defensible. The Polish devaluation of the Zloty by about 14.5 percent in May 1991 casts doubt on the feasibility of defending a fixed rate over the medium term even with substantial support from the international financial community (which Poland received) and even when the rate chosen initially is significantly *under*valued to improve the chances of defending it. Indeed, the latter condition is problematic since the benefit of international competition accruing from convertibility is blunted if the exchange rate is seriously undervalued. Moreover, the change from an overvalued to a significantly undervalued exchange rate induced an inflationary shock in Poland, the legacies of which seem to be continuing inflation.

So what exchange rate regime should be chosen after macroeconomic stabilization has been achieved in a transforming country? Williamson (1991) favors a crawling peg tied to the ECU, a policy that requires periodic devaluations to offset any inflation differential with the EC countries. Since the latter half of the eighties, Hungarian exchange rate policy can be viewed as choosing a real exchange rate anchor and supporting it by a crawling peg policy of periodic devaluations to offset differential inflation. Consequently, the Hungarian laboratory beginning in the mid-eighties provides useful insights for evaluating Williamson's crawling peg proposal in the context of a gradualist program toward convertibility.

The crawling peg: an assessment of Hungarian exchange rate policy

The official exchange rate in Hungary is (and has been throughout the eighties) somewhat overvalued despite periodic devaluations. The National Bank of Hungary (hereafter, NBH) pursues an exchange rate policy in which the forint is pegged to a basket of ten convertible currencies with a large weight given to the U.S. dollar. In 1989, the central bank's scope of authority to adjust the peg was increased from a margin of plus and minus 1 percent to one of 5 percent. From January 31 to February 21 of 1990, NBH devalued the forint in three steps by the maximum allowable amount, bringing about a moderate decline in the real effective exchange rate. In *Figure 1* we plot the *real effective exchange rates* for Hungary and Poland from 1988–1990 and establish the relative non-volatility of the Hungarian rate. By definition, the IMF real effective exchange rate index rises when the rate of inflation in domestic currency exceeds the weighted average of the inflation rates of

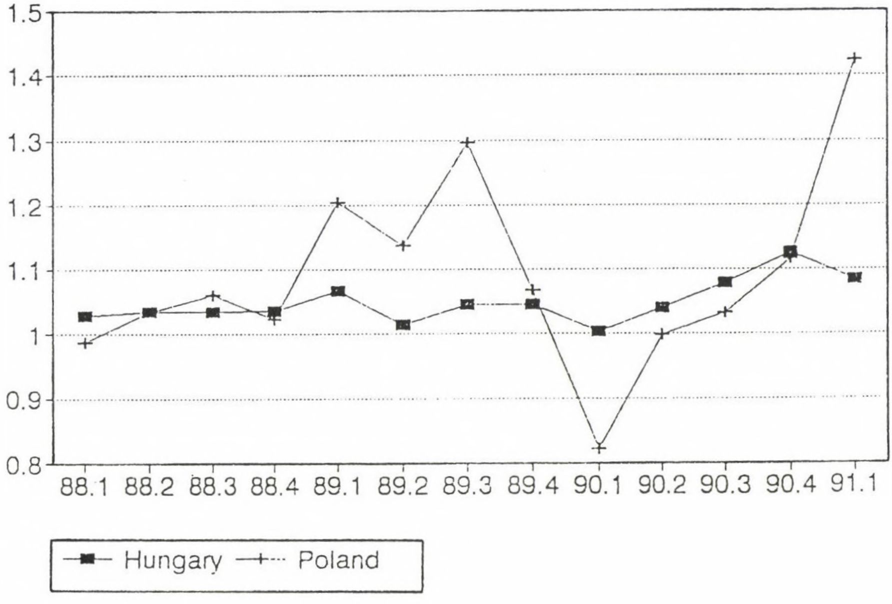

Fig. 1 Real effective exchange rate 1987.Q4=1

Source: IMF (1991)

a country's major trading partners. Such a rise may signal the need to devalue the domestic currency. When tracked over time, the real effective exchange rate should indicate the degree of over (or under) valuation of the domestic currency. Therefore, it is both an important signal for policy makers to monitor and an important indicator of the fundamental equilibrium exchange rate.

Charting the real effective exchange rate by quarter from 1988 to 1990 indicates that the NBH maintained fluctuations within a relatively narrow band of 2.5 percent. Exchange rate policy in Hungary for the past three years appears to be consistent with a real anchor approach. However, the nominal rate remained somewhat overvalued in 1990 and the forint was still supported by some exchange controls. At the end of 1990, only 10 percent of Hungarian imports appear on the list of restricted goods and services. With import liberalization almost completed, the Hungarian forint is mostly convertible for domestic corporation wishing to buy foreign goods and services (*Bokros* 1990). However, the NBH still maintains control over foreign exchange transactions. Domestic nonfinancial institutions generally do not have the right to hold foreign exchange accounts or to retain a portion of their export earnings in hard currencies. To maintain a relatively high level of reserves to support the financing requirements of the foreign debt, the NBH has the exclusive right to buy these receipts in 1990.

Currency convertibility was established as a medium-term goal of the official government gradualist program. In the second half of 1991, the NBH established a domestic interbank foreign exchange market. Instead of forcing companies to relinquish their foreign exchange earnings from export activity, the central bank now must purchase the hard currency it needs to service the debt from the commercial banks. At the same time, the commercial banks sell hard currency to their corporate customers to purchase imports. This internal market has virtually eliminated the premium in black-market in hard currency transactions. Currently, the black-market exchange rate is about \$1 to 79–81 forints while the official rate is about \$1 to 78.53 forints or about only a two and one-half percent differential.[5]

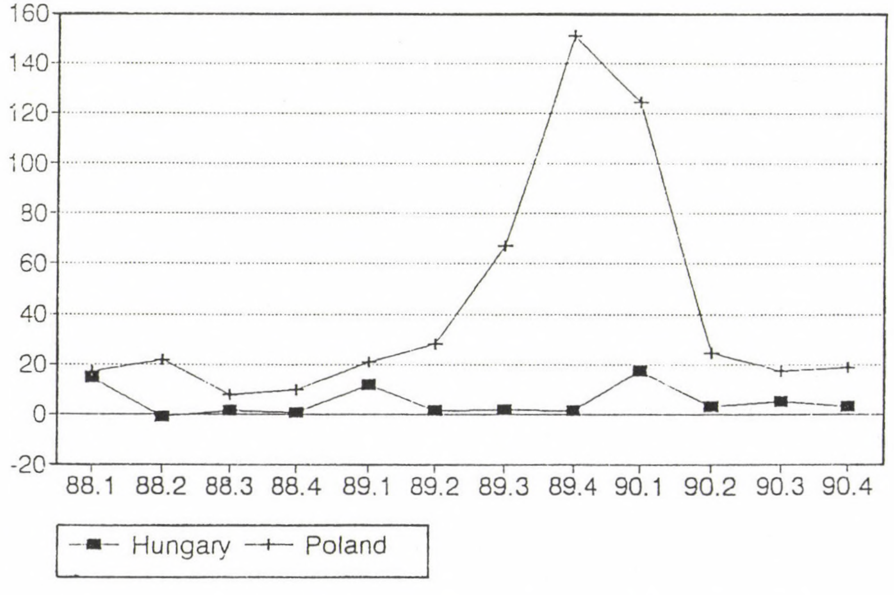

Fig. 2 Consumer price index (Quarter-to-quarter changes in percent)
Source: IMF (1991)

What was the rationale for a gradualist program toward currency convertibility in Hungary? When exchange controls are removed from the business sector, more frequent and more severe devaluations may be required to maintain the real exchange rate anchor if inflation is not under control. Hungarian experience with

[5] *Figyelő*, August 1, 1991.

inflation during the eighties can be divided into two periods, one of moderate inflation (1980–1988) and a period characterized by accelerating inflation (1988–1990). Using quarter to quarter changes we considered inflationary pressures in Poland and Hungary during this latter period (see *Figure 2*). While inflation builds to hyperinflation in Poland by the middle of 1989, inflation in Hungary is characterized by first quarter spikes in each year followed by much smaller changes in the subsequent three quarters (single-digit on an annual basis). We conclude that much of the inflation in Hungary during this period is due to a series of one-shot price adjustments that coincide with price liberalization but are not accompanied by any mechanism for transmitting the inflationary spikes into accelerating (or hyper) inflation. One explanation focuses on the Hungarian authorities tax based incomes policy to control the growth of the nominal wage bill. This policy is reflected in a relatively stable and slightly declining *real wage* during this period.

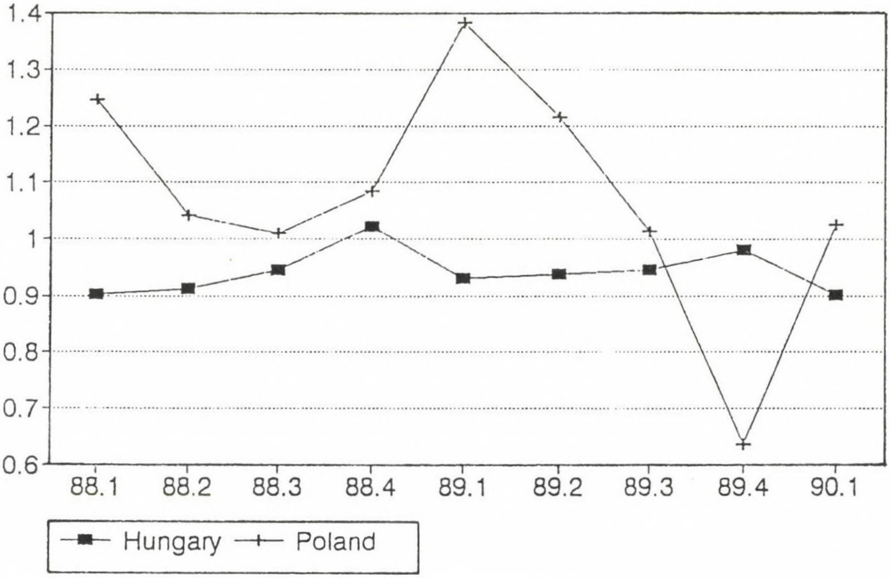

Fig. 3 Real wages 1987.Q4=1

Source: IMF (1991)

As *Figure 3* indicates, the real wage drops significantly in the first quarters of 1988 and 1989 due to the spurts of inflation and only returns to its fourth quarter level as each year progresses. *Hillman* (1990) argues that nominal wage discipline has been sufficient to control real wages during this period in Hungary (p. 59). By contrast in Poland, real wages reach a peak in the first quarter of 1989 at what Gomulka argues is 30 to 40 percent above economically sustainable level (*Gomulka*

1990, p. 132). The real wage is also more volatile in Poland both before and after stabilization.

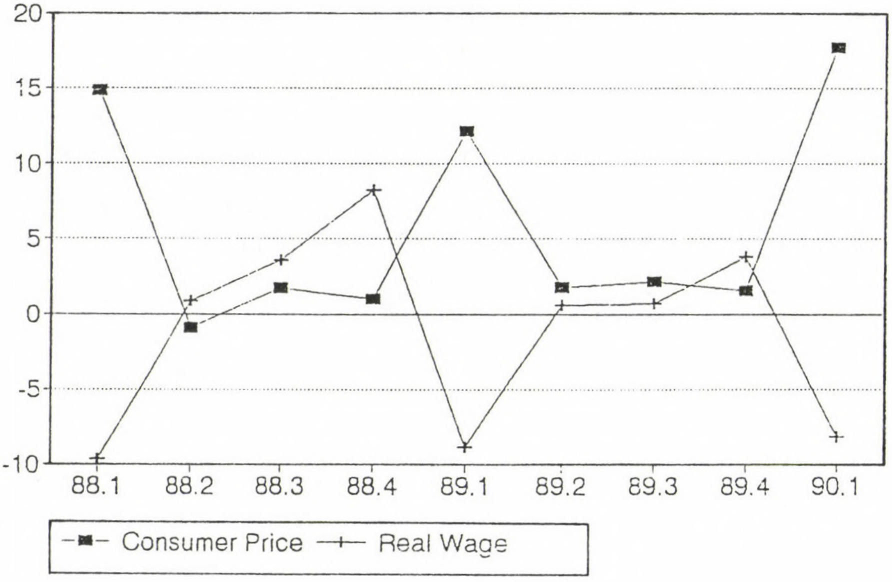

Fig. 4 Consumer price and real wage, Hungary (Quarter-to-quarter changes in percent)
Source: IMF (1991)

Figures 4 and *5* relate quarterly changes in real wages to quarterly changes in the consumer price index in Poland and Hungary. For most of the period, the changes in the two rates are inversely correlated in Hungary. The data is consistent with the wage discipline explanation. In Poland, little correlation is observed. In conclusion, wages do not seem to be a transmission vehicle for accelerating inflation in Hungary during this period. Rather price liberalization in a shortage economy is the major contributing factor to the inflation in the later part of the period in Hungary.

The equilibrium exchange rate and the macro balance

The NBH's adoption of a gradualist program toward currency convertibility is based primarily on its concern for meeting its foreign debt obligations given the extremely thin existing financial markets. Hungary has accumulated substantial foreign debt over the past decade. The government liabilities to the NBH pay a

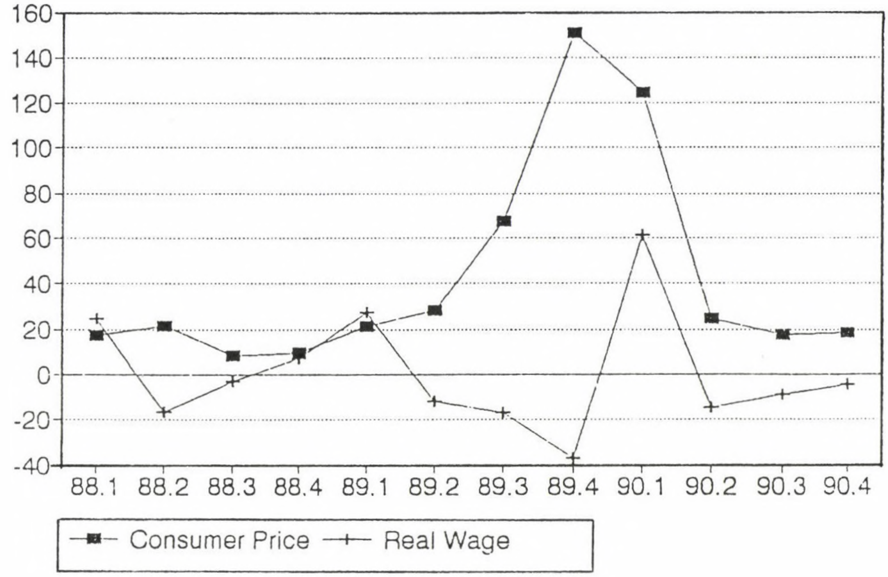

Fig. 5 Consumer price and real wage, Poland (Quarter-to-quarter changes in percent)
Source: IMF (1991)

below-market, forint-denominated interest rate. The NBH in turn is responsible for meeting the foreign currency requirements of the debt service which in 1991 will be about \$4.1 billion, \$2.4 billion of which is principal repayment.

To assess the debt servicing concerns of the NBH, we used a macro model in Ábel and Bonin (1991) describing the linkages between the current account deficit less direct foreign investment and the stock of foreign debt. The analysis based on this model shows that although depreciation of the forint may lead to an improvement in the trade balance once the price-responsiveness of Hungarian companies is sufficient to blunt any J-curve effects, depreciation will also increase the burden of servicing a foreign currency-denominated debt. It is an important empirical question which effect will dominate the current account.

The importance of *foreign direct investments* in macro stabilization of heavily indebted transforming economies lends special importance to often neglected issues of financing their debt and the potential influence of privatization on capital markets.

The privatization issue is a good example of the "chicken-egg" problem in transforming from the socialist planned or bureaucratically managed economy to a capitalist market economy based on private initiative. Without the appropriate infrastructure and property rights legislation, the road to privatization is fraught with potholes. In all of the transforming countries, forces against privatization and in favor of renationalization and state administration have arisen. This backlash is often supported by a *reductio ad absurdum* argument. Foreign ownership is unacceptable for the usual nationalistic reasons. Wealthy domestic buyers are tainted by either previous ties to the old regime (nomenclature) or profiteering in black markets to acquire their wealth. The conclusion is to return state assets to the government for custody during the period necessary to educate a new managerial/entrepreneurial class.

Even among groups sympathetic to privatization in these countries, proposals are often ill-conceived and practices often amount to little more than selling state assets at bargain-basement prices in transactions that involve abusive insider trading. Proposals to distribute state assets to the general populace using a voucher system and follow-up auctions are likely to have little impact on the agency incentive problem. The object of privatization should be corporate restructuring not wealth redistribution. Conventional wisdom indicates that takeovers play an important disciplinary role against managerial malfeasance in Western stock markets. Yet the existence of independent corporate raiders in the emerging nascent stock markets in the transforming countries seems to be decades away.

The fiscal budget and the transformation

In many of the transforming countries, the inflationary pressures from price liberalization are exacerbated by conditions of excess aggregate demand. For this reason, two phases of the transformation may be distinguished. In the first, monetary stability and fiscal balance are sought accompanied by a manageable balance of payments position. In the second phase, industrial restructuring and reform of ownership and property rights are key issues. Monetary overhang is often referred to as the major problem encountered in the first phase. Somewhat ironically, the major difficulty encountered in the poststabilization phase is a lack of domestic savings to support enterprise privatization. The household savings rate is remarkably low averaging less than 1 percent of GDP up to 1990. This ratio increases to over 4 percent of GDP in 1990 (OECD 1991b). The apparent contradiction between monetary overhang from too much accumulated savings and a lack of domestic financing for privatization within a reasonable time horizon goes unaddressed. The real problem is neither too much or too little savings but the lack of appropriate financial intermediation which is needed to channel savings to proper use in the economy.

In Hungary, the root of inflationary pressure lies in the size of fiscal intervention rather than the monetary overhang. But this is just another form of the deficient financial intermediation, where everything is channelled through the budget. The total money stock is defined conventionally so that compulsory reserve funds of the enterprises (used by the government to confiscate profits but only up to 1984) and the clearing accounts of the fiscal budget (a discretionary instrument of fiscal policy and not the monetary system) are excluded; however, savings notes (a bond that acts like a savings deposit) held by the households are included. On the basis of different behavioral characteristics, broad money (M2) can be divided into three separate money circuits in Hungary. First, the household money circuit comprises currency, demand deposits, time and savings deposits held by the households. Second, enterprise money consists of various kinds of enterprise deposits (with the exception of the compulsory reserve fund deposits referred to above). Third, the monetized fiscal deficit is defined as the government money circuit.

Using quarterly data for the period 1974–1986, *Ábel and Székely* (1988) examine the causality relationship between these separate money circuits and prices. They find no causal relationship between household money and the consumer price index but strong causality running from enterprise money to the consumer price index. The household money circuit and the enterprise money circuits are separate in the sense that no causal relationship exists between these two circuits. However, the authors find strong causality running from the government money circuit to enterprise money and weak causality from government money to household money. Consequently, they conclude that any overflow from the government circuit significantly influences the other two money circuits.

The importance of these findings is highlighted by considering the two polar cases. If all three circuits were separate or, in the opposite case, if money were to integrate the economy perfectly, simple monetary explanations for inflation would suffice and monetary overhang would be the main cause of inflationary pressure. In Hungary and most likely in many of the other formerly socialist economies with underdeveloped monetary and financial sectors, inflationary pressure is due to the overflow from the government money circuit, i.e., fiscal deficits. Segmented financial arrangements make monetary policy more difficult to analyze. Instead the focus shifts from monetary instruments to the fiscal budget and the implications of drastic changes in its size and structure.

The central government fiscal budget deficit in Hungary did not rise above 6 percent of GDP since 1982. The highest deficit between 1982 and 1990 was 4.66 percent of GDP recorded in 1986 a year in which the world average was 5.18 percent and the average for developing countries was 6.49 percent. (GFS 1990, pp. 80–81) However, such a statistic does not mean that Hungarian fiscal policy was on the right track. In no other country in the world were central government expenditures higher than 55 percent of GDP for the entire period of the 1980s as they were in Hungary. Other countries experienced years in which this ratio was higher than

Table 1

Extent of price regulation

Hungary

(in percent of total final consumption)

Year	Administered prices	Product/Company specific regulation		Total regulated
(1)	(2)	(3)	(4)	(5=2+3+4)
1987	38	21	–	59
1988	22	21	5	48
1989	19	12	7	38
1990	16	6	1	23

Legend:

a) Administered or official prices set item by item by the relevant authorities (basic food, energy etc.)

b) Product-specific regulation: If the company wants to change the price of the specified product, it must report this in advance to the price authority. In certain cases, the authority may initiate negotiations with the company.

c) Company-specific regulation: The price authority arranges price consultations with the company and with the relevant partners (suppliers or users of company products) to define the main guidelines and targets for the economic year. The company may increase the price of some of its products above the target but it then must keep the price of some other products below the target.

Source: *Annual report of the Hungarian National Bank 1990*, p. 23.

in Hungary but none of them maintained such a high percentage for the whole period.[6]

In Hungary during the 1980s, the fiscal budget redistributed a large percentage of the national income. Subsidies and other current transfers represented 66.46 percent of central government expenditures in 1988. (GFS 1990, pp. 42–43) In this year, subsidies alone accounted for about 13 percent of GDP. Desegregated into broad categories and measured as a percent of GDP, consumer subsidies equalled 3 percent, housing subsidies 4.8 percent, and producer subsidies 5.2 percent, of which agricultural subsidies were 3.2 percent of GDP. A subsidy reduction program was initiated in 1989 having as its aim the elimination of all price subsidies in 4 years.

[6] The following countries had higher fiscal expenditure to GDP ratios than Hungary for one or more years in the 1980s but each of these countries exhibited ratios lower than 55 percent ratio for other years in that decade: Belgium, Guinea-Bissau, Guayana, Israel, the Netherlands, Nicaragua, Tonga. (GFS 1990, pp. 90–91).

The interim target for 1990 was to reduce the share of subsidies in GDP from 13 percent to 7.8 percent.[7]

Coincidental with this subsidy reduction program is a continuing policy of price liberalization. The purpose of the latter is to decrease the proportion of prices regulated by the Price Office over time. *Table 1* documents this change from 1988 to 1990. The liberalization of domestic markets in the 1990s involves the elimination of price subsidies that were a significant component of fiscal outlays in the 1980s.

Another implicit claim on fiscal outlays is the service of the externally held public debt. In Hungary, the public debt is over 60 percent of GDP. Per capita net foreign debt in Hungary is \$1,772 while in Poland it is \$890.[8] Foreign debt was accumulated by direct flows through the fiscal budget. The fiscal budget deficit exhibits no particularly visible correlation with either household savings or enterprise net savings which is defined as enterprise savings minus enterprise investment. However, there is a strikingly strong negative correlation between the *fiscal budget deficit* and the *current account deficit* (see *Table 2*). Hungary has exhibited its own "twin deficit" problem in the 1980s.

Table 2

Net saving rates by sector

Net saving as percent of GDP, Hungary, 1980–1990

	Business savings minus business investment	Household savings	Fiscal budget surplus	Current account deficit
1980	3.27	0.24	-8.38	4.87
1981	1.80	0.90	-6.55	3.86
1982	0.66	0.58	-3.56	2.32
1983	-1.28	0.85	-0.41	0.85
1984	-1.30	0.58	0.92	-0.20
1985	-1.79	0.91	-1.34	2.23
1986	-2.12	1.28	-4.66	5.50
1987	-3.69	-0.17	0.32	3.55
1988	-2.04	0.92	-0.26	1.38
1989	-1.96	0.12	-1.91	3.76
1990	-2.69	4.09	-0.24	-1.15

Source: 1980–87 Ábel–Ember–Király. 1990.
1988–90 Ministry of Finance, Budapest (August 1991)

[7] For more detail see Ábel (1990).

[8] See *Lindsay* (1990).

Comparison of the Hungarian and Polish transformation strategies: volatility versus relative stability

A comparison of the situations in Poland and Hungary in 1988 and 1989 provides insights into the similarities and differences of the starting points for the transformation in the two countries. For Poland, the transformation is usually taken to begin with the stabilization program that was implemented on January 1, 1990. For Hungary, choosing a date on which the transformation begins is more problematic partially because of the gradualist program pursued so far. Nonetheless, for the sake of convenience and comparison in our presentation, we consider two distinct periods using January 1, 1990 as the temporal dividing line. The prior period is taken to be the eve of the transformation; the latter period the beginning of the transformation. The aggregate economic data exhibits much more volatile behavior in Poland than in Hungary during each period. Thus the data support our contrast of transformation strategies in the two countries but they also indicate that the two countries had different immediate histories prior to launching the transformation.

In both countries, the official *exchange rate* was *overvalued* throughout the initial period despite frequent devaluations in Poland. The ratio of the parallel (free) exchange rate to the official one ranged from 5.3 to 7.1 for the first nine months of 1989 in Poland (Lipton and Sachs 1990a). In Hungary, the black market rate commanded a premium of between 30 percent and 40 percent during 1989. The National Bank of Hungary pursued an exchange rate policy designed to dampen fluctuations in the real effective exchange rate (see *Figure 1*). In 1989, when the central bank's scope of authority to adjust the peg was increased from a margin of plus and minus 1 percent to one of 5 percent, from mid-March to mid-April, the forint was depreciated twice by the maximum allowable amount bringing about a rather steep decline in the real effective rate. However, as *Figure 1* indicates, the fluctuations in the real effective exchange rate in Poland were significantly greater than in Hungary during 1988 and 1989.

By the end of 1989, Poland was suffering from hyperinflation with prices increasing at over 150 percent measured as the quarter to quarter change in the *consumer price index* from the third to the fourth quarter (see *Figure 2*). The quarter to quarter measure of inflation in Hungary did not exceed 15 percent prior to 1990 and the annualized inflation in 1989 was around 17.5 percent. The major portion of the inflation in Hungary occurs during the first quarter in 1988 and 1989 with the quarter to quarter changes in the consumer price index equal to 14.89 percent and 12.13 percent. As already discussed, these increases reflect the substantial reduction in subsidies on consumer products implemented at the beginning of each year. Inflation in Poland exhibits no such pattern as it builds steadily to hyperinflation throughout 1989.

A comparison of *real wage* indexes for the two countries beginning in 1987 again establishes the more stable nature of the Hungarian situation prior to 1990. As *Figure 3* indicates, the real wage in Hungary has decreased slightly from 1987 with significant drops in the first quarters of 1988 and 1989 due to the spurts of inflation from price liberalization. For Poland, Lipton and Sachs (1990a) report annualized increases in real wages in 1988 and 1989 of 15.0 percent and 11.6 percent respectively. On a monthly basis, they report a peak in August 1989 that is 73 percent higher than in January 1989 and a spike in December 1989 (p. 110). The quarterly IMF data that we plot in *Figures 3* and *5* exhibits slightly different characteristics but the basic point is unambiguous. On the eve of the stabilization program, Poland is experiencing hyperinflation and the government has not gained control of wages. On the other hand, the Hungarian government begins 1990 facing more moderate inflation and with wages under control.

On the eve of its stabilization program, the *fiscal deficit* in Poland had risen to over 8.1 percent of GDP. In Hungary the fiscal deficit rose from a surplus in 1987 to a deficit of only 1.9 percent of GDP in 1989. The projection for 1991 indicates a significant increase from 0.3 percent of GDP in 1990 to over 4 percent reflecting an increase both in the fiscal deficit and in the net savings position of the household sector. The most influential factor in the projected increase in the fiscal deficit is the loss in tariff revenues from oil imports from the Soviet Union for which Hungary must now pay hard currency due to the disintegration of CMEA.

Conclusion: current and future prospects for progress in transformation

Poland has not been more successful in reigning in domestic inflation as the appreciation in the real exchange rate witnesses. By the first quarter of 1991, the real effective exchange rate in Poland was 73 percent higher than at the beginning of the transformation program after the substantial devaluation of the zloty. Indeed, a subsequent devaluation occurred in May of 1991. The nominal anchor at an undervalued rate was not sufficient to harness inflationary pressures in Poland. On the contrary, the substantial devaluation on January 1, 1990 introduced an inflationary shock that resulted in continuing inflationary pressure.

By contrast, fluctuations in the real effective exchange rate in Hungary resemble outcomes that would be expected if a policy based on real anchor were pursued.

From 1988 to 1990, several devaluations in the nominal exchange rate were required to maintain a relatively stable real rate in the face of a series of inflationary shocks stemming from price liberalization policies. However, adjustments in the nominal exchange rate responded to rather than transmitted inflationary pressures in Hungary. The prospects for reigning in inflation in the near future seem brighter for Hungary now that price liberalization is virtually complete.

The gradualist policies in Hungary designed to dampen fluctuations in the real exchange rate and real wages were successful in producing less volatility in these measures than that accompanying the Polish "Big Bang". Significant institutional and legal changes accompanied the gradualist policies of the late eighties and early nineties. Shock therapy in Poland seems to have been unsuccessful in controlling inflation and the economic system may be suffering from a lack of institutional development and a "legislative lag" (*Schaffer* 1990). Will the basic structure in place in Hungary be sufficient to weather the serious shock of the dismantling of the CMEA and the loss of Soviet markets? Will Poland's experience with shock therapy provide a head start in penetrating Western markets? The jury remains out on the question of whether gradualism or shock therapy can be championed as the clearly dominant strategy for the transformation.

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ДВА ПОДХОДА К СМЕНЕ СТРОЯ В ВОСТОЧНОЙ ЕВРОПЕ: "ШОКОВЫЙ УДАР" ИЛИ "МЕДЛЕННАЯ, НО СТАБИЛЬНАЯ" ЭВОЛЮЦИЯ

И. АБЕЛЬ — Д. П. БОНИН

В статье внимание сфокусировано на трех аспектах стабилизации и международной интеграции, а именно; реальной заработной плате, инфляции и реальных действующих валютных курсах. Используя эмпирические данные инфляции и реальные действуюшие валютные курсы, мы оцениваем выбор постепенного развития, представленный венгерскими реформами. Перспективы продолжения программы основаны на реальных валютных курсах, сдерживаемых с помощью подвижной поддержки корзины конвертируемых валют. Это сравнивается с опытом Польши, который состоит в шоковой терапии в сочетании с минимальной поддержкой.

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FIRST LESSONS IN THE TRANSFORMATION OF THE ECONOMIC SYSTEMS IN CENTRAL EUROPE

L. CSABA

This article offers a brief survey of international literature that analyses change of the economic system in the Central European countries. The struggle between the followers of shock therapy and step by step progress is in the limelight of theoretical discussions, but, practically, differences between measures taken in the countries where systemic change is in process are not so sharp. The first experiences show that making equilibrium in economy must not be considered identical with developing a market-oriented economy.

The turn of the 1980s/1990s has become one of the most fascinating periods of modern European history. With the collapse of the Soviet empire small nations of Central and Southeast Europe[1] now face an unforeseen challenge. The sixties, seventies and even the eighties saw waves of cautious and radical attempts to improve and decentralize a socialist economy that was based on the predominance of public ownership.[2] Following the revolutions of 1989–90, however, the new geopolitical realities have enabled the small countries to opt for a Western-type pluralist political and economic order.[3]

What does the option for the market imply?

The need to introduce a fully-fledged market order is no longer a subject of discussion among the political forces enjoying parliamentary representation in the region. All the more polarized are the views on the ways and means of getting into

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The present article is based on a series of lectures delivered at the Universitá Commerciale Luigi Bocconi (Milan) in May, 1991.

[1]The customary political term "Eastern Europe" has become totally meaningless with the collapse of the Yalta peace system. Therefore—following the detailed substantiation by *Szűcs* (1983)—all ex-socialist Balkan countries are qualified as "Southeast Europe", whereas Czecho-Slovakia, Poland, Hungary and the new German provinces are called "Central Europe". We find unjustified the dislike of some—e.g. *Tallár* (1990)—concerning the return to the established categories of historiography and geography as if this return were a cultivation of seclusive, paternalist or even rightist-authoritarian traditions. Of course, any concept can be misused, even geographical terms, and, unfortunately, there is no escape from misinterpretations.

[2]For an analysis that gives historical wide-ranging insights and cross-country analysis of these cf. the study of *Kaser* (1990).

[3]The useful comments of Ms. K. *Lányi*, Mr. G. *Oblath*, Dr. I. *Schweitzer* and of Dr. L. *Szamuely* are gratefully acknowledged. All remaining errors and omissions are exclusively mine.

the paradise of capitalism, especially those pertaining to stabilization, privatization and to the economic role of the state.

This is only right since, beside the economic system, it is economic policy and its goals and instruments that also need to be re-defined. Moreover, contrary to the postulates of some international organizations and certain economic quarters, there is no consensus view in contemporary Western economics pertaining either to the nature of the market economy or to the interpretation of market outcomes and failures. Therefore the philosophy and arsenal of appropriate economic policies to be adopted in order to assure socially acceptable and economically efficient outcomes are also subject to debate. Controversies among various Western schools of thought are conceptual in nature; thus disagreement prevails over instrumental, methodological and time-related aspects of a desirable therapy. Therefore no matter how diligently ex-socialist countries study Western economic science, they cannot expect to find "appropriate" solutions which would readily be applicable to their particular situations (*Haffner* 1990, pp. 163–166). Instead, each country has to rethink a wide range of available theories and policies, their successes and failures, and nobody can avoid the laborious task of adjusting these for their own purposes and environment. In other words, they have to elaborate how the market will function in their particular national setting and what sort of policy mix can be applied in conformity with this fundamental constituent of a pluralist order.

It is not only conventional economic controversies which emerge in Central and Southeast European countries. There are two further factors making orientation difficult:

1. Previously available evidence, be it that of theories of planned economies or of comparative economic systems, has lost its relevance since the very subject of their inquiry has more or less disappeared. Therefore the "prime" sources, like established science in the East and most of Western Sovietology can offer little help in analysing relevant policy problems. This is because their fund of knowledge and their orientation tended to postulate the collapsed regimes as viable (if not eternal) alternative, points of reference.

2. General economics—especially its mainstream—operates with elaborate models, categories and laws which have been abstracted from an advanced, structured market order, itself a product of centuries of self-corrective evolution. In contrast, the main characteristics of Central and Southeast Europe from our perspective is that the continuity of market-based evolution was forcibly interrupted. Through the "expropriation of the expropriators" it was precisely the elementary features of the market system's design, incentives and regularities—which form the axiomatic backbone of the postulates of mainstream economics—that were prevented from operating. If some elements did survive, this was only in a very distorted and rudimentary form. Common sense offers very little understanding of the workings of "planned", i.e. bureaucratic economies, as is also shown by the examples of developing countries.

What system is to be transformed?

It seems superfluous to detail again how manifold the economic distortions inflicted by mandatory planning have been if we compare the actual workings of a socialist economy to a market order—the ideas on this theme unfolded in the monographs of *Kornai* (1980), *Soós* (1986), *Winiecki* (1988) and Csaba (1990). Thus our starting point is that privatization in Central and Southeast Europe means something qualitatively different from what it is in developed or even developing market economies. In the latter case the job of policy-makers is to expand an already available and comparatively superior private sector's share in an economy where it was previously dominant or at least sizeable. By contrast, postsocialist countries have yet to bring about this sector (or leave it to evolve) and must concentrate on creating an environment where putting private money into a (long term) investment—rather than consuming it or putting it into a foreign bank—makes economic sense, or at least is one of the options. "Private" entrepreneurs of the irregular or maffia economy in postsocialist countries normally do not risk their own money (let alone their property).[4] They only tax away (monopoly) situation rents and turn it to their personal benefit in a typical precapitalist manner; therefore productive investment would be the last thing they would think of. All in all they supplement rather than undermine a bureaucratically overdetermined economy. Thus the crux of postsocialist privatization is in breaking the rule of bureaucratic coordination, and rendering all of its forms subordinate to spontaneous market processes.

The old distinction of Kornai (1984) between the two fundamental forms of coordination (with either of them dominant) is of decisive importance in our understanding of the subject and the nature of what the entire transformation process is all about.[5] The wording also reflects that, in reality, it was misleading to label the socialist half of the old continent as "European centrally planned economies". It is common knowledge by now that in the entire socialist period, but especially in the 1980s, macroeconomic planning in "Eastern Europe" was rendered an empty ritual and an ideological point of reference at best—rather than an omnipotent instrument for exerting anybody's particular political priorities. Planners did not have a major say[6] in the final allocation of resources; moreover, they did not prove to be terribly successful in their *ex ante* setting of those famous macroeconomic proportions either. Judging by the computations that try to capture the actual rather than officially reported performance of ex-socialist states (*Heitger* 1990),

[4] For a lucid summary of available evidence see *Dallago* (1991b).

[5] A detailed analysis of the notions, tasks, concepts and dilemmas involved is available in the monographs of Kornai (1990) and *Siebert* (1991a)—thus I feel relieved of having to repeat the pioneering task.

[6] Their influence hardly exceeded that of the financial organs or of powerful sectoral lobbies, let alone political organs. It is true that, formally, planners produced synthetic documents but most major allocative decisions were taken outside the frames set by these documents.

planners in the 1980s often had difficulties in identifying even the direction of actual changes, let alone their quantitative characteristics. Paradoxically, under the ossified centralized regimes of the 1980s, a lack of any form of efficient macroeconomic control became the rule all across the "Eastern European" region. This was amply exemplified both in macroeconomic/stabilizing policies and in terms of the functioning and modifying of the economic system. Nothing worked in the direction it was meant to. This factor must have had a considerable effect in eroding state socialism as a system. Most of the top leadership earnestly believed that they were actually managing socio-economic processes, and kept on reacting to the statistical reports falsified in order to serve their tastes; they had little idea about those obvious phenomena that were shaping socio-economic realities. This factor was particularly strong in the non-reforming regimes and in the Soviet Union.

Therefore the demise of the planned economy began prior to the abolition of the central planning organs—a step which had taken place in Hungary alone[7] (and, by definition, with the dissolution of all former East German administration it also came about in the ex-GDR). Still, the collapse of planning has not automatically led to the predominance of market forces, and even the role of monetary regulation has remained supplementary to bureaucratic coordination. In post-planned economies it is intra-bureaucratic bargains which are decisive in most issues, and they are constrained, only in truly extreme cases, both by the legislative branch of power and the press. Therefore general rules of the game, as laid down by legislation or by governmental documents of various sorts, apply only in exceptional cases. Exceptional (bureaucratic) arrangements have remained the general rule, just as before the change of the régimes. True, bureaucratic continuity in governance is not unprecedented in modern European history—one only has to think of the consolidation after the French and Russian revolutions, or of the working of the Austrian state.

All in all, one of the most relevant legacies of state socialism is the limited governability of the new democracies. This puts severe constraints on the implementation of any radical project in any of these countries. This is good news and bad news at the same time. It is good news if one considers the large number of economically non-sensical propositions echoed by the new political parties and the old vested interests. However, it is bad news if we consider the technical complexity of the task of transforming any economic system in its entirety. While Central and Southeast European states are searching for their respective new identities, international competition has not lessened. In 1992, the Single Market will turn from being a challenge into a reality. Meanwhile the political capital of the new regimes is melting quickly, which is basically inevitable. Yet, it was only the Polish élite

[7] This decision originated in a September 1988 resolution of the Grósz Government, though its implementation was left to the Antall administration.

which made use of the unique historic opportunity provided by the change of the régime.

"Dèsètatisation?"

Postsocialist countries therefore face a historically unprecedented task. On the one hand they have yet to create what for Western privatization processes is given: tens of thousands of competing economic actors, the entire middle class (owners *en masse*) and the entire infrastructure of the market. Therefore re-regulation, i.e. the creation of new rules and institutions, is just as important a task in making the transition to the market succeed[8] as a deregulation—a process which has come to a halt under the conservative government in Hungary. The first half of this task is to cut all forms of state bureaucracy substantially (say, by half) while providing much better pay and higher social standing—including political immunity—to those remaining in the administration. The second half of this task is to bring about institutions, rules and procedures that enable marketization to be both faster and socially more acceptable than under "cowboy capitalism".

Nobody familiar with the actual institutional and policy arrangements of modern Western welfare states would seriously doubt the irreplaceable and lasting economic role of the state in a modern social market economy—the achievement of the latter being the aim of the postsocialist transformation process. It is all the more controversial, however, when it comes to interpreting what this economic role implies in actual policy terms. Dallago (1991a) comes to the conclusion that only the collapse of ossified Stalinist structures and the rehabilitation of the market as a fundamental coordinator in economic processes make it possible—even imperative—for postsocialist economies to introduce modern indicative macroeconomic planning.[9] In the same line of thought Friedrich *Haffner* (1990, p. 176) concludes that the monetary and fiscal instruments developed under reformist socialist economic policies are but one step from capitalist practices of market regulation, where the state ceases to be the main subject of market processes.

Without discussing the philosophy behind these propositions it is worth recalling (*Brus* 1990 and *Hedtkamp* 1990, pp. 47–48) that even the most enlightened and loose version of macroeconomic planning implies by definition a narrow instrumentalist concept of the market, especially of prices and monetary flows. The latter often applies in a different way to some of the microeconomically oriented

[8] The same point is made by *Portes* (1991a) and *Chavance* (1991, pp. 14–15).

[9] For a recent overview of the conceptual and cross-country diversities of relevant experience cf. the December 1990 special issue of *The Journal of Comparative Economics*, entitled "Indicative planning".

neoclassical analysts[10] of the transition. Still, as elaborated above, in our view the crux of the entire problem of transforming the inherited bureaucratic economy lays precisely in reinvigorating and liberating the market as the single most important coordination mechanism of economic processes. This task is hardly manageable without a qualitative and quantitative rolling back in state redistribution of incomes, otherwise the free marketeer political slogans will become empty words for economic practice (as is already being experienced). Therefore the Archimedean point for the entire transformation process is a reform of public finances which should result in a 15–20 percentage point decrease in the budgetary redistribution of GNP. Thus such areas as transfer payments, old-age pensions, health care and higher education (as well as other welfare expenditures comprising the larger part of current budgetary outlays) can hardly be exempted from these across-the-board cuts, as some propose (*Bauer* 1991) on moral grounds; if the latter were the case there would be virtually nowhere to withdraw from. Moreover, these areas are characterized by the co-existence of waste and lack of performance. Thus the old arrangements cannot be sustained any longer anyway. Therefore, only if the underlying logic of the whole system changes does it make sense to import regulatory techniques from advanced countries, otherwise very modern options may soon become dysfunctional in an alien context.

This is one of the relevant findings of a new area in economics: that of transforming entire macrosystems. One of the peculiarities of this area lays in the circumstance that the political need to act often preceded and superseded economic theory, for the latter has no established recipe for this unconventional task.

Shock or therapy?

It is the sad history of what used to be a separate East German state which best illustrates what shock treatment implies in terms of systemic transformation. With the German monetary and economic union the particular set of issues related to stabilization by definition has disappeared. Thus the very area which normally induces politicians to adopt shock treatment did not exist, still the political context compelled an instantaneous introduction of a market order to the ex-GDR economy.

The GDR used to be the second strongest socialist power. Still, as could be demonstrated *ex ante* (Siebert 1991b), it was no problem whatsoever for the Federal Republic to absorb an economy one-tenth the size of its own. Meanwhile two further aspects gained in weight. On the one hand, as has been stated *ex post* (in March 1991) by the Bundesbank president involved, German unification was a unique historic act in which a purely political logic was totally and unconditionally

[10] Interestingly, *Hare* (1990, pp. 582–583) deplores Czech and Hungarian reformers for joining this "antiquated and under East European conditions particularly misleading" theoretical line.

superimposed upon economic options. Therefore it is no wonder that the actual costs of unification (thus of transition) were grossly underestimated, in order to conjure an important winning card in the election game. The conversion rate between the Ostmark and D-Mark was not the only purely political issue; so too was the instantenous adoption of the entire Federal German legislation (including collective bargaining, job rights and the promise to equalize wages irrespective of productivity). True, the bloodshed in the Baltic states in January 1991 provided a very early justification for the political haste. Still, economic costs remain, with a third of East German labour being redundant and 70 percent of GDR industry heading for closure. All this taking place with 200 thousand new ventures in 1990 and 600 thousand new ventures in 1991.

This is the other side of the same coin. The concrete ways and means of unification have virtually knocked out the economy of the ex-GDR. The politically set currency conversion rate and the lack of correlation between productivity and wage increases alone would have sufficed to erase most of the East German economy. This process is further aggravated by a very lavish restitution arrangement which deters investors—foreign and domestic investors alike. On top of this is the bureaucracy of the Treuhandanstalt, having inherited not only the buildings and the staff, but also the aspirations of the now defunct (but once almighty) State Planning Commission. Knowledgeable East German analysts (*Heise, Schadow and Schilar* 1990) had already advanced the proposition back in late 1990 that this agency should be dissolved and replaced by commercial banks, management buyouts and various forms of spontaneous privatization. There is an ever-growing majority view in Germany that without suspending restitution and transforming it into monetary compensation the East German economy will be crippled for a very long time.

It seems increasingly plausible that the net value of social capital in the ex-GDR is negative. Net capital value can indeed be negative (in terms of discounted returns), for a fairly large part of physical capital was originally meant for purposes which have now lost their relevance in the context of a single German market (e.g. brown coal mines that secured East German self-sufficiency in energy supplies, the famous Trabant car factory, or the computer industry specialized for the Soviet market). These do not have a market value at all. Other capacities may have some, but the costs of applying West German environmental standards, paying wages that catch up gradually with West German levels while productivity falls, as well as other cost items, may exceed their receipts. The official capital valuation procedure elaborated during the unification process did more harm than good. In this case nominal asset values and nominal debts were converted at a 1:2 rate into D-Marks. Thereby the completely meaningless socialist capital valuation system was, in effect, re-invigorated.

As is known, the challenge of perestroika induced the GDR leadership to introduce some pseudo-reforms—the most relevant being the so-called Eigenwirtschaftung der Mittel. This was a kind of simulated capital market. The crux of the innovation was to introduce some of the formal elements of the capital market without its substantial features (Csaba 1987). In practice this meant that, at least formally, a growing share of investments were financed from credit. True, this credit was allocated by the centre according to bureaucratic criteria, but since the conversion and capital valuation process introduced at the time of German Economic and Monetary Union (GEMU) this world of façade has started to live a life of its own. Relatively competitive, recently invested assets carried debilitating debts, which used to be meaningless under socialism, but proved to be crippling in the real market. Interest paid on these used to be an irrelevant cost-item; now it syphons off a sizeable chunk of the inflows, leaving no room to profits. No wonder, therefore, that it has been some of the relatively most viable/modern East German plans that have faced bankruptcy first, because their old "debts" have not been cancelled. With the more competitive parts of ex-GDR industry phased out via an accounting procedure, instantenous competition from the international (basically West German) markets did the rest of the job.

It is no surprise that the artificial valuation of East German assets, achieved by converting their bookkeeping worth in Ostmark to D-Mark at a rate of 2:1, implied their gross overpricing (the market rate used to be 4:1). Moreover with their "value" officially set, the spontaneous, intuitive market process of finding out the actual supply-demand price for any given asset was severely constrained. With an omnipotent Treuhand carefully guarding the interests of the budget it is no longer a mystery why virtually no foreigner has bought anything from what used to be a socialist success story. Understandably, West German capital also prefers to invest greenfield rather than taking over existing plants, even for a nominal price or with a *de facto* state subsidy. All in all there is also a growing belief in Germany that both the instantenous nature of unification and the mechanic transplantation of the entire set of Federal German legislation has caused more harm than good, at least in economic terms.

With the actual procedures of unification economic adjustment in the five new German provinces has been put under several constraints. Eventually, none of the more conventional instruments of adjustment open to a less developed country were able to be relied upon, like devaluation of the currency, keeping wages low, undervaluing capital assets, less meticulous labour legislation, tax holidays for investors or temporary neglect of environmental concerns. After a year of GEMU only one sixth of the East German companies have been privatized, though the conventional arguments referring to the lack of domestic savings or to the lack of an appropriate legal infrastructure or to narrow capital markets hardly apply to Germany. Although in 1990 alone 100 bn DM was transferred to the ex-GDR, the estimate for 1991 is 150 bn DM still the flow of labour from East to West has reached pre-GEMU levels. The prospect of a newly emerging Mezzogiorno is becoming increasingly probable.[11] Therefore it is hard to escape the conclusion that although West Germany has achieved a political and historical success, the very concept of importing/exporting an economic model in its entirety, be it even as successful as the German social market economy, has suffered a severe defeat. In more general terms, the adoption of ready-made fixes seems to be an ill-concieved idea in trying to speed up the transition from "planning" to the market.

This seems to be a lesson to be kept in mind just as much as that of the failures of the incrementalist approaches that have dominated socialist reforms. It seems to be difficult to come to meaningful propositions about how to transform the state socialist legacy unless factors conventionally dismissed as "extraeconomic" are taken into account. The heritage of the new democracies is not confined to the need to discount the value of all stock indicators reported in official statistics. It also survives in the monopolist-minded behaviour of economic actors, as well as in the nature of social expectations. On top of it, national characteristics, and historic and cultural endowments, all show marked forms of continuity. All these added together are bound to soften up any radical governmental project to change society, whatever its inspiration. This might also explain why the wide and various forms of interplay of specific factors have had one thing in common in all less developed countries: they have thwarted the projects based on a radical marketeer interpretation of mainstream economics.

Privatization and convertibility

Up until very recently there was hardly any policy-relevant literature available on privatization that could be applied under the peculiar conditions of transforming the entire bureaucratic macrosystem into a market.[12] Most theoretical writings were confined to comparing an abstract public company to an abstract private

[11] There still remains a fundamental difference favouring East Germany. In a modern post-industrial economy 70 percent of employment is in the services sector. This sector is already expanding in the five new provinces thanks to private and public investment alike. Therefore focussing exclusively on industry might overshadow intersectoral relocation of labour into the tertiary sector, which is a healthy corrective to the overgrown socialist industrial development of the last four decades. Still, the main argument that stresses the opportunity costs (i.e. foregone benefits) of the actual shock, is a potentially more gradual and differentiated transition to an East German market economy, and this remains valid.

[12] For a general introduction cf. Winiecki (1991) and *Voszka* (1991a). Analysing available Hungarian proposals to reform and improve public ownership (retroactively elevated to privatization schemes) *Kőhegyi* (1991, pp. 34–35) concludes that implementing these would result in a rather embarrassing structure of public cross-ownership and institutional owners, with the private sector remaining subordinate. Analysing the spontaneous processes of transforming property rights that have in fact taken place in recent years in Hungary Voszka (1991b) prognosticates an etatist, state-dominated capitalist future for this country right through the 1990s.

company, and trying to substantiate the superiority of one form over the other. State policy in Western countries has hardly relied on these. Instead it has followed very general ideological convictions—as in the case of Reaganomics and the Thatcherite revolution. Not surprisingly Reaganomics went hand in hand with an exploding federal budget deficit, and Thatcher's policies have not managed to roll back (although they have restructured substantially) the macroeconomic share of governmental redistribution of incomes. With the exceptions of Chile and Turkey the macroeconomic share of private versus public ownership has not changed qualitatively since the privatization drive. In OECD and in developing countries the results of privatization have proved to be mixed, and the outcomes of the privatization of the Dutch postal services or the deregulation of the US airlines have left room open for value-biased interpretation. In other words, while the general case for privatization is well established, an automatic application of this option for each and every country and each and every area of economic activity looks inconclusive, especially if and where other constituents of a competitive or at least, contestable market order are not (yet) available.

With the dissolution of state socialism the conservative experimentation in the West has gained new significance. All Central European governments now give priority to the evolution of a domestic entrepreneurial class. Summarizing international privatization experience, Anders *Åslund* (1991) underlines two major lessons for this region. First, the speed of privatization is a relevant issue, as a very slow growth in the share of more efficient private ventures may only have negligible impacts on overall economic performance. Second, he warns against subordination of the process of the transformation of the property rights structure to the short-term interests of the Exchequer, because this is the best way to prolong and slow down the process. The above described East German experience, as well as the Hungarian practice (*Ahogy* 1991, and *A PM* 1991) of slowing down the process in the first year of the conservative coalition government, seem to lend support to these warnings.

Åslund contests the conventional wisdom of beginning the process of privatization with agriculture. All postsocialist countries suffer from rural overemployment, whereas international markets for farm produce are flooded by cheap produce. Moreover, stabilization policies will inevitably lead to high positive real rates of interests, which will be a tough novelty compared to the financing practices of earlier decades. Thus fast market liberalization and privatization would produce very high rural (structural) unemployment. This is also a strong argument of the Swedish expert against restitution as a means of creating proprietors.

Both the example of farming as a sector and of the ex-GDR as a country illustrate that the timing of—*per se* excellent—measures is anything but irrelevant for the success of the entire transformation process. Thus it is hardly surprising that currency convertibility figures high on the agenda, although there is absolutely no consensus view about when it should come about. Adherents of a shock-therapy doubt the capability of any central government to administer gradual reforms of any sort under the given postsocialist context (*Dornbusch* 1991, p. 3; *Nunnenkamp and Schmiedig* 1991, p. 11.). Therefore convertibility is seen as an urgent issue: the sooner the better. Furthermore, it would act as a guarantee against reversion of the whole process, a guarantee which the population itself can also check. At the other end of the spectrum there are those who doubt that even the best government could administer all interrelated measures in a congruous way. Thus—arguing with the hysteresis problem (Portes, 1991b)—they doubt the advisibility of introducing radical but later hardly sustainable measures. In their sequence, of course, convertibility is somewhere at the end of the list.

Analysis of the first year of shock-therapy in Poland and Yugoslavia suggests a fair degree of precaution is needed, as direct political—*par excellence* "extraeconomic"—interventions gave the original programmes a serious flaw. Though these can largely be blamed for maintaining high inflation and even for the suspension of convertibility in Yugoslavia back in December 1990 (prior to the civil war), it is also right that the shock-therapy could certainly not deliver what it promised in any of the countries. Latin American shocks have not produced irrefutable evidence of the superiority of this approach either.

In my view the place of convertibility in transition depends on the type of therapy applied, whereas the latter should depend on the actual conditions of the patient as well as on the objectives of the operation. Thus I find the generalized debate on shock *versus* gradualism rather meaningless. Under the Polish conditions of late 1989 or under current Soviet conditions the credibility of the government is so limited and the disintegration of the market is so overwhelming that there is hardly any alternative to shock-therapy. The same could be said about Bulgaria or Romania. However, in Czecho-Slovakia, Hungary and a pre-unification hypothetical East Germany, there remains little room for shocks, because tasks of economic stabilization are incommensurably easier; thus the need for truly brutal action is hard to justify.

In more general terms: once a shock remains the only option, then—of course—we should not spend a week on cutting the cat's tail. If and when, however, a rest and a few pills would do, we should not start a surgical operation simply because this seems to be more appropriate for our professional qualification. If the cure is *via* the pills, convertibility is bound to emerge as an end-result. If, however, the option is for surgery, I do not see why it should not be introduced instantenously as part and parcel of an operation which is painstaking anyway.

This view contrasts with the more conservative approach which sees no room for currency convertibility before the structural crisis in the postsocialist economies is overcome. Postulating the unfeasibility of this task, *Szegvári* (1991) doubts very strongly the sustainability of any currency convertibility in any of the postsocialist states. Still, the events of 1989–91 as well as Latin American and Southern European experience allow for an alternative interpretation.

First, currency convertibility does not presuppose the overcoming of all major economic problems. Countries such as Greece or Portugal indicate that one can maintain convertibility with the presence of an overextended bureaucratic state sector, and the resultant prolonged structural crisis—albeit with continuous devaluation of the domestic currency. Polish experience seems to go in the same direction. However, if one thinks of Soviet or Yugoslav experience, one may conclude that if—for political reasons—there is no general progress in transforming the bureaucratic economy to a market order, financial liberalization alone will not suffice to provide the momentum to change the overall direction of developments. However, this is self-explanatory.

The real issue for us is the following: if we presuppose a socio-political majority ready and willing to promote the transformation of the entire macrosystem into market economy,[13] which is the best way to attain this goal, and where is the place of introducing convertibility in the sequence of reform measures? In the case of more or less consolidated economies the conventional sequence elaborated by *Nuti* (1990) may be expedient: discipline fiscal spending, liberalize prices, break up monopolies, introduce bankruptcies, start privatization, open to external markets, and introduce current account convertibility. However, in cases of disintegration reforms from above have simply been too little too late: only stabilization through a shock can create credibility for future governmental action. In this case the monetary and fiscal measures needed for stabilization would be equal to creating the conditions of currency convertibility. Moreover, a market clearing rate of exchange could also serve as a point of orientation ("nominal anchor"). Once the new government has been committed—both by its electoral platform and its declaration of currency convertibility—to maintaining a fair degree of external and internal liberalization, vested interests and the bureaucracy will find it difficult to revert the overall process. The examples of Yugoslavia and the Soviet Union, where the process has never gained political legitimation, will not be compelling to Bulgaria, Romania, Vietnam or Albania if forces supporting a market economy win the elections.

The real danger for the latter experiments may lay elsewhere. Namely, that politicians and the public would follow the fairly common mistake of mixing up stabilization with systemic transformation. If and when currency convertibility takes place as a result of stabilization surgery, it would be naive to believe that the task of systemic transformation has also been mastered, even better than in gradualist countries. On the contrary, transition to the market will involve more social and economic costs, thus it will require more endurance. Maintaining currency convert-

[13] This can be postulated only after those wanting a market economy have won truly democratic elections, which are yet to take place in Yugoslavia and the Soviet Union—at least on the federal level, where monetary policy is being formulated (for the time being). In the cases of Albania, Romania and Bulgaria free elections have not produced a clear majority favouring capitalist market economy.

ibility does deprive the governments from the option of resorting to some of the conventional protectionist techniques. Thus it is probable that bankruptcies will be more frequent, and both the rates of inflation and unemployment higher than under a gradualist approach. This will be hard to sell to the public if political expectations have been raised artificially high and national pride has been brought into play in order to justify the vices inherent in shock treatment. Still, once this road has been entered upon, there can be no more return to controls, because only external pressure (competing imports) transmitted through the exchange rate can force ossified production structures to adjust themselves to market signals. In this case the economy will undergo a period of recession, during which it will be difficult to legitimate a process of quick privatization with the concomitant income disparities—especially if democratic institutions and a free press remain intact.

To some extent there seems to be a trade-off between speed and quality: the shortage economy can indeed be overcome overnight. Meanwhile, since no separate economic entity (with a national identity) is likely to endure the East German experiment with instantenous transformation, the "fever" showing the protracted illness—inflation—will probably be a lasting phenomenon. This is not known to be the best inducement to save, even less to spend one's savings on economic investment—e.g. on buying bad public firms—under the legacy we discussed in the introductory section. The interest of foreign investors is bound to remain lukewarm especially in the initial phase. Their investments would be particularly needed because of the limited domestic savings. Therefore the "jump into the market" does not vouch warranty for getting there quicker than through a deliberately longer path of organic, orderly transformation. In the latter case the number of losers is by definition smaller, whereas those profiting one way or another from the changes are steadily on the increase.

This is the real issue in favour of organic transition, which is the driving force behind socio-economic change. This explains why the balance of forces has been continuously changing to the detriment of Stalinist forces. Therefore it is of little help if the adherents of shock treatment simply abstract this away in unfolding their version, thereby pretending as if this issue were not emerging once the economy had been subject to the shock (*Pfouts and Rosefielde* 1991). The problem is precisely that, in the action-reaction chain, popular reaction to the proposals based on pure economic theory is considered to be outside the focus of attention of analysts—which is certainly not justified if pure theorists advance policy advice.

This is the main problem neglected by those favouring the introduction of various partial versions of "convertibility", like retention quotas or currency auctions. We can join Portes (1991b) in seeing these as dangerous levers in the hands of bureaucracy which produce one thing for sure: misallocation of scarce foreign exchange.

On the political economy of systemic transformation

From what has been said in the previous sections, it already follows that we have strong second thoughts about various schemes aiming at an artificial acceleration of the change in the structure of property rights. While we sympathise with the considerations lying behind these, we doubt that societies which have just been liberated from socialist experimentation would cooperate with any radical experiment of whatever colour. This is added to what has been said before on "bureaucratic inertia" and "inability to enforce whatever governmental priority" there is in the new Central European democracies. In other words the overall environment to any radicalism is hostile, and this should be addressed when suggesting our economic medicine.

The basic paradox—notes *Roland* (1991)—is how to get a reform policy accepted if it will surely hurt a large number of vested interests from the very outset? He lays great emphasis on the *ex ante* coordination of reform measures as well as on their proper timing and sequencing. Neglecting these—by adopting a 'big bang' approach—will sow the seeds of an all-out rightist-populist backlash. Presenting an applied economics framework for interpreting transition problems, Roland bases his theory on collective action failures. In his view the most relevant element explaining the massive changes of sides in 1989 was the change in the preferences of the least informed agents. Even they could comprehend: maintaining the old arrangements could not offer much more to them. It could not save them from economic hardships nor could it offer any perspective. A strong point in his analysis is that he attempts to prove that state socialism was not a system based on equality, but one rooted in an intricate set of feudal inequalities. Thus the crux of the political controversies is not whether they bring more or less equality, but whether there is a redistribution of previous privileges and rents accruing from favourable situations. Therefore resistance to sensible economic propositions extends to many fields, exceeding concepts such as the interests of "the working class" or the "bureaucratic strata" would imply. In the centre of this sequencing of tactics is a large number of different interest groups, that should gain "something" from the new arrangements, and only a limited number of "target groups" that are directly confronted by governmental policies.

This is the point where the pet project of radical reformers comes in: namely, free distribution of property. As an abstract concept, free and equal distribution is a fast and fair way of creating actual rather than proxy proprietors. In practice, however, this option creates at least as many problems as it solves for systemic transformation, and it is small wonder that it could not really overcome political hurdles in the Central European states.[14]

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[14] In Germany and Hungary it has not been applied, whereas in Czecho-Slovakia, Russia and Poland only one fifth of the wealth to be privatized is *planned* to undergo this procedure.

If we consider the proposition that shares should be distributed equally among the population, then two consequences can be taken for granted. a) a large part of the population will turn capital assets into current consumption, which is inflationary; b) those keeping and accumulating the shares will have little competence (and for quite some time, ability) in overseeing managers; thus managerial efficiency and selection will hardly improve.

Both problems might be bridged if vouchers (or certificates, entitlements to shares) are issued and profit-oriented holdings administer the companies during the transition period. Still, if there is a secondary market for vouchers (or restitution cards[15] in the Hungarian case), their price will definitely be depressed due to factor a). If b) were a realistic way of improving managerial efficiency, socialist reforms in the East and public companies in the West would have fared much better than they actually have done in practice.

Still, the basic problem with this option is that shares/vouchers would soon be concentrated in a few hands. Economically it is all very well, but politically it is not so appealing. Most of the public in Central and Southeast Europe would hardly be impressed by argumentation based on the game theory that random distribution is politically neutral. It is more likely to be seen as an unfair game of the new government, and proof that "capitalist equality" is no better than "communist equality". This would soon result in a kind of economic nihilism, which is the best soil for rightist-authoritarian wizards.

Alternatively, it is conceivable that state property could be distributed at random—for example, each employee would get a stake in his workplace. This kind of distribution—like restitution—would certainly amplify social tensions. Why should I be content with the greengrocer's shop on the corner if you get Harrod's? What do I have to do with the injustices your grandfather suffered, especially if we consider that the state became bankrupt in between? Anyway, who is the legitimate owner? For example, why should ordinary Germans be collectively excluded from restitution in Poland, Hungary or Czecho-Slovakia? If one thinks of the post-1938 period, several persons/institutions could aspire to the position of legitimate owner. If one-time claims are revived, nobody will ever invest, due to the legal uncertainty of property. Nobody will want to buy property if all the claims upon it remain unclarified. Nobody will want to modernise, restructure or accept it as collateral. This story is an all too familiar one in East Germany. Alternatively, if we approach the problem via self-management or municipal ownership, this does not imply a move closer to proper private ownership.

As an in-between form of self-management and private property, employee stock ownership programmes (ESOP) constitute an important element of both Polish and Hungarian schemes of privatization. The rationale for these projects is largely political: if everybody has some form of share in ownership, it is assumed

[15] Compensation-notes according to the official English of the relevant Act.—*Ed. note.*

that people will find it easier to swallow the accumulation of wealth in the hands of a few.

It seems to me that the economic justification of these projects in Central Europe is rather weak. For one thing, according to Western experience ESOP owners do not behave like petty capitalists—in the best cases they behave like savers (cf. *Andreff* 1991). In the worse cases they cash their property as soon as they can or use their leverage to protect jobs rather than promote structural change. The inflationary effect of applying underpriced shares is obvious. Still, from the employee perspective buying anything under the ESOP scheme may well be a misallocation of scarce savings. In a depressed economy it is not at all easy to pay dividends that could compete with interest rates or with savings held in a foreign currency. The main problem, however, is that the social dynamics of an ESOP scheme are not towards the creation of more real capitalists, and in addition to this the inflationary potential is a serious flaw for the Central European economies already struggling with high rates of inflation.

As far as the social implications are concerned, ESOP seems to be a misguided answer to actual political strains. According to all evidence the public resents two basic features of the transition in Central Europe: a) in the case of Hungary most of the tax burden falls on employees, whereas entrepreneurial incomes tend to evade all forms of direct taxation (one third of all ventures reported losses for 1990 and the sum of the two-thirds who did pay taxes fell way behind the sum of employee taxes, which is an obvious aberration of the system of collection); b) the overwhelming majority of entrepreneurs do not risk their property. Thus their profit is rightly seen more as a (monopoly) situation rent than a reward for virtue.

Therefore, instead of ESOP, it would be more helpful to legitimate transformation by organizing more efficient tax collection (at lower tax rates) and by having more real capitalists risking their own money instead of simply putting up with letting sharks rule the market.

It is most important to appreciate that this concern—first pinpointed in the book of Kornai (1990)—is widely shared in Central Europe. For example, in the case of Hungary a lot of economic common sense could be said about the economic advantages of "spontaneous privatization" (*Matolcsy* 1990),[16] which has been quite widespread in Poland as well (*Gruszecki* 1991). Still, these transformations—called by the Poles "nomenklatura" privatization—have not really gained social support. People resent these deals, and not simply because the political class of the *ancien régime* has gained such prominence in the process. They dislike the widespread, insider deals, which are prohibited in most civilized countries. Moreover, they detest the situation described by Voszka (1991b), in which both the Treasury and actual (small) private proprietors are left out of the deals. Instead these deals

[16] Actually, the government was forced to readmit it, for if they had not done so the entire process of restructuring property rights could have come to a halt. cf. (A PM 1991)

produce a cross-ownership among public firms and between public firms and state-owned banks, i.e. a situation in which the corporatization of public firms becomes the main obstacle to their actual privatization.

Actually, this paradoxical situation emerged due to the fact that "dèsètatisation" was seen to be so urgent that it could not wait for real buyers to show up. In other words—once again—quality and speed rarely go hand in hand. The attempt to produce large budgetary revenues in Hungary was surely responsible for the selling of several retail chains in package deals, thus transforming public monopolies into (foreign) private ones and preserving the lack of competition on domestic markets, with all its consequences.

Here we have come to the fundamental political economy problem of systemic transformation. Is the old Marxist maxim really true, i.e. that property ownership directly determines everything else? In an inverted way this maxim is often voiced from various quarters where it is maintained that prior to full-scale privatization nothing will really change in Central and Southeast Europe, because the near-defunct state sector is bound to erode any marketising attempt. Our analysis seems to point to a different direction. It is more in line with German economic thinking—notably Ordnungspolitik—in which it is the quality and competitive nature of markets, the constraint of organized vested interests by the state, and the keeping of the economy open to external competition which matter in formulating proper economic policy during the transition. Expanding private property is an important long-term task, but it is not a sufficient condition for creating competitive markets, efficient adjustment and high quality management. Cutting back the budgetary redistribution of GDP, following a policy of stable money and keeping markets contestable, is at least as important in the course of transition as is the change in the property rights structure, which is a time-consuming job anyway.

All in all, lowering the short- and medium-term expectations while lengthening the time horizon in which entire macrosystems can be transformed under given historic conditions is the sobering conclusion to be drawn for all those having a stake or interest in Central European transformation processes. The debate will continue, but the dividing line between the more and less policy-relevant theoretical propositions is already being drawn by economic practice.

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СМЕНА СИСТЕМЫ И СТАБИЛИЗАЦИЯ В ЦЕНТРАЛЬНОЙ ЕВРОПЕ — МОЖНО ЛИ ИЗВЛЕЧЬ УРОКИ?

Л. ЧАБА

Теория преобразования макросистемы — совершенно новая область сравнительной экономической науки. Статья посвящена обзору международной литературы, анализирующей смену экономической системы в странах Центральной Европы. В центре теоретических дискуссий стоит спор между сторонниками шоковой терапии и приверженцами постепенного прогресса, однако на практике различия между странами, вставшими на путь смены системы, не столь уж резкие. Первый опыт показывает, что нельзя отождествлять достижение хозяйственного равновесия с построением рыночной экономики, ибо последнее представляет собой гораздо более многообразную и достижимую лишь в долгосрочной перспективе цель: поспешность (резкий удар) готовит почву для ответного наступления правых популистов. Бесспорно тупиковым решением создания частнособственнической системы является немедленная адоптация моделей, хорошо зарекомендовавших себя в других странах, преобразование государственных предприятий в акционерные общества и попытка создать собственников путем реприватизации. В ходе длительного процесса смены системы постепенное ослабление и свертывание роли государства остается отчасти задачей правительства.

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MARKET ECONOMY WITHOUT TRADE? GLOSSES ON THE NATURE OF THE SOVIET ECONOMIC CRISIS AND ON THE PROSPECTS OF A MARKET REFORM

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Since 1987 several reform programmes have been accepted in the Soviet Union. The last one was officially declared as the programme of transition into a market economy. The implementation of some parts of it was started, though with shorter or longer pauses, and sometimes with reversals. The de-nationalization of property has been progressing since 1990. Almost nothing was done to transform the central product distribution system into wholesale trade. Trading ventures have been pushed into the background even in the second economy. Our paper is going to examine the causes and possible consequences of these phenomena.

What are we going to deal with?

In this short article I would like to introduce the Soviet economy's mode of operation from one aspect only. This is to see how, in the Soviet economy, during the Brezhnev era and in the Gorbachev-initiated transformation period, right up to the present day, furthermore according to the existing reform programmes, the commodities and services have reached, are reaching now, and have to reach in the near future, the actual user or consumer. As it is known, several methods can be used for carrying out this task. On the one hand it may be requisition, compulsory deliveries, ordering instructions (zakaz-nariad), or plan-contracts. On the other hand, it can be quotas, limits, marking out suppliers, mandatory acceptance, assignment of goods, rationing, queuing and so on. The flow of products may, in the meantime, be accompanied by flow of money (from the buyer to the seller, if these roles do exist), though this is not a necessary concomitant of the system. Of course, there also exists in the world a market-type, a commercial way of transacting the process in question, but this usually needs the participation of a specific figure, i.e. the merchant.

Here it is worth noting that studying an economy with exact scientific methods (or just walking in the town streets of such a country), one does not necessarily discover which of the above listed solutions is or are employed in the given economy. Exact economic tools, such as the input-output table, contain no information whatsoever about how the output of one sector becomes the input of another. Also, as far as the customary (comparative) examinations of the professional literature are

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concerned, the word "market" or "transition into the market economy" are often written down without the authors even thinking about who the participants of the given market are, and how they are supposed to interact (if to do anything at all) with each other.

I think that it is worthwhile to look closely into the specific forms of the market-substituting institutions and procedures which have taken shape in the Soviet Union. First of all because they played a great part in contributing to the fact that, despite its favourable position both in the world market and the CMEA, the Soviet economy had fallen into a serious crisis by the late 1970s. This is also important because the mere existence of these specific forms, as well as their far-reaching results, will be fundamental in determining the time needed for realizing any imaginable market reform, and for estimating the chances of its success in the Soviet Union.

At this point I feel it proper to explain what I mean by the term "market". In the sense I use the term here, a market (of commodities and/or services) is created by enterprises (either small or big, state-owned or private, being in cooperative or collective ownership). These, through their own choice and decision, build up among themselves relationships of information, of selling and buying (based on bargaining and contracts) and other forms of relations, too (e.g. integrational, leading-and-following ones etc.). The rules of creating and maintaining these relations are partly given from outside (e.g. by commercial or business law or sometimes even prices), or they might be formed by bargaining and agreement between the participants of the market (particularly with respect to prices and the rules of market behaviour). The creation, maintenance, and realization of such relationships require some expenses. They appear as the costs of the collection and forwarding of information, of the maintenance and use of market organizations and the commercial infrastructure, regardless of whether they are possessed by the producers and/or users, or by independent trading companies (merchants). Depending on how far the inputs of enterprise (or private production) activities can be obtained only from the market, and how far the outputs can be realized only within it, furthermore, depending on the degree to which the partners can be freely chosen, competitive situations can develop between the participants of the given market. The quality of the competitive situation is determined by the availability of information and the regulations valid in the given market (or partial market).[1]

Two things follow from this description. The first one is that the operation of an economy—i.e. to what extent it can be considered as a market economy—depends on the existence or non-existence, the advancement or undevelopment, and the integrated or disintegrated condition of the so-called wholesale markets. It does not rest on the question of whether the final consumers (households) obtain their necessities or the things due to them for money, through a network of shops,

[1] For a more detailed interpretation of the concept of market, see: Lányi (1979).

or somewhere and somehow else. The second one is that if it is possible to completely eliminate the above-listed market-type relations (informative, bargaining, contracting and other) between the companies, and to replace them by mandatory delivery instructions or the appointment of suppliers, and to make the economy function in this way, then it makes practically no difference whether or not the same companies receive mandatory plan targets for other kinds of their activities, e.g. for production.

The main characteristics of the distribution system in the Soviet Union

Of the countries of the former CMEA region it was the Soviet Union in which de-commercialization was taking place even in the seventies. In the period of a rapidly growing foreign-trade turnover no Soviet producing or servicing company (corporation) was allowed to order any import product or to be the addressee of any export plan target.[2] Also, a persistent ideological battle was fought against the commercial (commodity supplying) relationships between CMEA member countries. (It was said that such relations embodied an "undeveloped form of collaboration".) The newly established union-level production associations, agro-industrial combines and complexes of the first half of the seventies provided an excellent opportunity for the liquidation of the purchasing and marketing departments (if they existed at all) of the enterprises, state-farms and kolkhozes they had absorbed. Although the latter had carried out no trading activities, in principle they should have known the names or addresses of some of their suppliers or customers, or might have met the state purchasing agency (Lányi 1976). It was also in the seventies that the organization of the State Committee for Material-Technological Provisions (the GOSSNAB, which was later on complemented with the GOSAGROSNAB, that fulfilled a similar function), stretched over the whole area of the Soviet Union, and became completely developed and stabilized (encroaching on the authority sphere of the State Planning Committee and the producing ministries). Beyond gathering the state reserves and beside certain tasks connected with foreign trade—mainly of imports—the GOSSNAB was given the task of providing all the producers, servicing units, offices and institutions of the Soviet Union with materials, semi-finished products, machines, parts and tools necessary for fulfilling their production and other obligations. The GOSSNAB organized the participation of suppliers and customers in the product flows going across the whole empire in such a way that up until 1989 they could not formally get into contractual relations with one an-

[2] From 1987 on this system ceased to exist. The responsible foreign trade organization is obliged to conclude a contract with the supplier or the user, generally within the frameworks of the economic plan or of the state order. See the collection of documents in Russian entitled "On the transformation of the system of foreign economic activities" (1987).

other. In the system of procurement (gathering up) of agricultural raw materials by the state, contracts are made for the quantities planned; their delivery is obligatory. In addition to this, the task of the Planning Office was (and is) merely to draw up the main product balances. The role of the producing ministries as authorities for allocating the quotas ('fondoderzhatel') varies and strongly depends on the extent of their sphere of authority at the given moment in the field of exports and imports.

The activities listed above are not called trade. This expression is reserved for the distribution system of consumer goods. The so-called domestic trade (both the state-owned and cooperative trade) possesses a wholesale distribution network (bazy) of its own. Their supply generally involves the intervention of the producing ministries, but it is often based on a contract made with the producer company. Here we also find a seemingly market-like institution that, twice a year, organizes fairs (of the light industry) where the representatives of the wholesale and retail trade can get acquainted with those of the suppliers and with their products. To a certain extent, they are allowed to make selections, too. However, they are mainly engaged in convincing the representative of the Ministry of Internal Trade to urge the suppliers through the Ministry of Industry's representative to deliver greater quantities; however, such promises are not usually fulfilled.[3]

Domestic trade has never been able to supply adequately the network of retail shops. Queuing, collective purchasing trips, and selling from under the counter, have always been evident; although the quantity of products has increased, these practices have not ceased to exist. The difference in relation to former times was merely that in the second half of the 1970s the so-called special (exclusive) serving was also democratized to a certain extent. For instance, from the durable consumer goods which were articles in shortage, quotas were detached for the district party committees in order that they could be distributed among the pre-eminent workers of the district.

In this system a minimal amount of certain types of trade can only be found in the following areas and activities: in model shops of producer companies; in some production contracting, procurement and foreign trade activities of the Centre of Cooperatives (the Centrosoiuz); and in the ever more narrow kolkhoz-market.

The big foreign trade unions, of course, were always trading, but only abroad. When, in 1986, 67 producers' unions, companies and development institutes were first granted the right of independent foreign trade, they obtained particular rights in the foreign market in connection with their foreign partners such that they were never and are not even today vested within the Soviet Union.[4]

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[3] These bargains were carried out under the supervision of the Fair Committee (Jarmarkom). (See: *Bik* 1989).

[4] See the collection of documents entitled "On the transformation of the system of foreign economic activities". (1987)

The privatization of distribution

One would think that under the given circumstances the companies and households would exert strong pressure on the authorities in order to replace the administrative form of distribution with trading. Also, one would have expected them to try to find some subterfuge for trading between the gaps of the planned economy and its legal system—or, perhaps masses of partially or totally illegal merchants and middlemen would appear on the scene. (Even in the 1950s and 1960s, what is more, in the Stalin era, systematically pursued private trade sporadically occurred: for instance, the selling of Siberian furs, or vegetables grown by Kazakhstani peasants who had arbitrarily seized land. (An almost legal form of trade in operation was when Georgian merchants bought up the windfalls from apple trees in the Transcaucasian region and delivered them by air-transport, using the regular passenger flights, to Alma-Ata.)

Nevertheless it was not trade but the privatization of distribution that became widespread as a mass-phenomenon in the last years of the Brezhnev era.

The most well-known forms of this—some of them definitely supported by the authorities—were the following:

When the agro-industrial complexes (agricultural enterprises of many hundred thousands of hectares) crushed the kolkhoz markets, the industrial companies in the towns started some collective (and private) auxiliary farms. The products of these were distributed (sold) among the workers of the companies by means of various collective and partially private ways.

In order to diminish ceaseless queuing, huge numbers of the big companies opened groceries and salesrooms in the area of their own plants. These were run by themselves, and they began to sell foodstuffs officially allocated from the commodity funds of domestic trade or other sources, or acquired in other ways.

In some member republics, especially in the Baltics, one extremely widespread form involved industrial enterprises producing certain inputs for agriculture—e.g. building materials—exchanged the quantity of products which were in excess of the plan target for the overproduction of kolkhozes and sovhozes (especially for meat). These products were then partly distributed among their own workers and partly utilized in further barter transactions.

The producing companies possessing model-shops began to distribute some part of those of their products that were in good demand through the model shop by special assignments to their own employees, or sometimes even to others (perhaps at reduced prices).

A kind of a secondary or tertiary distribution based on mutual favours between companies, companies and offices, offices and working organizations of intellectuals had taken on, by 1982–83, entirely institutionalized form. It was carried out in the framework of weekly and monthly allocations and deliveries, and was generally transacted by trade-union or party committees.

Also, some of the special supplies were officially transferred to shops open to the public. For the shopkeepers and their employees this provided a framework in which they could use a great part of these commodities for fulfilling semi-official and entirely private orders in return for certain favours and bribes.

Up to the beginning of the Andropov era an increasing quantity of commodities slipped out of the official circulation channels. As a result of this, not only a product shortage of critical size (though in many respects only a seeming one) became apparent in the Soviet Union but at the same time an actual dual system and, together with it, a dual power system developed in the sphere of distribution.

If we consider the rule over distribution as the basis of the Soviet-type (economic) power, then the break-up of the distribution system, and its slipping out of the hands of the competent authorities must be seen as a crisis phenomenon threatening its foundations. Therefore the lawsuits brought for breaking down private distribution were spectacular political actions in which even death sentences were passed. The most conspicuous of them was the sentence on the director of Gastronom No. 1 of Moscow, the famous Jeliseev-shop. (The Central Asian distribution systems which were given wide publicity in subsequent actions, were quite different things and do not belong to this category. In those cases there was no question of dual power but merely of the survival of some very ancient forms of power which could be "unmasked" in the milieu of the modern world as general, large-scale corruption.)

Here it is worth stopping for a moment, to say a few words about what economic and management factors played a part in that the privatization of the Soviet distribution system took place precisely in the late 1970s. Namely, the official distribution system was always in a miserable state and everybody—the party, the government and the press—was dissatisfied with it. Taking into account the extremely rapid differentiation of production, of productive use and personal consumption in the 1960s and 1970s, and the astoundingly drastic reorganization campaigns in industry, no one would have been surprised if the system of distribution, which was centralized beyond belief, had collapsed. But this did not happen. In fact, the GOSSNAB discovered that some of the produced goods must be left at the disposal of the member republics and the local authorities. Also, since the movement of products is extraordinary slow in the Soviet Union, the stocks were not to be underplanned (overdistributed).[5] The material basis of this generosity was created by the improving terms of trade caused by the explosion of raw material prices, the capital drawn away from the CMEA region and the surplus in

[5] Therefore in 1989 many have suggested—and a debate has developed on the subject—that by putting the commodity reserves and the stocks "settled" at most various places on the market, the shortage of goods could be eliminated. The value of the reserves was then estimated at 500–520 billion roubles. At the reform conference held in autumn 1989 I. I. Slunkov, secretary of the CPSU, qualified the proposed action as being inappropriate. (*Ekonomicheskaia Gazeta*, 1989e).

the balance of accounts with the developing countries. In this way remained many more products than earlier to be distributed by offices, groups and individuals and it was done in a fully legal way. However, since in the given system goods can only become accessible by distribution (allocation), despite the centralization of the official distribution organization, even the distributing power became divisible and started to multiply in its own way. Not even the fact hindered the process that, in the course of this, many had to transgress the limits allowed by law.

Thus, when in the Gorbachev era, with a material background already much more penurious than earlier, the doubling of distribution was re-started, it constituted, from the outset, a matter for the police, according to the preceding practice. Consequently, in the first half of 1990, in the territory of the RFSR alone, the courts passed 86,500 penal sentences because of speculation, blackmarketing, hoarding commodities in shops or stores, and illegal trade (Sinilov and Golovnin 1990).

The official system itself has not changed much in the meantime. Thus, the consequence of the fact that during the Andropov era police finished so drastically with the new type of distribution, was that in several spheres of the economy, in the second half of the eighties, organized crime became the protagonist of the re-started private distribution. This does not seem to be very promising from the aspect of the progress of economic reform.

Also, it does not augur too well for the so-called small-scale enterprises (subsidiaries and cooperatives of large companies, cooperatives of private persons). These, when engaging in wholesale (mostly mediating and agency) activities, act in general, even in favourable cases, rather close to the boundaries of legality. Hence they are exposed to both political (police) pressure, as well as to the competition and blackmailing of official distributors and the underworld. Perhaps the saddest but most entertaining story of this appeared in a private interview, in which the police superintendent of Novosibirsk questioned a wholesale merchant. The latter was working illegally, but was ready to pursue well established and fair business transactions (*Cheplygin* 1990).

How much of trade is affected by the market reform?

In the Soviet Union the Supreme Council resolved on the general extension and continuation of the economic reform in 1987. With regard to trade, all that happened was that in July 1988 the Council of Ministers ordered that deliveries aimed at production and technology would have to be based on contracts between the supplier and the user. Those items for which quotas and limits are in force were to be distributed by GOSSNAB, as was the practice earlier; those for which no quotas and limits existed, were to be considered as being in the so-called wholesale order. This means that the GOSSNAB is obliged to give information about the potential suppliers and to collaborate with the user in placing a so-called direct order. Should this fail, the two competent ministries have to make the decision, if necessary with the intervention of the GOSSNAB.[6] All the other procedures have remained unchanged. As is known from other sources, the GOSSNAB is, in general, only obliged to supply the companies to the extent of state orders (although state orders sometimes exceed the company's existing capacities). For all these, marketing campaigns were tentatively organized, and at the campaigns anything could be freely purchased—although at multiple prices. In the meantime, some of the companies were allowed to choose between remaining under the control of a ministry or becoming independent. However, the companies who chose independence could not obtain commodities whose distribution was linked to quotas or limits. Therefore they asked for permission to be put back under the wings of the ministry. (*Korotkov* 1989). They had every reason to do so, especially since, in the sphere of the producing ministries, a veritable movement had started for the sake of setting up so-called trading centres as their own institutions for distributing the commodities coming within their competence and for supplying the companies belonging to them.[7]

In order to avoid any misunderstanding we must note that in one of his statements Shatalin (*Ekonomicheskaia Gazeta* 1989b) expressed the opinion that, the economic reform must lead to wholesale trade and to a developed consumer market. Yet, the famous 500-day plan itself wanted to maintain the system of state orders and compulsory distribution for the most important products (*Crosnier* 1990).

The programme—the implementation of which could also be pursued in practice with varying degrees of hindrance and interruption—was the so-called Gorbachev-programme. This was actually drawn up by the reform committees. A more detailed version of it was discussed at a big conference in October 1989 and, following this, it was debated in the newspapers. In the Soviet Union this was called the "radical reform" (*Ekonomicheskaia Gazeta* 1989c). A detailed explanation and reasoned line of argument were given in a presentation given by L. I. *Abalkin*, deputy prime minister. (*Ekonomicheskaia Gazeta* 1989d). Abalkin's speech made at the November 1990 session of the Supreme Council, and published under the title "On the practical tasks of the transition to market economy" (*Ekonomika i Zhizn'* 1990a) can, in many ways, be considered as the continuation of the original programme.

It should not be forgotten that in the period between the two speeches, denationalization of the state companies (and to a smaller extent their privatization) got underway; laws were passed on property, land, and on tenancy. A new law on

[6] The text of the decree was published by *Ekonomicheskaia Gazeta* (1988).

[7] The new appearance of the ministry. What will it look like? (*Ekonomicheskaia Gazeta* 1989a).

companies and taxes came into force. Decrees were enacted in connection with stock companies, limited liability companies, small-scale enterprises and the elimination of monopolies. The privatization of retail trade and public catering also started, but no other part of the commodity flows was affected.[8] Nor was this realistic, since in 1990 there were many political crises, and many of the until then existing supplying relationships ceased to exist. Everybody began to withhold the produced commodities and bartering became the general form of trade between republics, regions, countries, towns, enterprises and kolkhozes. It is perhaps right to note that in the opinion of an analyst (albeit a foreign one) the over-all spread of barter transactions indicated that the potential customers and suppliers knew or, in the meantime, were able to become familiar with each other (or the agents). Hence, there would have been no obstacle to the immediate and complete elimination of the system of state orders and compulsory distribution (allocation) (*Tammen* 1990).

After all these, with regard to trade, what details are included in "The main trends of the stabilization of the national economy and of the transition to a market economy", which had been present in Abalkin's above-mentioned speech?

The deputy-prime minister acknowledged that the turnover of commodities needed an enormous change. His suggestions were the following: commercial (commodity) exchanges should be established (stock exchanges are already in operation). A new contracting and trading system has to be created which—based on the existing organization of the GOSSNAB and the Ministry of Internal Trade—would assure the fulfilment of "direct contracts" between the member republics, and realization of the (central) state programmes. This would be done in such a way that the contracting parties would commit themselves to making the enterprises fulfil the contracts they had concluded with each other (as was customary in the CMEA). Market infrastructure and "other market-type state structures" were also mentioned but no explanation of them was given. Albakin's experts estimate that the period of transition to a market economy will last about 2–5 years and, as it turns out from the quoted speech, they would not dare to change the remaining management structure until at least 20 percent of the leaders not only advocate the new system, but are proficient in operating it.

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[8] The related legal provisions can be found in the following numbers of *Ekonomika i Zhizn'*: March 1990, No. 13, p. 23, decree of the Council of Ministers on tenancy of land, factory plants, shops etc.; July 1990, No. 29, p. 14, decree on securities; August 1990, No. 34, pp. 19–21, draft bill of the RFSR on the tenure purchase and gratuitous transfer of state property; December 1990, No. 49, pp. 11–13, decrees on the limited liability companies and stock companies.

According to the data quoted by Abalkin in his speech delivered at the November 29 session of the Supreme Council, in the first ten months of 1990, 23 thousand shops and approximately 5 thousand other enterprises and plants were leased. In Russia, the Ukraine, Azerbaijan and Central Asia alone 21 thousand shops, 9 thousand restaurants and 13 service plants were privatized (sold). *Ekonomika i Zhizn'*, December 1990, No. 49, p. 3.

Instead of a conclusion, two questions

Who would have thought that it would be the Soviet Union where hands would be laid on state property earlier than on the offices of the supreme distribution (allocation) authority, and where they would privatize before they would actually introduce trading? Perhaps it would be right to change the title of this paper—"A market economy without trade"—into a more appropriate one: "Capitalism without a market"?

This is not only a play on words. Just recently, American observers began to notice that the existing Japanese capitalism is not based on the type of market which is known in the United States (*Neff, Magnusson and Holstein* 1989).

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РЫНОЧНАЯ ЭКОНОМИКА БЕЗ ТОРГОВЛИ? (РАЗМЫШЛЕНИЯ О ПРИРОДЕ СОВЕТСКОГО ХОЗЯЙСТВЕННОГО КРИЗИСА И ПЕРСПЕКТИВАХ РЫНОЧНОЙ РЕФОРМЫ)

К. ЛАНИ

Начиная с 1987 г. в Советском Союзе было принято несколько программ реформ, последняя из которых и официально была провозглашена как программа перехода к рыночной экономике. Часть этих программ, с меньшими или большими перерывами и отступлениями, начали претворять в жизнь. С 1990 г. идет разгосударствление собственности и даже частичная передача в частные руки. Но в то же время еще ничего не сделано для того, чтобы на место централизованного распределения товаров поставить торговлю (оптовую торговлю). Характерно, что даже во второй экономике и в теневой экономике торговое предпринимательство также значительно отстает. Исходя из чрезвычайно распространенной нелегальной распределительной деятельности в конце периода брежневского руководства, а также на основе данных советской прессы, в статье делается вывод, что место торговли уже занято официальной или нелегальной приватизацией (бюрократического) распределения. Поэтому отнюдь не очевидно, что нарождающийся советский капитализм будет базироваться на рыночном хозяйстве.

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CHANGING FORMATION AND PRIVATIZATION

R. HOCH

In Hungary—and in other former socialist countries—the restitution of capitalist relations is on the agenda. Accordingly, the central political problem is *privatization.*

Even the elementary interrelations of this process are unclear and debated—rather in implicit than explicit form.

Should privatization be fast or implemented gradually? Who will be the new big capitalists? How is foreign capital judged in a nationalist and a liberal approach? How is the dilemma of Ricardo vs. List judged in Hungary of the late 20th century. How are social classes affected by privatization? What are the possible perspectives of development?

Nowadays in almost all political texts and actual economic analyses one of the most (or precisely *the* most) frequently found concept is *privatization.* It is only natural that the central idea of the changing of the social formation (in fact, of restoration) is the transformation or re-transformation of state property into private property.

This process is in compliance with the ideology according to which state property is unable to operate efficiently, and only an economy which is based on private property can be effective. All the parliamentary parties in Hungary (and the majority of those which have no seat in the Parliament) say "yes" to privatization; differences can only be found between them regarding its interpretation, its extent or its pace.

However, in the political texts and analyses dealing with privatization several subjects can be found which, although important, have no bearing on the deepest interconnections of the subject matter. Such are: privatization vs. reprivatization; state-directed privatization vs. "spontaneous" privatization. In my paper I am only going to touch upon these topics where necessary, and will not deal with them at all if they are not specifically relevant for my article.

Antecedents

In the socialist countries, particularly in Hungary, the necessity of changing ownership relations was a matter that appeared early on in the various attempts at reform. More accurately, at the outset the necessity of change cropped up as an idea or a problem connected with organization activities and organization structures. In the late 1950s and early 1960s, for the analyst aiming at changes, the basic and self-evident cause of rigidness and the inability to adjust as well as of the monopolized character of the economy was *overcentralization.* In other words, the fact was that an overwhelming number of economic activities were organized and forced into large companies, even if it was neither economically, nor technologically justified. The real reason for overcentralization was connected with political and, to greater extent, ideological motives. In industry, the medium- and small-scale enterprises and small venturers were reduced to a minimum, even driven out of existence. In agriculture and in the sphere of services small enterprises sporadically survived, although medium-size companies were missing. Still, there were insufficient possibilities for such activities and, especially in the case of services, too few people were involved. (In Hungary, the collectivization of agriculture was successful precisely because it solved fairly well the combination of large-scale and small-scale plants, i.e. the division of labour between the collective farms and household plots. What it did not accomplish was medium-scale farming. However, in general small-scale farming was not really a form of small enterprise.)

Using the expression of G. *Révész*: With regard to the company-structure of the economy the "texture of stitches" was unhealthy.

The conclusion is obvious: beside the large companies and to some extent instead of them, a number of medium- and small-scale enterprises is needed. Without this, there can be no question of supply being adjusted to the demand of consumers, of a "consumer market", or of competition among the sellers. In other words, one of the basic conditions of developing a socialist market economy is a radical transformation of the economy with regard to company sizes.

The criticism of the structure has, from the outset, implied (in the early 1960s this was in an implicit form, but not too much later it became explicit) the need for a *certain* reform of the ownership relations. One part, or a concomitant phenomenon, of every wave of the reforms since 1953[1] has been an increase of the share of small-scale ownership and small ventures and, in general, decentralization in the sphere of companies. In contrast, during the eras of counter-reform, the share of small-scale ownership declined and centralization, in general, was strengthened.

For a long time, the criticisms of the size structure of companies and of the endeavours aimed at changing the ownership relations were very closely linked to one another. It was said that the big companies should be mainly in state and cooperative ownership; the medium-size companies should be owned by small state enterprises and small cooperatives, while small-scale enterprises and small ventures should be in private ownership. This is the way in which the need for an economy with mixed ownership appeared.

However, to recognize the necessity of the reform of state and cooperative ownership was at least as important as this. The 1968 reform was a substantial change of state ownership. It was also an important from the aspect of ownership

[1] In the second half of 1953 and in 1954 a series of jokes were born beginning with the words: "Uncle Kohn has got back his trade license..." (The name symbolizes the small shopkeeper or artisan.–Ed.note.)

reform that the self-governing character of cooperative ownership was principally recognized. The possibility of self-government of the state companies was recognized by the stand taken by the Central Committee as late as 1984.

To put it in a more general form: up to the end of the 1950s and the early 1960s the concept of state (and also of cooperative) ownership was internally undifferentiated and of a monolithic character; however, from the mid-1960s on, in theory—but also in practice—the articulation of the differences started.

The most important new trends may be indicated with the following slogans: "So far state property has been in the ownership of state administration. Now most of this property has to be freed from this state administration character." "Self-management has to be recognized also with respect to state property." "Holdings have to be established which will control the companies in accordance with the requirements of efficient economic management." "The serious defect of 1968—i.e. the short-term profit-motive which prompted a wasteful management of the resources—has to be replaced by long-term interest, which means interest in accumulating wealth." "Room should be given to the counter-interests between company leaders and the collective." "Within the sphere of the state companies a great many medium-size and small-scale enterprises are needed." "Big state enterprises must be allowed to split into parts on their own initiative. Or, the other way round, they should be able to establish looser or closer voluntary unions. What is more, even cooperatives should be allowed to be members of such unions. The unions should be allowed to found enterprises." The aim of all these endeavours was that the operation of the state companies should become economically efficient.

A similar reform process started in connection with cooperative ownership. There were two trends which seemingly contradict each other, but in reality conform from several aspects. One of them says that the cooperatives should operate in the form of companies. The other opinion is that these companies should be genuine cooperatives. This means that the distributable funds should significantly increase or, to be more precise, the ratio between the divisible and the non-divisible funds should be inverted, to the advantage of the divisible ones. (In the agricultural cooperatives the share of non-divisible funds reached 90 percent. This is no cooperative.) The concept of "changing into companies" was purely aimed at increasing efficiency. The "changing into cooperatives", apart from improving efficiency, was also an ideological motive, (aimed at anti-statism and at democratic self-government).

However, the road of the reform was far from being straight. The last declining path could not be replaced by a rising one any more. A typical particularity of the 1972 counter-reform was re-centralization with regard to both company (and cooperative) sizes, and—in conformity with the latter—the ownership relations. By the time the way could open up for a new wave of reform, in the late 1970s and in the 1980s, quite different economic and political circumstances had appeared. There is still another factor, which may not have been the most important one but its significance must not be underestimated. The 1960s saw the high point of Keynesianism in the capitalist world. The economic role of the state and state ownership were very important elements of this theory and policy. In contrast to this, the 1980s saw the triumphal march of neo-liberalism, with state property being pressed into the background and widespread reprivatization become the order of the day.

The new wave of Hungarian reform started in a crisis situation. The country was indebted, the IMF dictated the conditions of economic policy, and this policy was spelt out in an increasingly aggressive manner. Economic policy was already characterized by restriction, with priority being given to repaying the debts and reducing consumption. Regarding the latter, in the early 1980s, this reduction was moderate (the income paradox asserted itself), while in the second half of the decade it became drastic. At that time political unrest began to grow (the question was heard more frequently: what is the limit to the population's tolerance?). Despite this situation (or just because of it?) those in power still stubbornly resisted any comprehensive reform (including the reform of economic policy).

Instead of a comprehensive transformation an—in my opinion distorted—reform process started in the early 1980s. It was distorted by insufficiency; the modifications did not reach the critical extent needed for a qualitative change. Insufficiency reveals itself in one-sidedness. With very little exaggeration, at that time the ideology of "small is beautiful" began to assert itself. Economic management opened a wide gate (after having expounded the foregoing, I need not prove that in my opinion this was right) for small-scale enterprises (economic working teams, civil-rights associations, leases etc.). However, it did not lay hands on the operation of the big companies. (The company council is, in my opinion, a blind alley, therefore it could not affect the essence of the situation.) Also, attempts to solve the problems of the big companies took the form of pseudo-small ventures (company economic workteams); of course, they had little success.

Since, instead of a true reform of the big companies, small-scale ventures came into the foreground unilaterally, the otherwise desirable development of the former ones remained in itself a substituting action. Production, exports, capital and employees, in their vast majority belong to the sphere of the big companies; therefore, it is only natural that small-scale enterprises in themselves are unable to solve the problems of the economy.

The radical change came about towards the end of the 1980s—this was the law on economic associations. (*Sárközy* 1991) The essential novelty of this law is not that it allows and prompts state companies to transform themselves into stock companies. Not even the fact that it allows the combination of state-owned and private capital. The necessity of joint stock (share) companies emerged much earlier, in connection with the 1968 reform. (Hoch 1991) This form in itself was suitable for the transition into a more efficient, more elastic form of social ownership. But, at the end of the 1980s—owing to the changing external conditions and the above mentioned internal circumstances—things began to go in the same direction as that of the changing social formation.

Same intermediate lessons

I think the things described above are not simply historical curiosities.

1. Today the ideology of "small is beautiful" acts almost like an official doctrine—and this tendency is getting stronger. Despite this, whether we like this state of affairs or not, the greatest or anyway the most significant part of the economy will be the sector of state companies. Consequently, in the coming years there will be no increase in efficiency, no significant accumulation, no notable technological development, no increase of production in the Hungarian economy, if all these factors are kept away from the state companies. The validity of these statements is even wider if we speak about the sphere of large companies. (This is because the "private" economy is not identical with the sum of small enterprises—of course, this identification is even less in western countries.)

2. The essence of privatization is the selling of big state companies to domestic, but especially to foreign "private entities"—in other words, to capitalists.[2] It is very important, from this aspect too, that the operation of the state companies should improve since this determines the price which can be achieved. If endeavours are actually made merely for the sake of getting rid of state companies, the selling of the latter may be no more than a squandering of existing resources.

However, the government really shows no serious intention, nor does the parliamentary opposition suggest, that there ought to be a search for more efficient forms of operation for the state companies. On the contrary, even the present government administration deals mostly with the question of how it could get rid of such enterprises—at any price. The result is that the majority of companies are again characterized by the least effective features of public administration. The liberal opposition also raises the objection that privatization is not sufficiently rapid.

In western countries the privatization of state companies is, in most of the cases, not simply a process of giving the companies to private owners. (*Kopátsy* 1991) For instance, the state-owned telephone company of the Netherlands was privatized. This involved transforming it into a joint-stock company, so that the majority of the shares were kept in state ownership. This is not the same as what we have heard about privatization.

[2]For Hungary it is not really important whether the foreign buyer is really a private capitalist or not. Someone has asked the interesting question of whether it is privatization if a Hungarian state company is bought by an Italian state company. My opinion is that from our view it is privatization.

The past forty years—together with state ownership—can be hated or liked. (Though giving voice to the latter is nowadays not too advisable.) However, one thing that must not be done by the economic analyst and even less by the economic policy maker is to behave as if the past forty years never existed. Similar to this is to pretend that state property could be made non-existent and disappear within a short period of time.

What kind of private ownership is created by privatization?

The logic of restituting private ownership and of pressing state property and the cooperatives (mainly those which have so far operated within the existing frameworks) between the narrowest possible limits is that collective property cannot work efficiently: if it belongs to everybody, it belongs to nobody. There is nobody who would be interested in properly administering such property, or who would provide for good administration. The property should "bear a name".

According to this train of thought, the most efficient property is small private property; this idealizes the peasant, the artisan and the small shopkeeper, who does everything himself and, at the same time, looks twice at every penny, and lets not a single grain, a screw or a gramme of salt be lost. It is here and in this way that we reach the ideology of "small is beautiful".

However, the present changing of the (social) formation is not a restitution of pre-capitalist relations, but that of capitalism. There are, however, different forms of capitalist ownership, too. According to the above line of reasoning, if capitalism is chosen, it is small capitalist property which is really efficient: namely, a company where the small capitalist controls both the economic and physical processes, and will personally take the employee by his ear if the employee does not represent the owner's interests to the maximum degree. The large capitalist company, the syndicate, the supra-national and multinational company are not the real ones—they resemble the state company. In French the joint-stock company is called 'Societé Anonyme', i.e. a nameless company. Here, there is a problem with "having no name". Yet the foreign capital which is brought by the potential buyer of the big state companies does not consist of grocers but includes large capitalist enterprises—among them, to a great extent, supranational companies. (For instance, it would be difficult to tell, who General Electric is personally, who has actually bought the Tungsram company.)

R. *Dorfman* (1978) after having expounded the theory of static general equilibrium and perfect competition as the idea of economic optimum, finally bows before the obduracy of facts. Namely, he recognizes that the oligopolies which constitute a serious defect in the system of a free market (p. 169), enjoy the advantages of mass production and mass trade, and that the foreign specialists visiting the USA study modern technology in oligopoly companies. (Dorfman 1964, p. 144) Then why all the propaganda about the idea of free competition?

The point is that democracy exists where there is a market economy. The conclusion is clear: nowadays democracy can really be found only in countries where a market economy exists. But it is far from being true that where a market economy can be found, democracy exists. We do not even know whether it is possible to liberalize the economy and politics at the same time.

Privatization and social structure

Privatization—as a matter of course—brings about significant differences in income and wealth. This is a fact that belongs to the essence of the social formation to be created.

There are many who claim that the Hungarian social consensus that existed in the sixties and seventies relied on rising living standards. This is only part of the truth. Among several other factors, an outstanding role was played by the fact that a middle class (not in the sense it was understood before World War II), comprising the overwhelming majority of the population, came into being. Many people had arisen from poverty; however, the possibility of amassing a fortune was limited. Now we are witnessing the disintegration of this middle class. Many of its former 'members' are growing extremely rich. However, there are more who are sinking to the minimum level of social existence or even below that. The situation is worsened by the fact that this process of differentiation is going on parallel with a general decrease in real incomes.

With regard to this, what does reprivatization mean? We hear that the state indemnifies the former owners; grants them property, or papers representing the right to property, which assure titles for receiving some income. Does this mean that in this distribution the state will lose revenue as credit goes to those who are indemnified? Not at all!

Indemnification (compensation) is made at the cost of those who are not participants in it; more generally, at the cost of those without property. At the same time, the majority of the indemnified will also not become rich by it, they only pinch off a little part of others' income, be they indemnified by securities or by physical assets, e.g. land. All this is done—as has been mentioned—under the circumstances of generally decreasing real incomes, especially of the real income of the propertyless. This is why those who claim that their main aim is the representation of the political and economic interests of the propertyless, ought to *protest* against the procedure of indemnification.

The target of creating a "social market economy" is contained in the programmes of all the parliamentary parties. Now, I do not want to emphasize that this concept does not stand up to scientific criticism. For a market is not social and what is social is usually not a market. The maximum we can say is that in a modern capitalist society, market economy and social economy (e.g. a 'grants economy') have to complement each other.

In the advanced capitalist countries the unevenness of property- and income distribution threatened the existence of the system before and after World War II. The condition of survival of the capitalist market economy was to build up a welfare state and a welfare economy. Welfare policy moderated the inequalities of incomes in relation to the situation at that time (of course, not the inequalities of wealth), or at least made it acceptable for the propertyless and those with little property.

In Hungary now a reverse process is going on. The aim is privatization (and reprivatization), and this is creating a capitalist market economy and differentiation of the society by wealth and income. It is not a social economy that is being built. On the contrary, the welfare system is pressed back or even cut back. (There will be changes which will improve the quality of these systems, a great number of which have already been recommended earlier, what is more, they have already been planned. Such, for example, is the placing of social insurance on a self-governing basis. However, this does not influence the fact that the chief trend of the changes will be reduction of the benefits enjoyed up to now. In practice, this process has been going on for a number of years, and in 1990 it grew stronger.) The maximum that social policy and income policy can do—and this is not negligible—is to somewhat slow down and mitigate the negative social consequences of differentiation. This is, of course, far from what some parties promised under the title of a "social market economy".

The pace of privatization

It is an accepted fact that changing the system means the creation of capitalist relations. However, the pace of the restoration is still an open question. Yet the speed of privatization may have various results, and this itself implies certain assumptions.

I begin with the latter. If I am convinced that privatization is the remedy to all of the troubles, I will urge its fastest possible implementation, regardless of any other consequences attached to it. It does not matter too much if the state-owned industrial plants are sold at low prices or if there are many corrupt practices in the course of privatization; it is of no particular interest exactly who the new owners are. (The above sentences were heard from the lips of well-known politicians!) However, if my opinion is that private ownership *in itself* does not solve everything then I suggest that in parallel with privatization, also certain conditions have to be changed. (For instance, in the third world the economies are mostly based on private property, and still, in the majority of these countries the situation is—to put it mildly—not better than it is in Hungary.) That is, those conditions on which the state of the economy depends—at least to the same degree as it does on the ownership relations. It also includes those conditions which create favourable circumstances for the operation of private property. Such is, for instance, vigorous development of the infrastructure—which in itself also postulates privatization but where the role of state involvement is more significant than in other areas. (*Zsubori* 1990b; *Kovács* 1990) The aim of this is, as I have already mentioned, to improve the operation of state companies, parallel with privatization. From the standpoint of "changing several conditions at once" only a more gradual, more carefully thought out and better prepared way of privatization can be recommended. The concept of advancing cautiously should not serve as an ideology for a government which (to put it mildly) does not profess the idea of socialism, but which likes economic power embodied in state property.

Unfortunately, we have to draw the conclusion both from the preceding and the present period that economic policy-makers are unable to conceive and carry out simultaneously more than one thing at a time. Especially unfavourable are the prospects if one of the main motives of privatization is to pay our foreign debts with property now in state ownership. To put it in more general terms, it is a serious danger to the country if financial government is the trustee of economic policy.

The variants of pace and their consequences

It is only natural that the variant which is urged, and the more gradual variant, entail quite different consequences.

An unquestionable advantage of the quicker solution is that we can soon get the operation out of the way and get if off our mind. Furthermore, owing to the inertia of things, the probability exists that a slower change covers up the omission of the changes. This is especially so when in the conduct of government statist features (of a rather feudal character) can anyway be discovered.

It is customary to mention among the consequences of this path the following: faster restructuring, higher unemployment, and sharper social tensions. There is some truth in these statements. Nevertheless, restructuring and privatization do not necessarily coincide. In principle, a drastic restructuring can also be implemented without changing the ownership relations. Also, the other way round, if branches and companies which are prospering go into private ownership, and the enterprises and sectors in a state of crisis remain on the shoulders of the state, privatization will not change anything in the structure of the economy.

Who are the new owners?

First of all, let us put aside prudery. The assets of the economy are placed not simply into private ownership, but into *capitalist* ownership. The "building up" of capitalism is in progress. At the same time, of course, by using various tools—credits, favours granted to small entrepreneurs, indemnification etc.—small private property is also widely promoted. (A greater number of small enterprises is an indispensable economic and political background for capitalist property.)

The real question is: Who will buy up the state companies? That is, who will be the big capitalists in Hungary? It is possible to argue for the *organic development* of capitalism. (*Kornai* 1990) This seems to be a convincing argument; in other words, capitalism has been able to show up its well-known historical virtues, because its development has been basically organic. We ought to approach these results and virtues. Organic development is, however, time-consuming.

In Hungary, in the foreseeable future no such amount of capital can be accumulated which could reach the order of magnitude (using the term in its mathematical sense) needed for buying up state property.

How can the process be accelerated? There are practically two ways of doing this. (They do not exclude one another.)

One of the ways is the so-called primitive accumulation of capital—that is, the creation of the capitalist class with state assistance. (In addition, it implies the creation of the proletariat, by depriving the workers of their conditions of existence.) The so-called primitive accumulation of capital partly preceded, and partly accelerated the organic development of capitalism. In fact, this process can be recognized in Hungary (and in some other, formerly socialist countries—e.g. in the former GDR, too.) The difference is that under our circumstances a real class of big capitalists cannot be created. True, national wealth can be distributed on the basis of merits and injuries; but by the allotment of fiefs only feudalism, and not capitalism can be brought about.

The other way is that the role of Hungarian big capital is taken over—at least in part—by foreign capital. For, if domestic big capital cannot be created quickly, either organically or by primitive accumulation, nothing will be left but foreign capital.

The judgement on foreign capital

With respect to the import of foreign capital (*A keresztény* 1990; *Bauer* 1990; *Szendrei* 1990; *Bauer and Kis* 1990) I do not wish to put the customary questions; for instance, what kinds of institutional and legal conditions are needed for foreign capital to come in, and why the creation of the conditions is protracted. I also do not want to press the question concerning what amount of inflow can be expected should such conditions exists; namely, whether in this case there will be sufficient foreign capital demand for rapid privatization. I lack the necessary preparatory information to make such prognostications. No data are available to me even about how the capital that has come into the country so far has been divided among the big, the medium-sized and the small-scale enterprises and ventures. Nor do I know how the imported venture capital is divided between capital-intensive and less capital-intensive activities. For instance, *no data are available* showing the proportion of foreign capital that is spent on advanced or high technology.[3]

What I should really like to speak about is the *judgement* on foreign capital. It is not so much in the scientific field, but rather in political and ideological quarters that sharp differences of views can be found regarding the question of how foreign capital and its character should be judged—consequently, what attitude should be taken towards that capital. I am deliberately speaking about differences of views, since in reality no debate can be spoken of. Often it is only possible to surmise what it is all about from certain remarks.

We may meet the concept: "rapacious, or hawk-capital". Such and similar formulations suggest a hostile attitude to foreign capital from the outset. These accept the import of venture capital as a necessary evil, which should be handled with very strong limitations and strict control. This reflects an ideology and policy representing domestic capitalists—what is more, a view which usually aims to protect the growth of a gentry-like capitalist class. (Is domestic capital a "dove"?)

Somewhat more articulate is the system of ideas according to which it is simply an anachronism to distinguish between domestic and foreign capital. Capital is international; it is senseless to look for its nationality. It may endanger our adherence to Europe if we distinguish between "Hungarian" and "foreign" capital. This is, *in general* the ideology of capital.

Where is the truth in this dialogue (of the deaf)? I belong to those who—even in the past—professed the opinion that venture capital (direct investment) has to be preferred to loan capital. (*Hoch and Radnóti* 1989) I even accept the charge that everybody likes to show the golden middle path between the extremes. Or, to put it more moderately: I am embarrassed—nay, not because I do not know which standpoint is right; in my opinion neither of them is—but by the question as to how much truth is contained in the one or the other point of view.

No doubt, the standpoint which judges international capital evil and Hungarian capital good, is a troglodyte one. This is especially true when our joining the advanced capitalist world is a main point in the programmes of all political parties; and when both the necessary amount of capital, as well as the badly needed high, or nearly high technology can only be obtained from the advanced countries; fur-

[3] In the excellent study of M. *Móra* (1990) we get rich information and data processing. However, it does not satisfy the above mentioned requirements.

thermore, it is well-known that domestic capital is sufficient for the privatization of only a negligible fraction of state capital—thus it is an infamous anachronism to judge capital on the basis of whether it is national or international.

On the other side, the representation or "articulation" of the interests of the country's economy is not a form of nationalism. The dilemma of D. *Ricardo* vs. F. *List* has not lost its validity even at the end of the 20th century! Namely, that unlimited economic liberalization is usually in the interest of the advanced countries, while for the weak countries it also entails disadvantages. Therefore, the interest of the latter is to somehow protect themselves against the harmful effects. (I. *Csurka*—one of the leaders of the Hungarian Democratic Forum—is thus right when he says that liberalism cannot be applied to the Hungarian economy without restrictions.)

Anyway, in the market relations between advanced and undeveloped countries it is impossible to fully avoid the negative results which may affect the latter. Protection against the negative effects means not only, perhaps not even primarily, administrative restrictions, though it may involve some measures of this kind.

After several decades of powerful protectionism, such a view might be rather unpopular. (Hoch 1987) Several years earlier a start was made to the gradual pulling down of the hot-house which covered the Hungarian economy. Now this glass-house is being demolished all at once.

What kinds of advantages and disadvantages are entailed by the import of capital? The incoming capital will, of course, follow its own benefit. It will serve its intricate, long-term interests in profit and property. International capital is not a Salvation Army. But this is not the question. The *concrete motives* for which foreign capital comes to Hungary may be rather varied. The real question is: Does the concrete motive concur with Hungary's interests, or not?

1. If a foreign syndicate buys (partly or completely) a Hungarian state company *in order to make it prosper as a part of its total capital*, to provide it with high technology, and assure its development by employing the company's research department; and if, by introducing modern methods of economic activities and management, and acquiring foreign markets, it wants to start an export offensive with up-to-date products and to spread these in the domestic market too, perhaps even creating new jobs, this is obviously an advantage to Hungary.

2. The balance of advantages and disadvantages is not as positive as this, if the motive of buying the Hungarian company is that some transoceanic enterprise wants to supply the European markets with some traditional product while at the same time *saving on transport costs*. For achieving this, it grants modern (not precisely high) technology and liquidates the research basic of the given Hungarian company. Or, it might be that it wishes to free its own companies from turning out traditional products. In such cases the import capital—paradoxically—preserves our backwardness by development and by widening the market. Such a strategy is

often asserted in the relationships of advanced capitalist countries with the third world. This is usually accompanied by dismissals.

3. The most general attractive factor encouraging the export of venture capital into undeveloped countries is *cheap labour*. The differences appearing in the labour costs may assure some comparative advantages for Hungary. The utilization of these has been urged by several economists in past decades. However, we have to compete with the price of (the diligent and disciplined) labour of the Far Eastern countries. In relation to the latter, Hungarian labour is expensive. This helps us understand the real reason for the concentrated—and successful—attempts to reduce real wages and liquidate social benefits (incomes) in money and kind. This attack started earlier, in the mid-1980s, but it has now become dramatic. The IMF has been urging, ever since the early 1980s, a drastic reduction of wages and social incomes and the liquidation of the earlier created systems of provisions and allocations. (The suggestions of the IMF study written in 1990 are mostly unacceptable, even for the present government.) This is also the framework for the requirement of bringing about a significant level of unemployment. From this point of view, these requirements are, of course, quite reasonable. Looking at it with the eyes of the capitalist willing to invest his capital in Hungary, the population living on wages and salaries lives too well—not only with regard to the peak achieved at the end of the 1970s, but even by today's standards. The fact is that the wage levels of Taiwan or Thailand are much more attractive.

4. It is a fairly widespread course of action in the market economies of the world that a given capitalist concern buys up companies operating in the range of its activities in order *to get rid of competition*. Such decisions are of a strategic character, so that buying and liquidating certain companies may also be justified by *potential* competition. And we do not need a restructuring which "weeds out" our competitive companies.

I am unable to tell to what extent' government policy can act to the ensure that, as far as possible, variant a) involving capital import should be dominant and variant d) should be avoided—and what kinds of regulators might serve the approach towards this goal. A thorough study would be needed to answer this complex set of questions. Maybe there is no positive answer and our fate is predestined. As someone has put it, we have grown from being a ferry-country into a country of subsidiary companies. And this is still not the worse!

Capitalist economy—mixed economy

Thus, the idea in the forefront of the dominant political endeavours is the creation of a capitalist economy. However, the economic systems in the western countries are not purely capitalist, but represent mixed economies. These are mixed economies which are *characterized* by capitalist relations. There was a time—in the 1960s and 1970s—when certain western theoreticians said that in their countries there was no capitalism, but a mixed economy. (Even today many feel that it is a better form to use "market economy" as a synonym.) In fact, the capitalism of this mixed economy is very different from the pure capitalism of the 19th or of the beginning of the 20th century. The state-owned sector has varied through time and, of course, taken different forms in different countries, both with regard to its extent and its form. A type of private sector can also be found in which the weight and role of the so-called non-profit institutions are significant. (In Hungary it is a common misbelief that the sphere of private ownership coincides with that of the profit-motivated institutions.) These are important criteria of a mixed economy.

If all the above is true, then why is the mixed economy still capitalism? It is because pure capitalism—owing to various social, economic and political reasons—simply cannot exist any longer; it is because the extent of the non-capitalist sectors—e.g. of the state-owned sector—is also determined by the interests of existing capital (for instance, it cannot grow to such an extent that capitalism should, some day, disappear); it is also because the changing of its extent from time to time (Keynesianism vs. Friedmanism) is also dictated by this interest.

The reformers who in the past two decades have wanted to transform the socialist economy, were also thinking about creating a mixed economy. However, they wanted a mixed economy which would be characterized by socialist relations and which would strengthen precisely these relations.

This is why it is also justified to ask whether emphasizing the necessity of the mixed economy does not serve the purpose of "saving something from the past"? I have to say "no", from several viewpoints.

First. Anything left over from the past becomes quite different under new circumstances. The state property of the conservative, statist government is not the remainder of socialism. and it is not so, even if the government is accidentally a liberal one.

Second. As I have already emphasized, capitalism is today the system of mixed economy. Anyone (party or movement etc.) who propagates essentially pure capitalism wants to lead the country back into the 19th century. Representing essentially pure capitalism shows only ignorance of what the capitalist system of today is like, and, especially, of what reprivatization means in the capitalist countries. The recognition and representation of this fact has nothing to do with any kind of nostalgia.

Third: the mixed economy is a lasting attribute of today's capitalism; it is not a transitory phenomenon. Thus it is a mistaken aim and policy which in essence strives to make certain forms exclusive by giving significant assistance to them, and then discriminates against other forms. Instead of privileges and discrimination, sectoral neutrality is needed. (Interestingly, some years earlier, sectoral neutrality was one of the most fashionable expressions. However, today it has disappeared from economic and economic political terminology.) Nevertheless, it is a wrong to argue that a sector-neutral policy will select out what is improper during the course of competition. The lasting historical existence of the mixed economy means precisely that all sectors are present in all spheres of activities albeit in one or another sphere of activity one or another form may seem more favourable. This is precisely the reason why it is necessary for policy to be sector-neutral.

Fourth. It is necessary to develop some sort of model which will be of lasting use in the long run. In the short term, there is simply no alternative to the way in which capitalist relations suitable to our age can come into being.

On the basis of our domestic relations and of the international conditions which exist today, to think in accordance with any other scheme is unproductive day-dreaming. Neither the semi-feudal capitalism of the 19th century nor that of the first third of the 20th century, nor socialism can come into question as variants. It is another question whether or not it is a realistic objective to *copy* the relations of the advanced capitalist countries. An important subject to be studied is how these relations can be adapted to our circumstances so that no form should be introduced which does not already have part of its content already in existence; thus we should try to fit the adoption to existing relations so that it may result in an upswing of our economy.

I am afraid that in the coming years not even this idea will find real support in the political and scientific quarters of the new establishment.

In developing the ownership relations and the structure of the mixed economy and, having taken into account our own circumstances, a widespread concept appears to be the so-called *employee ownership*.[4] While the endeavours at implementing it can and should be favoured, we have to point out that the concept is not unequivocal and it may cover a lot of naivety full of good intentions. (*Sinkovics* 1990; Zsubori 1990a; Kopátsy 1991; *Bródy* 1990; *Kozma* 1991)

It is here that I have to mention that an endeavour somewhat similar to the latter is to allot a significant part of property to the self-governments (local councils).[5]

[4] One of the most widespread models of bringing about employee ownership is the internationally known Employee Stock Ownership Plan (ESOP) (its Hungarian version is MRP) which is a collection of crediting, taxation and organization techniques with the aid of which the possibility is granted to the employees to buy either a part or the whole of the capital of the economic association which employs them. In the case of stock companies this is done by granting registered shares and, in the case of limited liability companies, business shares. ESOP opens up the possibility of collective buying for those employees who cannot or dare not start independent enterprises and wish to continue their work as constituents of a greater organization. The employees pay the purchasing price of the property part sold to them by instalments; primarily from the gross profit falling to the property which came into their ownership and, in addition, from donations. After having accomplished the process of payment—and as the result of it—the employees will, in an individual capacity—be partial owners of the company. (*Lukács* 1991)

[5] L. *Kotz* (1988) claimed that a significant part of state property should pass into the ownership of various types of self-government. He then called this re-socialization. Today there are many

All this may take the form of a cooperative movement. In practice, movements involving productive cooperatives may take place in any sector of the economy. Employees' stock ownership can also exist in Hungary, even in an inalienable form. Every employee can receive—as an indemnification—shares. The trade unions may collect funds for capital, and they may create new jobs out of their own resources. As a matter of fact, the workers' councils also belong to this category—namely, if the collective has real power of disposal within the company (e.g. in the question of whether they should privatize and how), in a certain sense, this is co-ownership. If an insurance institution serving people living on wages and salaries pays pensions from the income produced by its property, and the institute is under the control and management of a self-governing body of the insured, the property of the insurance institute is also property of the employee.

Hence, "employee ownership" may cover rather varied contents. Any possible form of employee ownership is necessary, primarily because it grants a certain protection to those living on wages and salaries or, at least, to some groups of them. What is more, it may also increase the efficiency of the economy's operations—precisely through competition of the ownership forms.

These forms also exist in the advanced capitalist countries; hence, by applying them, we are copying—but even copying can be better if it is multifarious. Also, in several respects, the scope of movement is greater in this case.

With regard to naivety: if we do not emphasize that employee ownership may provide *certain* protection, but claim that it basically changes the situation of persons living on wages and salaries in capitalism, or perhaps even capitalism itself, we are cherishing illusions, both in ourselves and in others. We have learnt, however, how serious damage can be caused by illusions.

Finally, what about the *long term*? Has history really come to an end when socialism collapsed in Eastern Europe, and capitalism has become the sole ruler in the world and the USA a superpower with no rival? Will the West, which has come into a very favourable position, be able to eliminate the well-known contradictions burdening the world and which were partly pushed into the background by the opposition of capitalism and socialism and by the bargain between the two superpowers? I thing that the events of the coming years and decades will answer these questions by saying "no".

However, people are not interested in what the ideologists think. A vast majority of people forms its opinion on the basis of its many years' experience; what is more, new generations have to come who will be able to think about the

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followers of this view. But today this is uniformly called privatization. This is despite the fact that the regional self-governments—the local authorities—constitute a part of the state or of state hierarchy. Consequently, their property is state property too, even if it makes a substantial difference whether the owner is the central state or a local self-government. (See: *Diczházi* 1990; Kopátsy 1991; *Ferge* 1989) world in other ways than their predecessors did, so that the earlier illusions should disappear. Hence, even if the world itself and our world's development live up to today's promises, nothing that has to do with socialism can get on the agenda of practice for several decades to come.

However, a leftist alternative of development has to be theoretically prepared (as somebody rightly noted: intellectual accumulation has to be commenced). This does not mean a return to the past, but a third, fourth or fifth road different from those followed so far. (Lakitelek[6] showed how popular the idea of the third road was in recent programmes—and perhaps this is true even today. However, events show how policy has swept away this endeavour.)[7]

Today these questions are not topical. Now privatization and the restoration of capitalism are on the agenda. However, the stand we take in the question of today will certainly influence our opinion—if we have an opinion at all—about our prospects.

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[6] Name of the locality where the democratic opposition movements held their first public meeting and proclaimed their programme (Ed. note).

[7] If the matter were not so serious, I would say that it is ridiculous, as the conservatives and liberals accuse and insult each other by saying that the other wants a third road.

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СМЕНА ФОРМАЦИИ И ПРИВАТИЗАЦИЯ

Р. ХОХ

В Венгрии, как и в других бывших социалистических странах, на повестке дня стоит создание капиталистических отношений. В соответствии с этим центральным политическим вопросом является приватизация. То есть в качестве основной задачи выдвинуто преобразование бывшей социалистической собственности в частную собственность, в первую очередь капиталистическую собственность.

Наиболее существенные проблемы этой целевой установки еще не уяснены и крайне спорны.

Некоторые из этих спорных проблем: следует ли проводить приватизацию как можно быстрее или она должна идти постепенно? Какими будут последствия скорейшей или медленной приватизации? Кто станет новыми крупными капиталистами? Как оценивается иностранный капитал в националистической и либеральной концепции? Дилемма Д. Рикардо против Ф. Листа в Венгрии конца XX столетия. Какой может быть роль т.н. собственности трудящихся? Как воздействует приватизация на общественные класса? Каковы возможные перспективы развития?

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FROM TWILIGHT INTO TWILIGHT TRANSFORMATION OF THE OWNERSHIP STRUCTURE IN THE BIG INDUSTRIES

É. VOSZKA

The slogans "from a planned to a market economy" and "from state to private ownership" are oversimplifications. The formation of associations has led to no breakthrough in eliminating the state character of property. The two processes are not necessarily parallel. Up to 1990 the decisive proportion of transformations was, and has been since, represented by a property reform rather than by privatization. The property pattern thus emerging may entail the danger of state administrative control slipping into the background without the evolution of a competitive market, the result being that managerial power left without direct control by owners may combine with the government's political considerations, which in turn may impede a radical change.

Association and property

The most conspicuous change over the last three years in the structure of enterprises has been the remarkable and prolific spreading of the association forms. While the number of economic units has increased by two and a half, the number of associations has grown seventeen times higher. It is also this process which may become the carrier of modification in the ownership structure, beyond the extension of the sphere of participants in the market, and the shift in the distribution by size. This paper does not deal with associations which came into being on their own basis and which were established purely by private capital. The number of the latter has grown very rapidly indeed—but their economic weight is much less significant than the rate of their growth. Therefore, we wish to concentrate our attention on the new economic units which have been created with participation of state property and, among them, primarily the big industries involved in the process.

How far did the association form change the proprietary sphere in this area? Unfortunately there is no accurate answer. At best there are some estimations which can partly reply to this question. According to our computations, the number of the associations in which state companies are also owners, may be between 3000 and 6000.[1] Some more detailed data are available about three sectors, i.e. about industry, construction and internal trade. According to records kept by the Ministry

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The paper is based on an empirical study compiled largely by Financial Research Co. Ltd. Therefore it is built upon thesis-like statements rather than on detailed, and explained findings. The most important sources of the research work are case studies by M. *Csanádi*, A. *Havas*, G. *Lamberger*, S. *Pásztor*, J. *Révész*, and É. *Voszka*.

[1] Details of these computations are included in the above mentioned study.

of Industry and Trade, 40 percent of state enterprises can be found among those that were the first to involve themselves in new associations, with about 10 percent of their property. (In industry these ratios are 47 and 8.5 percent, respectively.)[2] However, the property which 86 percent of these investors took to the associations represented only a small part of the capital—in fact, less than a quarter of it.

Thus, it seems to be true that only a relatively small part of state property came to be organized into the framework of the various associations, though the process affected about one quarter, or one third of the joint stock- (share) and limited liability companies, and almost half of the state enterprises. Apart from this, we do not know too much about this small amount of property—namely, in what proportion it became associated with private capital. According to the records of the Central Statistical Office, at the end of 1989 the associations in private and other mixed ownership amounted to 90 percent of the total number of the associations.[3] When analyzing the situation it has to be taken into account that this category includes also the associations employing the private capital of foreigners, and also that of the cooperatives. And, what is more important, even the share companies or limited liability companies (where only a single share or a fraction of a business share is in private hands), are included in this "mixed" group; or in the hands of another "mixed" company dominated by state-ownership.

On the basis of all this, and on our own detailed, though far from complete assessments, we can confirm the general opinion, according to which the foundation of associations has brought about *no breakthrough in the process of eliminating the dominance of state ownership in property.* The characteristic way of transforming the state enterprises was to establish a firm in partnership with other state-owned companies. In addition to the appearance of foreign investors, the influence of private capital in share, and limited liability companies established on the basis of the big industries is not significant. However, if we consider the number of the cases, it is certainly not negligible either.

Hence, the process called *spontaneous privatization* in Hungary is, to a great extent, *not privatization* in the legal and formal sense of the word. The establishment of associations and the modification of the structure of ownership are not necessarily concomitants. The relation between the two kinds of changes is a manifold one. They can also be carried out separately. Namely, state-owned property can be sold to private persons or entities without any form of association, and any state-owned company can be changed into a share company without private capital appearing in it. In recent years the latter form has been typical. However, we must not forget that the establishment of associations *may also promote* privatization. The appearance of the primary elements of valuation of property and of the security form—of the possibility of division into smaller parts—facilitates the involvement

[2] Non-published data of the Ministry of Industry and Trade.

[3] Data published by the Central Statistical Office, analyzed by M. *Móra* (1991).

of other, genuine new owners. Large groups of associations which we have studied are characterized by a multiple-stage transformation or at least by the planning for it; they wish to win foreign partners, private entrepreneurs as their partners, or to establish smaller firms (mainly limited liability companies), into which leaders, employees or, incidentally, external firms would also join in.

At this point, however, the trend may turn in the opposite direction. The development of an intricate network of associations, such as the spreading type of limited liability companies of stock companies' limited companies, *may impede* the widening of the sphere of privatization. The question as to who is the real owner in practice—i.e. the potential seller—in this structure again grows uncertain. If the interests of those concerned do not urge stepping forward, the types of organizations living on the borderline between state- and private property—namely, those that utilize the advantages of both spheres and thus reduce personal risks to a minimum—may become permanent. The fact that the behaviour models of the second economy have become deeply rooted, make it very likely that such endeavours will grow significant. This, in turn, reduces the chances of strengthening a competitive market based on personal or company risk.

The motives for establishing associations

Before running too far ahead in weighing up the consequences, let us go back to the initial point. What motivated the foundation of associations in the sphere of the state companies?

First of all it has to be stated that not only bankrupt companies or companies in a financial and structural crisis established associations: the positions at the outset varied from every point of view. M. Csanádi analyzed the balance sheet data of 57 companies which were the first to be transformed and which invested the majority of their property into share-, or limited companies. From this she drew the conclusion that their distribution according to sectors, the sizes of their assets, and the development of their indicators about their sales' structure, liquidity and effectiveness were shown to be highly varied: "A changing environment may elicit similar reactions from very different enterprises". (Csanádi 1990) We may add that a significant number of economic units (according to our estimates, more than half of them) were not affected by the association form, whereas they had had at least as many reasons for the transformation as the cognate companies in similar positions.

Secondly, interests running contrary to each another were linked to the establishment of associations. However, the endeavours were neither exclusively nor primarily characterized by the different interests of the various participants (factories, companies, financial leaders, sectoral or establishing bodies). It is perhaps even more important that bringing about associations has proved to be appropriate for asserting interests which are contrary to each other, even within one particular organization. They can be termed "traditional efforts" (i.e. natural ones, conserving structure and behaviour), which are at the same time profit-oriented.

The aim of the company which establishes an association can be simultaneously: to make its internal unity independent, to maintain its organizational and financial unity, and to protect it against government intervention. Furthermore, it can be to obtain additional favours, to extend business relations, to create the view of a "holding company", interwoven with proprietary threads, and to strengthen internal interpenetration. In the supplying and purchasing companies and in the banks which themselves also become new owners, the market-, semi-market- and non-market elements of investments all live beside each other. The double-mindedness of state management means no longer simply the traditional opposition between sectoral and financial interests, for it also reflects the confused views of the state about its role. To put it in a simple form: *the interest of the state as an owner is to save the companies, to protect their monopoly position and to neutralise as much as possible the effects of competition.* On the other hand, as the representative of public interests, it really ought to keep its eyes precisely on increasing efficiency, even at the cost of tolerating some local shocks.[4]

The association form has spread—contrary to expectations—so quickly because it granted a real possibility of assertion to these endeavours formulated in dichotomies. The main advantage of this organization form is precisely its plasticity. This is why it has been able to survive the changing of the political system as a way out and as an expedient process, and this is why it may be one of the carriers of "peaceful transition" and of continuity.

Until the summer of 1990 a decisive number of transformations did not represent genuine privatization but—for the sake of the organic transition—an *ownership reform.* It was a reform in the contents of the changes: the actors and processes involved in the exercise of ownership rights changed within state ownership. At the same time, it was a reform in the constellation of interests: the compromise between the variously oriented and—even in themselves—mixed endeavours based on the real chance of simultaneous assertion. This has been a typical feature of the reforms of recent decades. Finally, it was a reform of methods, too. The concepts were formulated in professional discussions, in positional struggles within the government and were hidden under technical and efficiency-oriented arguments. However, unified, comprehensive plans, and the control from above on implementing them, had ceased to be characteristic by 1988.

The multilateral and not unfounded initial forbearance, the changeability of judgements over the course of time, as well as the unforeseeable speed of political changes disprove the statement—and render it improbable—that the changing of state enterprises into associations was a previously developed strategy, a "diabolic plan" aimed at preserving earlier management, or company positions for posterity.

[4]For detailed coverage of this subject see the writings of A. *Nagy*.

One may rather talk about drifting, about some short-term, ambiguous attempts at resolving emergency situations. The properties of the mechanism, followed by the decisions made on developing certain legal institutions and on concrete company situations also support this assumption.

Spontaneity and the role of the state

The order of decisions on establishing associations was shaped gradually, by the development of precedents prior to the subsequent (and delayed) regulation. The process called "spontaneous privatization" was really spontaneous in the sense that in the majority of cases the companies made associations not as a result of state instructions. Often, they themselves initiated the foundation of share-, or limited liability companies and they themselves decided on the concrete frameworks, too.

In such types of transformation it was primarily the internal negotiations between the companies' top management and the leaders of separate factories or plant units that determined the division of assets and liabilities, i.e.the new structure of ownership. The bargains were characterized by mutual interests of maintaining—or improving—the standard of operation (relying on earlier mechanisms of decision-making), by the seeking of compromises, and by conviction. From the uni-directional endeavours it is worth emphasizing the intent of underestimating the starting capital. This was also motivated by the prospect of minimizing the claims for dividends, by better chances for selling the securities (in the future), and by the interest of winning the new owners. However, since the transformation was not accompanied by privatization (by the appearance of private owners), the much heard accusation—namely that state property was being sold out—was not true. The unquestionably significant role of agreements within the enterprises' frameworks must not make us forget that the supervisory organizations, were active participants in the negotiations even preceding the establishment of the Agency of State Property. Hence, the process was *not spontaneous*, i.e. it did not develop without some direct external influence.

First, the regime itself pushed the economic units in this direction. It did this through negative stimulation, by a restrictive economic policy narrowing down financial sources and the domestic market, and by making the situation of large-company groups doubtful. However, it must be said that some positive incentives were added to the negative ones, i.e. normative and individual favours linked to the transformation and the acquisition of property. *Second*, transformations directly conducted by government bodies were also no exceptional phenomena, especially in cases when certain units were in a position of bankruptcy. In such cases it has been conspicuous that the state bodies considered the same alternatives and viewpoints as the companies did. Without mentioning the cases of complete blockages of failures, the results of the implemented transformations have been no better than average. The buyers were not forced to compete, the assets were undervalued, and the selling price was questionable. The most dubious results in the sphere of state decisions have been linked to the involvement of foreign capital—namely, to the transactions where the property in fact slipped out of the sphere of state ownership, and thus where one really may speak about "selling out". *Third*, central apparatuses were also able to intervene into the establishment of associations by the companies through several other channels. The bringing into existence of joint ventures had to be licensed—though to a decreasing extent—by some authorities. These were allowed to decide on the changes in the units under the supervision of state administration and to draw the companies managed by self-governing bodies into their direct competence. At the sessions of company councils the representative of the supervising ministry was present *ex officio*, so the authorities were informed about the plans in due time. Finally, the company managers also negotiated with representatives of the state administration, even when this was formally not compulsory.

In such cases the leading organizations remained fairly passive. It often happened that even in enterprises managed by bodies of the state administration, internal bargains were decisive, while even companies operated by company councils made no decision without the intervention of government bodies. This also indicates that the company council or, later, the association form was not the cause but the result of the phenomenon which is usually called "company self-ownership". This latter term has now, some critical sting in it, indicating that it is some way from the positively sounding. A system of decision-making which becomes formal is merely the reflection of the actual power positions. If this is true, even the lack of legal acknowledgement of self-ownership would not have modified significantly the methods; the establishment of associations would have, at most, been restricted to a narrower sphere. On the other hand, the attempts at changing the mechanism for making decisions—one might say, the attempts at "re-nationalization"—or at centralizing the decisions concerning the structure of ownership, are questionable not only from the view of effectiveness but also from that of the possibility of implementing them.

Such attempts appeared, however, also in the era of the Németh government. Creating the State Property Agency and the formulation of the guiding principles of the policy regarding property—which are still valid—belong to this period. Also, (though with not too much publicity) some official propositions in the autumn of 1989 were already unequivocally speaking about the radical reduction of the proportion of state ownership; and the majority of the economic laws which were passed after the changing of the government were already prepared during this period. To take two examples, we can cite the legal provisions on privatizing retail trade and public catering, and the regulation of competition. Thus, there certainly were some antecedents—but some unequivocal changes of emphasis also came about. The most conspicuous of these is demonstrated by the fact that the Antall-government, instead of looking for new owners, has been striving to answer the question of who the seller should be. This means that before determining the substantial trends, it considered the restitution of its power—forfeited partly by its predecessors—as the most important task.

However, formal confirmation of centralized decision-making, such as the placing of the State Property Agency under government supervision and extending its competency did not visibly lead to a clear distinction of the different roles. In the autumn of 1990 the Agency considered the most important achievement of its own activity to be the upswing of self-initiated transformations of the companies and the fact that it had not slowed down. The economic units have been ready to cooperate, and they themselves have often asked for help, i.e. for state intervention.

This opinion is also confirmed by company experiences. The chief concern of the state company leaders is to find the executive of the State Property Agency who is competent in their matter, to detect the currently actual top-level interests and, knowing these, to develop the system of argumentation and the bargaining strategy for the purpose of asserting their own endeavours.

The efforts at centralizing elicit the strengthening of the companies government-orientation and the old, not even temporarily forgotten adaptation reflexes. In this situation all the partial elements of transformation, of privatization (the form, the time-schedule, the selection of owners and/or managers) can become subject to bargaining. Hence, the fading of the borders between state- and company decisions means not only the similarity of motivations and the (dubious) results of such decisions, but also a new wave of intertwining economy and policy. The transactions are again made by offices, government agencies, committees and secretariates—in conformity with their power aspects or perhaps with their interests. At the same time, responsibility is obliterated and companies have a strong influence. This appearance of the centralization pitfall in a new form, hampers getting across this concept in its original form, if it exists at all as a coherent policy. The centralization of the spheres of authority enhances the chances and demand for the stabilization of the companies' bargaining position which, as it has been up to now, will—even in the future—lead to mutual dependence and exposure.

The government may argue by saying that this state of being intertwined is merely transitory and at the same time it brings about the conditions for breaking down state ownership. However, the final result cannot be made independent of the original motives of the individual participants and of the characteristics of the decision-making system. These are those things which determine the time-schedule and concrete direction of the transformation of the ownership structure. Therefore, before we can outline the apparent trends, let us look at the first experiences of the structure's operation such as has taken place up until now.

Outlines of the operation of the new ownership structure

The owners of the associations which have been created on the basis of state enterprises are, in the overwhelming majority, state institutions: i.e. promoter (trustee) companies, banking institutions, partner companies. Those personifying the owners are their representatives delegated to control and lead the bodies of the share-, and the limited liability companies. What endeavours are followed by these owners, and with what determination are they followed?

The intensity of the interests is rather poor. None of the delegates of the shareholder organizations risks his own property, and even less his position. The primary post (occupied in the delegating firm) is not endangered directly by some mistaken proprietary decision. The criteria for such a decision is in fact very vague: as with every corporate body, directorate, and supervisory committee, responsibility is difficult to see clearly. Material interests are also limited. The remuneration of the representatives is always fixed, independent of the company's achievements. The representatives' incomes may cease to exist only if they are recalled or in the case of the liquidation of the company—but it is not difficult to gain a similar post in some other share-, or limited liability company.

These findings do not apply equally to all representatives of proprietors characterized by state ownership. The strength of the interests depends on the relative size of the investment, compared to the size of the owner's own property, on the importance of the association, on the significance (or, in extreme cases, the exclusiveness) of the ownership role, and on the primary rank of the representative himself. At the two ends of the intensity scale an executive of some large bank or large company and, opposite to him, the general manager of the trustee can be found. Between them are the delegates of smaller firms, the highly ranked representatives, and the employees of the trustee organization. In other words, for the latter the proprietary role has become a priority. Though the interests linked to that are subdued by the weakness of direct material interests, their positional adherence is relatively the strongest. Therefore, in principle, they can be the best owners in this sphere.

The content of their interests may be formed in two directions. One of them can be seen with the owner who is very familiar with the activities of the share-, or liability company, who adheres to the given line of products, clings to the influence of the majority, and who is said to be "gathering up the screws". The other type is the financial investor, purely "cutting off coupons". Today, within the sphere of the trustee companies, the combination of the two approaches seems to be the most frequent. A partial maintenance of the "screw-gathering" role may be motivated—beyond the force of inertia inherent in preserving power and the accustomed routines—by the undeveloped norms of being a trustee, by the plasticity of the owner of the institution operating as a state-company and also by being threatened from outside. (Some trustees are, however, stimulated precisely by their uncertainty to develop the institutional frameworks of the more unambiguous role of coupon-cutting, since the property, the activities, and the employed staff of the centre which came to be emptied, can be transferred into the new investing association and this form is more difficult to attack from outside.)

The mixing of roles is even more typical of two other groups of owners: the banking institutions and the purchasing- and supplying companies.

Large credits—for which the repayments themselves are dubious—mean a dependence not only for the debtor but also, from another view, for the creditor. One of the most important motives for converting debts into shares was precisely the repression of this defencelessness. The banks, even in their position as creditors, have been careful not to initiate liquidation procedures. In addition, as owners they may feel still more intent to bridge over the liquidity troubles of the associations—even if they seem to be lasting ones—by granting new credits. (Namely, the strict collection of the debts would again push the firm, scarcely saved by the conversion of the debts, to the verge of bankruptcy. Thus, the role of the bank as an owner would cease to exist and a part of the capital invested in shares would be lost.) This is exactly the reason why the coexistence of the banks' statuses as owners and creditors, carries in itself the typical conflict of the banking roles: they attract each other.

Thus, taking on the proprietary role, in contrast to the original intents, may further prompt the banks to continue financing, i.e. the pitfall of credit granting may grow deeper. This, at the same time, means that the redistribution performed by the banks, replacing the state budget, reduces the existential risks of the association, and also reproduces the basic situation of mutual dependence. However, if it is a large bank in a critical situation, the budget must also intervene in order to prevent the whole financial system from collapsing. Thus the intertwined, concentrated proprietary structure may prove to be rather unstable.

Nevertheless, intertwining has started. 35–40 percent of the large banks' shares are in the hands of companies, and investments in the contrary direction are also significant.[5] Half the credits were granted to the owners of the large banking institutions, but only between a quarter and two thirds of the doubtful or failed debts fall to this sphere. The concentration of credits by sectors and by amounts is high. No summarized data are available about the practice of financing the associations in bank ownership. The operation of the pitfall of credit granting, and strengthening the redistribution by the banks are, however, at least not impossible.

An income distribution that crosses the interest in increasing the dividend and exchange-rate profits may start even if the owners of the association are supplying and purchasing partners. One of the driving forces of such types of investment is precisely the assurance of purchase orders. The claim to maintain these connections between associations in the long run may, on the one hand, preserve the product

[5] *Spéder and Várhegyi* 1991. The following data and findings also stem from this study.

structure of the association, and the poor quality of its products and services. On the other hand, if the roles of suppliers and buyers come to be intertwined, not only the fact of placing the orders, but also the price is easier to influence. High prices may lead to decreasing dividends for the association but for the selling proprietor they mean a growing profit. (In the case of the buying proprietor an opposite interconnection will prevail.) The invisible pumping over of incomes based on ownership relations restricts competition by the exclusiveness of partnership relations and by dictated prices.

The combination of a physical, not purely investment relation with the role of ownership becomes the more important the more limited the competition is. The situation at the outset is just this; such are the types of motivations which stimulate investments. If the owners of the associations are buyers and suppliers, creditors or "screw gatherers", they also contribute to hampering the development of competition.

The centre of proprietary decisions: changing of the leaders

The unfavourable effects of the internal role conflicts of the owners cannot be eliminated either by strengthening the profit motive or by the spreading of private ownership. Another level of conflicts may, in turn, mitigate them; this is a differentiated composition of the owners of the association, and the appearance and solution of the oppositions arising among them (linked to viewpoints concerning dividends).

The first years of operation of the recently established associations were not spent on these types of negotiations and the modification of association strategy was also pushed into the background. The owners and managers were more concerned with developing the frameworks and postions for the long run.

An important area of the founders' and investors' decisions was the modification of the initial proprietary structure—partly by utilizing the gradual changes which were either forced or allowed by the gaps in the law and partly by the urge to acquire additional capital. The former type involved running through a chain of processes: "*transformation—conversion of bank debts—selling abroad*". This was characteristic of the large companies struggling with liquidity and market problems. For them it became clear that the association form, together with the changing of debts into shares, could only bring a transitory release. The latter type aimed to increase the capital of limited liability companies formed out of smaller parts of company property. These companies wanted to solve the problem of lack of cash and this often brought about the appearance of foreign capital. Finally, domestic private capital has also appeared, primarily in small limited liability companies. This is usually in the form of investments of the leaders or perhaps of the employees. In such cases the background for assuring gradual change was not motivated by the intent to create greater operating capacity or to increase significantly the basic capital, as it was in earlier cases; it was rather due to caution and the wish to reduce personal risks.

Thus, the non-state-controlled movement of the ownership structure leads towards genuine privatization and toward diversification of the participants. This, of course, does not exclude the concentration of capital. The crystallizing points are the foreign and—in addition to the investors—commercial capital. The trading associations created from the departments or units of state enterprises, as well as the traditional foreign trade firms with powerful capital, acquire increasing quotas in productive (industrial) associations.

The second focal point of proprietary decisions is the changing of the leaders. It seems that it was a general trend that at the moment of the founding of the associations the earlier top managers were left in their positions. Since the transformations were built upon internal consensus and on agreements concluded with the new owners, it is not surprising that the leaders of factory units and/or company divisions were appointed as managers. In several cases, however, such confirmations proved to be temporary and the new (perhaps foreign) proprietors, or the trustee companies replaced the managers.

Even the position of the trustees has not been much safe. The general managers of the large companies which were devolved into groups of share-, or limited liability companies have mostly chosen the directorship of the trustee or holding company (operating as a state company) instead of the managerial post in the new associations. In such cases the government, after the "re-nationalization" which was easy to carry out in 1990, could dismiss the former leaders perhaps by indirect incentives (e.g. by the delegation of a committee for supervising the transformation), or by the right of the owner having a majority.

Thus, the common opinion about preserving the politically rooted power of managers for posterity is in part true but this "posterity" is only for a short period. The viewpoint which objects to *converting power into ownership* (and which is mostly politically motivated and has to be interpreted as part of the fight for power) may be subject to even more questioning. It is precisely the replacement of the company and the trustee company-leaders by the regime which shows that purely managerial positions are in question. What is more, these positions are much more uncertain than they were earlier. The same applies, though with a somewhat clearer demarcation of the roles, to the managers of associations. The formula of "company leaders changing into owners" occurs relatively rarely and—at least in the big industries—it can be found at lower levels (e.g. in the stratum of the leaders of workshops or plants which are turned into small limited liability companies). It is another question that some managers, by investing their over-average income into (private) undertakings independent of their company, may have become proprietors.

From the viewpoint of managers, the changing into associations may mean the confirmation of the proprietary role in an additional special sense. Namely, if in this way their rights of disposal increased and extended to selling business shares, securities or even plants, and they can determine the directions of activities more independently than earlier, this can be understood as a peculiar phenomenon of "conversion into ownership". This stands apart from the framework of formal law.

The creation of share, or limited liability companies is formally a decentralizing process, which also results in the decentralization of decision-making. Be it the breaking down of a large company into a group of associations, or transmitting some smaller portion of property into an association, new units are formed with new legal personality, independent budget relations and a public balance sheet. However, the potentiality of independence does not come to be realized under any conditions whatsoever. The founding of associations does not automatically entail the end of the former relations, nor of the methods of management and control which earlier existed within the company. According to our experience, the relation between the founder (trustee) and the share-, or limited companies depends on the transformation of the earlier central organization, the power of the factories' endeavours at achieving independence, and their production and marketing capacities. Finally, it also depends on the financial and liquidity position of the whole company group. A scale of dissolution of the traditional relations can be drawn up according to these factors. The chance of effective decentralization is the greatest where the departments themselves and sections of the centre also changed into associations. The efforts of factories to achieve separation have traditionally been strong. Also, owing to a weak liquidity position, internal resources available for redistribution are slight, and perhaps the founder is forced to give up his position of being the owner of the majority. Until this comes to pass, there is no institutionalized guaranty against restoring the earlier close connections.

This aspect also shows that the positions of the associations' managers is influenced not only by the relations between the founders and the share-, or limited liability companies, but—in a broader sense—also by the formation of the ownership structure, and the method and the extent of the proprietary control.

The probability of a direct and strong control is high, if the shares are possessed by a few, active organizations or persons who have good local knowledge. In the present situation such criteria can be fulfilled by the trustee companies, or to a certain extent by banks or foreign investors. If the owners belong to the "screw gatherer" or physically committed type, they practically also perform managerial functions. Mixing the roles may paradoxically be nurtured by a contrary direction of selection, too, but from the other side. Namely, if the proprietary control is poor, the authority of managers grows wider. Increasing independence—linked with the effects of the past decades' reform measures—entails the informal deconcentration of the proprietary rights.

The "dominion of managers", as we know, is not an unknown phenomenon even in successfully operating market economies. This trend is strengthened by the special circumstances of the foundation of associations in Hungary: free selection of some of the investors, the increased possibility of manoeuvring created by the diversifying ownership structure and—mainly—the precariousness of the position of institutions and their representatives who have embittered shareholders. To a certain extent the signs indicating the strengthening position of the managers—though it is difficult to judge its measure and sphere of action—may be transitory. The organizations—mainly those of the state—which became shareholders, will, in the course of time, have a better understanding of the operation of the associations, and the routine and norms of exercising the managers' rights will take shape. Also, if the rearrangement of the ownership structure continues, and its state-character is pushed into the background, the new private and common proprietors will exercise strict control on the managers.

However, it is obvious that a significant part of even the advanced forms of private property—i.e. the structures built upon hundreds or thousands of shareholders, or on institutional investors (such as pension funds or foundations)—are inappropriate for fulfilling this role. However, there are a number of signs which show that it is precisely those types of owners who will be dominant in the Hungarian economy. On the one hand it is a direct and legitimate interest of the regime to accelerate privatization, and the simplest way of doing this is to distribute some portions of state property among artificially created institutional investors. On the other hand, the parliamentary parties are competing with each other in preparing schemes. The common substance of all these schemes is—beyond the differences in the methods of solution—building up the smallholders' structure based on the distribution of property. Such endeavours coincide with the interests of not only large groups of citizens but also with those of company managers.

These solutions create a weak structure of proprietors in the sense that the direct control exercised on managers will not be stronger than it was in the framework of state ownership. This trend is not generally unfavourable with regard to economic effectiveness, since the proprietary control may be replaced by the market of capital and securities, and the competitive situation may be taken in a broader sense. Nevertheless, it is not absolutely sure that undeveloped and monopolized market relations and ownership structure that have been produced artificially and without a background of strong private interests, are suitable conditions for transforming the economic order and the whole of the national economy—i.e. for gradually bringing into existence the relations of a competitive market.

Continuity and organic development

With regard to the transformation of the ownership structure, the period of two years and a half between 1988 and the autumn of 1990, concerning its chief characteristics, may be considered a uniform phase. Continuity appears in the policy of government and in the power structure within the economy, too.

The step from the working capacity of state property to its breaking down was—at least in the form of declarations—taken by the Németh-government and this government also worked out a great part of the legal framework. The new government—in the first half year of its activities—proceeded on the way started earlier. The only substantial change was the attempt at concentrating the proprietary rights of the state, i.e. the centralization of the sphere of the role played by the seller. However, in the meantime the basic dilemmas concerning the future tasks of the state, the outlines of the new ownership structure, the sphere of favours and non-preference, and the acceleration of changes and its socio-economic costs, remained unresolved. The changes may further on be classified as belonging to the category of the ownership reform—in contrast to privatization which means a radical transformation. It is also a reform in the constellation of interests, in the methods of drawing up drafts and—to a great extent—in effective transformation, too. The majority of modifications linked to state property have not eliminated the characteristics of state ownership; it is those involved in—and the methods of—exercising proprietary rights, that have changed.

The ownership structure that has developed up until now thus raises the danger that new sub-centres of redistribution (rooted in the relations of banks and large companies and concerns) and diffuse, weak ownership patterns will come into being. Therefore it is not impossible that the control exercised by state administration will be pushed into the background, without the development of a competitive market. Hence, the power of managers, not controlled directly by the owners, will still not be subject to the limitations of the capital and securities' market and the competitive situation.

These tendencies can be built on the interaction of managerial incentives and the political and power-viewpoints of the government—i.e. on the actual power relations and not on their radical rearrangement. In this sense an organic development is present, aided by the internal disorganization of the hierarchic planned economy, which preceded the changing of the political system. Bearing this in mind, the given stage of the dissolution has not meant that the political turn created the forms of motion for the operation of advanced, new economic frameworks, and for the endeavours of well defined political groups. The basic reason for continuity is precisely the plasticity of the social structure and—partly because of it—political power which is without a solid basis.

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ОТ ОДНОЙ НЕИЗВЕСТНОСТИ К ДРУГОЙ НЕИЗВЕСТНОСТИ. ИЗМЕНЕНИЕ СТРУКТУРЫ СОБСТВЕННОСТИ В КРУПНОЙ ПРОМЫШЛЕННОСТИ

Е. ВОСКА

Становится очевидно, что лозунги: "от плановой к рыночной экономике" и "от государственной к частной собственности" — являются крайними упрощениями. Образование объединений (совместных акционерных компаний и обществ с ограниченной ответственностью) не привело к радикальным изменениям государственного характера собственности. Эти два процесса не обязательно совпадают. Решительные изменения скорее имели место в реформе собственности до 1990 г., и это продолжается и в настоящий момент: то, что мы наблюдаем, это скорее реформа представления интересов и метода разработки сценариев и изменения произошли лишь в том, кто осуществляет права собственника, а не в государственном характере собственности. Складывающаяся структура собственности таит в себе опасность государственного административного контроля без создания конкурентного рынка, в результате чего отсутствие прямого контроля менеджеров со стороны владельцев предприятий в сочетании с политическим давлением правительства может помешать радикальным изменениям.

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BEING HIDDEN (THE PRIVATIZATION OF ÁPISZ)

S. PÁSZTOR

The privatization of ÁPISZ Trading Company has been included in the Hungarian chronicles of economic scandals of the late eighties. In retrospect it can be judged that the objections raised to the privatization of ÁPISZ (notably, the selling out of state property to company managers and to foreigners, as well as the fact that company managers themselves choose the owners), could have been worded during the transformation of numerous other companies, too. Why it was just ÁPISZ which first got caught in the net? It went its own way and its privatization represented a challenge, hurting institutions and various interests.

ÁPISZ Trading Company deals with wholesale and retail trade in paper articles, stationery and office supplies, as well as toys and fancy goods.[1] Its retail activity is concentrated in Budapest where its market share is still 80 percent. The PIÉRT (Stationery Trading Company), which specializes in wholesale trade, has only a few retail trading units. The original advantage of ÁPISZ in this field is indicated by its 60 shops in Budapest, while the dominance of PIÉRT is shown by its wholesale depots located in every county seat. For fifteen years now PIÉRT has attempted to break the quasi-monopolistic position of ÁPISZ in retail trade (with no success so far); the counter move of ÁPISZ took place in 1982 when it obtained a permit allowing it to perform wholesale trading activity. So far it has been able to establish two warehouses and a depot (cutting out about 10 percent of national wholesale trade).

The capital of PIÉRT is about three times as large as that of ÁPISZ. It has to be mentioned here that PIÉRT was founded by the ministry and it has nationwide authority. On the other hand, ÁPISZ was founded by the Council of the Capital in 1949 (after the nationalization of shops which had previously been owned privately) to satisfy the demands in Budapest. In 1990, when a large number of companies founded by the councils had been organized into associations, the (new) government and the State Property Agency (as the name suggests, the guardian of state property) declared that the founder and the owner are not necessarily the same: i.e. companies founded by the councils are also in state ownership.

Coming back to the market situation of ÁPISZ, the manufacturer's stores of the Paper Industry Company and its successor companies, which had been reorganized into a retail network, had to be taken into account as competitors of the same weight as PIÉRT. (Formerly these stores operated jointly with ÁPISZ.)

[1] This case history was made in the framework of the TS research programme, commissioned by the Institute of Economics of the Hungarian Academy of Sciences.

In 1990 the then (first) president-manager of ÁPISZ Trading Co. Ltd. began establishing the company's provincial retail network. (In the provinces there are about 600 stationery shops.)

Two-thirds of the activity of the wholesale warehouses of ÁPISZ serve the company's own shops. Prior to the privatization of the company the shop managers could place orders freely with other suppliers as well. The wholesale activity has decisively contributed to the success of ÁPISZ. It is enough to mention that the wholesale price margin is more than twice as wide as the retail one.

The supply of ÁPISZ covers a particular segment of the domestic market and domestic consumption which is not only regular and stable, but also increasing. This is highly appreciated—especially by its western suppliers.

The main foreign trading partner of ÁPISZ is Ferunion, whose joint firm is Werla, a part of the Berger agency, one of the owners of ÁPISZ and registered in Vienna. By the way, the Berger agency is the exclusive representative in Hungary of such famous firms as Rotring, Pelikán and Faber-Castel. 80 percent of the import activity of ÁPISZ is transacted by Ferunion and 20 percent by Konzumex.

In the eighties ÁPISZ managed extremely successfully; in trade it was regarded as one of the most prosperous companies (if not the most prosperous one). This efficiency was reflected in the managers' and employees' incomes. Excellent salesmen worked in the network (in the large or special shops), too, and it was not only the company's top management which was outstanding with its novel strategy compared to its environment.

At the beginning of 1989 the company's leading apparatus (especially its director) gained considerable experience in the process of transformation into an association, by using outside experts. The well-balanced economy of ÁPISZ facilitated, on the one hand, the acceptance of the director's efforts at transformation by the company's employees and managers; on the other, it attracted foreign investors "performing their first actions" in Hungary. The radical privatization techniques and conditions of the latter broke off the company's remaining personnel relations with the state administration and this resulted in aversion on the part of the so-called independent experts, who had previously played an important role in initiating the transformation into associations.

Phase I: recognizing the opportunity and realization

Motivations

ÁPISZ did not undergo a forced course of transformation. It is widely recognized that its successful management favoured the continuation of its own way of operation. However, external stimuli were strong and affected the company's managers. This did not happen at the same time, but closely, one after the other, and within a narrow time interval.

In the late eighties the reform of ownership, transformations, and the Act on Associations became centres of attention. Even if it did not urge the managers of ÁPISZ to take practical action, it did not induce them to evade the offered opportunities of consultation either. The experts of the Pénzügykutató Rt. (Financial Research Co. Ltd.) convincingly argued that transformation into an association would bring unconditional and permanent advantages precisely to those companies that were being managed successfully.

Simultaneously with the attention of the experts of the Financial Research Co. Ltd., a large American investment company (Andlinger) showed interest in ÁPISZ. The American firm was attractive to ÁPISZ as a potential owner because it has a considerable involvement and experience in the American stationery trade.

The conditions of transformation were clarified and worded for the managers of ÁPISZ at the discussions with the experts of the Financial Research Co. Ltd. and Andlinger. At that time (in early 1989) the first draft of the Act on Preliminary Privatization was already on the table of the Németh government. This attracted attention in the summer of 1990, and was aimed at the liquidation of company centres and at the privatization of shops involved in trade (and in public catering). Although the managers of ÁPISZ were informed by the experts that the government would remove the draft from the agenda, the requirement that they had to keep the company in one unit was the first and main condition of transformation.

First of all, they had to make the company council accept their ideas. The management had to win the confidence of the company's employees in their opposition against a possible foreign owner, and even more against the government's intention to establish a mass of small-scale owners. Therefore, the managers of ÁPISZ not only guaranteed the security of employment but also intended to ensure a decisive role for the employees as owners. (Fort the sake of comparison, Andlinger would have welcomed only three, or a maximum of ten employees of ÁPISZ being in managerial posts among the owners.) Finally, among the conditions a separate requirement was worded; namely, that the transformation had to precede the initiative of the state administration. This aspect soon got precedence over everything else. What before had been considered as an aspect of prestige (i.e. that the American firm's interest be replaced by its effective proprietary share) was no longer important. The company wished to change its status and make it irreversible before the Act on Transformation came into force. Meanwhile, the interest of Andlinger changed, because at that time it regarded another company, Caola (a firm producing cosmetics articles) as really attractive. However, as a form of compensation it called the attention of Citibank Budapest (its Hungarian banking partner) to ÁPISZ.

At that time ÁPISZ had already been a client of the bank for two years; it is one of the Hungarian concerns of Citicorp; so the bank was familiar with the company's economy. Even without the proposal of Andlinger it had watched the events taking place at the company. Its interest became serious when, instead of roundabout means, its director personally visited ÁPISZ. (Citibank was also pushed for time due to the anticipated coming into force of the Act on Transformation, which had not then been finalized.)

The Act on Transformation affected the last stage of the privatization efforts of ÁPISZ. The fact that the company got into this situation within a little over half a year—compared to the initial stage of enquiring and gathering information—can be explained by the series of administrative provocations againts ÁPISZ and other trading companies, on the part of the Ministry of Trade. In the fall of 1988 the Ministry of Trade asked for, and received authorization from the government to launch a series of privatization experiments. From among the approximately 300 company directors, they invited 15 to the initial consultation. At this consultation the experts of the ministry described the government's ideas on privatization. In return, they asked company directors to begin transformation and privatization, and to inform each other on their experiences at meetings. These meetings were to be convened later on, and held on a regular basis.

In an interview, the head of the Commercial Division of the Ministry of Trade who also led the consultations described his own, as well as his division's opinion on the unavoidable need for centrally directed privatization. "In our opinion, company centres must be liquidated or transformed into independent economic associations with changed functions. Shops and restaurants—i.e. business premises—have to be sold at current market prices through tenders; or if it is impossible, they have to be leased out. A commercial bank has to be established for sales, leasings, concluding contracts, as well as for handling the purchase prices and leasing fees." (Gál, 1988.)

The Ministry of Trade did not act circumspectly in several respects. It invited, almoct exclusively, retail trading companies to the consultation. These had been founded by the councils, and it was for this reason that they were thought to be actually owned by the councils, or at least to be under the supervision of the councils. However, the Ministry apparently forgot to inform the Council of the Capital about its plans and did not invite it to the initial discussions. The circle of companies selected was also miscellaneous: some companies had already others been transformed in 1988, others (like ÁPISZ) had only considered the possibility, while others did not want to change their organizational systems.

The experts of the Ministry of Trade not only hoped that the experiences gained at the consultations would confirm their definite opinion that centrally directed privatization could not be evaded, but also that they would obtain useful knowledge from the large number of companies. At the same time, the directors wanted to receive unambiguous guidance on property assessment (valuation), the situation of leased premises and on the processes of privatization. Yet, instead of receiving such guidance at all the discussions, including the fourth and last in

May 1989 they were threatened: if the directors did not privatize their respective companies, they would be put under administrative supervision.

"We shall learn about privatization during its course." This optimism was, and remains characteristic of the advisers, the investment companies, the property agency, self-appointed experts and companies alike. However, from among those listed only the latter have to face the risks involved—at least this is what the common assumption has been.

The intensifying pressure coming from the Ministry of Trade is explained by its confusion regarding its role, since it acted as an owner although in fact these retail trading companies were owned by the councils. The behaviour of the Ministry was also characterized by its shifting of responsibility since it did not want to face the failures of the transformations that it had initiated[2] nor their negative judgement by the public. Its attitude was also motivated by what its unsuccessful function as a catalyst eventually brought about: it promoted the final separation—in sociological terms—of state property from state administration, such that it could not be repossessed by any authority. Thus, only judgement and threat were left for the Ministry of Trade.

As can be seen from the above, ÁPISZ escaped administrative intervention, and its rapid transformation can be explained mainly by the threat, and this was decisive. Its manager was convinced that he represented, or was able to represent state property at least as much as the Council of the Capital or possibly the Ministry of Trade. This representation was actually necessary since its foreign negotiating partners looked for an exact owner. They could not negotiate with a body such as the company council; while the powers of the Council of the Capital were not valid, and in particular not exclusive rights. This was due to the lack of an Act on Self-Governments.

The range of choice and the plan

The experts of the Financial Research Co. Ltd. elaborated three possibilities for the transformation of ÁPISZ into an association. These were as follows:

- the transformation of the shops into limited liability companies (ltd-s),
- full transformation into a joint stock company,
- organizational separation of property management and operation.

[2] It is possible that the three council-owned companies in Borsod county, which privatized at the end of 1988 by way of acquiring mutual ownership of each others' assets through making the appropriate entries in their bookkeeping, wanted to meet the expectations of the Ministry of Trade. Anyhow, one can conclude this from the date (and it is absolutely irrelevant whether these companies were invited to the consultations or not.) "We have always understood in an orderly manner what we had to do. When we had to lease out the shops under contracts we did it. When the Act on Associations was announced, we established an association", declared the director of one of the ltd. companies. (*Gál* 1990b)

The experts recommended the last version, with the additional point that the shops also be transformed into ltd-s at the end of the multi-phase process. In the first version "the company should sell some of the leaseholds of the council jointly with the council, and should found limited liability companies from the others, also jointly with the council and with private entrepreneurs. From the units constituting its own property it should also establish ltd-s with private entrepreneurs and possibly with foreign partners. In this version the company would voluntarily perform full privatization ... obviously, it should share in the profit with the council and with the new partners." In the version in which the company was to be transformed into an association "it is basically not entrepreneurs brought in from outside who get into the given ltd-s as co-owners, but the present employees and executives—with all the positive effects accompanying the process." Concerning the company's full transformation into a joint stock company (as a second version), the experts called attention to the fact that "the ownership of state shares is as yet unsettled ... it is not clear who would receive the shares for the purpose of handling", and that "only 20 percent at the most of the proceeds from" the selling of shares "would belong to the company (joint stock company)".

The third version—the establishment of an ÁPISZ property managing company (trustee) and an ÁPISZ joint stock company—was elaborated in detail as the version to be implemented. According to the written proposal, first the so-called small ÁPISZ joint stock company would be established with a registered stock capital amounting to 100 million HUF, in the framework of an exclusive (closed-circle) foundation. In the opinion of the experts of the Financial Research Co. Ltd., the stock capital of the joint stock company would have to be raised to one thousand million HUF. This would embody the property of ÁPISZ, following the registration of the small joint stock company. According to those making the proposal, it would have been advisable to distribute 10 percent of the shares as free employee's shares, 50 percent should have been sold to foreigners, and 20 percent to business partners and banks. The remaining 20 percent should have been left to the ÁPISZ state-owned company for the purpose of management. After ensuring the conditions required for the operation of the ÁPISZ state-owned company as a property administrator (in the fourth phase of the transformation into an association), the above-mentioned shops (in the form of ltd-s) would have been established.

The written material prepared for the company council showed the general uncertainty regarding the future of state-owned companies; such uncertainty was also a characteristic of the experts. In this period it was regarded as desirable for the successor associations of several trading companies to have a common property administrator. The opinion in connection with the ÁPISZ state-owned company was that—if no other solutions were offered—the company would merge with the joint stock company three year later.

The choice

With a cautious approach, ÁPISZ first established a joint stock company with low stock capital. This stock capital was much less than 100 million HUF—to be exact it totalled HUF 40.260.000. ÁPISZ brought one of its shops into the company as a contribution in kind. Outside owners were Ferunion (company for trading in ferrous products), Fömterv (Civil Engineering Company of the Capital) and Szivárvány (department store for clothing articles), each with a share of one million HUF, as well as the College for Trading and Catering with a share of HUF 100.000. The three managers of the ÁPISZ Trading Company acquired shares amounting to HUF 50.000 each, definitely in order to strengthen the employees' confidence.

Without exception, outside owners were so-called "preferred" owners. Apart from Ferunion, which we have mentioned as the main foreign trading partner of ÁPISZ, the others became owners not because of their business records, but through personal contacts. The significance of personal relations is also shown by the fact that the economic manager of Fömterv will become the manager of ÁPISZ State-Owned Company after the establishment of the joint stock company.

Following the registration of the "small joint stock company", ÁPISZ announced that the next shareholders' meeting would take place on 30th June, when preparations were to be made for the raising of the stock capital according to the original schedule (elaborated by the experts). Between 20th May (when the date of the shareholders' meeting had to be decided on, due to the obligation of announcement one month prior to the event) and 30th June the director of Citibank Budapest Co. Ltd. visited the company. Following this visit, the privatization of ÁPISZ basically bore the marks of the Citibank experts' ideas and techniques. After an extremely intensive period of negotiation an already elaborated proposal was presented to the shareholders' meeting on 30th June. This proposal met the previously mentioned conditions of ÁPISZ, it was completed with financial knowledge from Citibank and complied with Citibank's expectations.

In parallel with the raising of the stock capital, the managers of ÁPISZ prepared for the organization of the ltd-s. (In addition to four to five servicing ltd-s—engaged in business management, accounting, maintenance and wholesale trade—they planned the establishment of 10 to 15 retail ltd-s.) Shop managers, however, definitely protested against the way in which the ltd-s were to be established by merging several shops. Possibly they would not have been so firm in their refusal if the shops managed by them were to have been made into independent ltd-s. Presumably, it was rather the neglect of the establishment of the ltd-s that caught the interest of Citibank and the Austrian Berger family—the third future owner of ÁPISZ Co. Ltd. (Without ltd-s it would be easier for them to monitor the management of the association, and their possibilities for intervening in company affairs would be much freer). Therefore, the managers of ÁPISZ no longer pressed for the organization of ltd-s.

At the shareholders' meeting on 30th June the raising of the stock capital of ÁPISZ Co. Ltd. to HUF 719.740.000 was announced. ÁPISZ Trading Company took all of its fixed assets and inventories as well as the right of lease of its whole business network into ÁPISZ Co. Ltd. as contribution in kind. Naturally, the ÁPISZ state-owned company (the later Dunaholding), as property administrator, received the shares of ÁPISZ Co. Ltd.

On 10th August a new shareholders' meeting was convened, at which the raising of the stock capital was laid down. During a break at the meeting the circle of shareholders widened. "Citibank Budapest Co. Ltd. purchased 27,454 shares which were not defined precisely." After the break the shareholders' meeting unanimously voted for the reduction of the stock capital, which had just been raised, to HUF 100 million. This was recommended by Citibank "in order to increase capital efficiency".[3] Anyhow, after this shareholders' meeting "Reuter English news agency announced that on Wednesday the representative of Citicorp declared in London that the privatization of the first Hungarian state-owned company would be realized with the participation of company managers and employees. Citibank Budapest Co. Ltd. signed an agreement, under which such an investment consortium would come into being in which the managers and several employees of ÁPISZ, as well as the Berger family would take part. ÁPISZ would be bought for HUF 700 million." (Gál 1989)

Debates on property

The management of ÁPISZ estimated the book value of the company's property to be around HUF 700 million by mid-1989. Referring to the reputation, long establishment and dynamism of the company, they determined the magnitude of property which could serve as a basis for negotiations to be HUF one thousand million. (The experts of the Financial Research Co. Ltd. had also recommended the raising of the stock capital to this level—at a time when Citibank was not yet on the horizon.) After examining the business books the potential buyers accepted HUF one thousand million as a starting basis. However, they expected to decrease it by the credits needed for financing permanent stocks and to correct it by pro-

[3] The attorney's protest expounded before the Supreme Court on 10th January 1990 was put down in the form of extensive notes. Therefore, its text is not a word for word quotation.

ducing an itemized inventory for determining property, and an itemized property assessment. The credits of ÁPISZ were around HUF 300 to 350 million. Sorting out or depreciation would hardly have been necessary to make the reassessed property less than book property. Therefore, the manager of ÁPISZ recommended to stick to the latter and, understandably, Citibank accepted the proposal.

Simultaneously with the raising of the capital, the actual and alleged owners of ÁPISZ (later on the justification of the distinction will be explained) prepared for the reduction of the stock capital (to HUF 100 million). Bargaining over property, however, was not merely apparent since the joint stock company was made liable for the amount corresponding to the difference of the raised and reduced stock capital. Such degree of indebtedness greatly affected the capacity for bearing costs and making profits.

The company's indebtedness came about by issuing bonds to the value of HUF 700 million, with a ten-year expiry period and bearing 15 percent interest. This means that for ten years ÁPISZ Co. Ltd. has to pay an interest amounting to HUF 100 million per year and, at the end of the tenth year, it has to repay the HUF 700 million in one amount.

ÁPISZ was sold at a low price and at the same time its quasi-monopolistic position was also preserved—this is how the essence of the criticisms can be summed up. Postponing the discussion of the latter, the problem now focusses upon the information the management of ÁPISZ had when they were preparing for the exclusive (closed-circle) foundation of the association. (Yet they may not be much of a possibility to gather such information.) After the precedents given it is obvious that they compared or were able to compare the price offer of Citibank only with the offer of Andlinger.

The essence of the technique favoured by the Andlinger company was as follows: they would found a small company with a low capital base (between half a million and one million dollars), and the company would raise credit without cover and with a high interest rate to be able to buy the target company with which it would merge. (Through merger amortization has to be paid from profit before taxes.) In order that the foreign firm can raise foreign credit, it has to possess a majority (at least 51 percent) share in the new association. Undoubtedly, Citibank's offer was more favourable than that of Andlinger.

Underselling or the selling out of the company could have taken place if the qualification of ÁPISZ was false or an important property asset was left out from the property assessment, or it is possible that both of them brought about the end result. Based on the criticisms, we can conclude the latter. The technique recommended by Citibank is usually applied in the developing countries when buying up bad companies showing a deficit. ÁPISZ, on the other hand, produced excellent results; thus, this technique has unambiguously undervalued its property.

At the time of its privatization, in two steps, ÁPISZ took into the joint stock company its entire network of shops, or more precisely, the right of lease of the network. (The owner is the state and the IKV (Communal Management) Enterprises manage them.) The right of lease is a right representing material value which should have been assessed and taken into account in the selling price—although this is not provided for in the legal rules.

After formulation of the objections and after the "disclosures" the employees of ÁPISZ and of the organization that was later to become Dunaholding said and argued that the Act on Self-Governments must settle the ownership question. If the self-governments were to receive the shops instead of the state, then according to this logic the rentals would be determined during business or market bargains. Their remarkable increase through the increase of costs would induce the associations to properly weigh up the situation. Beside raising the rentals, the self-governments can also decide on the selling of shops or on merging them into associations. In the last days of the ÁPISZ Trading Company its managers still believed that—if the Privatization Act entered into force—they would be able to buy proprietary rights. At that time—accepting the experts' opinions and similar to other companies' transformations—they did not intend to take the rights of lease into the joint stock company; such rights would have been kept by the property administrator. The Privatization Act has not been introduced, and ÁPISZ as well as its later owners have undoubtedly made maximum use of the opportunities offered by the Act on Associations and by the accounting rules.

The privatization technique of Citibank was unambiguously advantageous to everyone originally acquiring the shares. It offered a guarantee for high dividends and profit on the stock exchange from rising quotation. However, further advantages for the current owners have not been ensured or specified for later periods (e.g. in the case of raising the capital).

Among the owners the position of the Berger company is unique. As a large supplier of ÁPISZ it not only has proprietary interests but market interests as well. More precisely, its acquisition of property is mainly a very safe way of ensuring the market. This is why one can assume that the magnitude of the dividend or the profit on the exchange did not play a distinguished role among the firm's motivations. It was a decisive motivation, however, that it acquired originally 15 (later actually 25) percent of the shares of ÁPISZ under extremely favourable conditions. Therefore, this firm was very interested in reducing the stock capital and in making ÁPISZ indebted.

The financial technique of Citibank "came in very handy" for the employees of ÁPISZ Co. Ltd. as well. As a reminder, among the conditions of transformation into an association and of privatization the involvement of employees in the business in the capacity of owners was emphasized. With a stock capital of HUF 700 million, also taking into account the Hungarian income conditions, this could have been achieved only by means of a preferential share construction. (Free employee's shares were omitted from among the possibilities at a very early stage—since they could amount only to 10 percent within all shares.) The acquisition of property, however, had to be made attractive, not only possible, for the employees. As an owner, it was not the incomes of state-owned companies but those of the private sector that provided the standard and basis for comparison. This is why low capital efficiency was out of the question.

Has Dunaholding come to grief? In the first approach the answer depends on bank interests. From ÁPISZ it received a promissory note for HUF 1.7 thousand million and for annual interest repayment. Taking into account the current rates of interest and the calculation of the present value—at the time of elaborating and accepting the construction—the value of the promissory note was not significantly less than the immediate payment of the HUF 700 million. Incidentally, the yield of the bonds can be increased by further endorsement and conversion. It was important, however, that Dunaholding acquired securities that could be mobilized as befits a property administrator. In another construction this might not have taken place so rapidly. This was not immaterial for Dunaholding (the ÁPISZ state-owned company) at that time.

Agreements

As a condition for concluding the business, Citibank specified the following requirements: reduction of the stock capital, payment of the par value of the shares—HUF 90 million—by the new owners (HUF 10 million would belong to Dunaholding or more precisely, at that time the ÁPISZ state-owned company), and the issue and purchase of bonds would have to take place simultaneously. In practice this also meant that the sale contract related to the stock capital—which amounted to HUF 700 million—would enter into effect only when the reduction of the stock capital had been registered at the court of registration. The owners had to pay in cash in the currency specified in the agreement. (The London concerns of Citicorp had to pay in foreign exchange and Citibank Budapest in forint.) The modification of voting proportions is included in the contract for the selling of shares, and it can also be found in the text of the Rules of Association (modified at the shareholders' meeting on 10th August 1989). ÁPISZ wanted to protect the employees as later owners and also wanted to protect itself against the competitors. Therefore, before the negotiations with Citibank and the Berger company, it restricted the voting proportions of outside owners. Citicorp is also obliged by American laws to restrict itself if specific conditions have been laid down. Accordingly, the shareholders' voting rights are connected to the par value of their shares with the restriction that no single shareholder or group of shareholders, one of whom is at least 50 percent owner of the other, or who has such an indirect or direct joint owner whose property share exceeds 50 percent, can have more votes than 19.9 percent of the votes exercised by all shareholders.

The planned distribution of the share ownership was as follows: 36 percent was to be owned by the employees, 15 percent by Berger, 10 percent by Dunaholding, 3 percent by small investors, and 36 percent by Citibank. The latter, however, consists of four firms: three of which are investment firms of Citicorp in London. These accounted for 10 percent and thus only 26 percent was the share of Citibank Budapest. Therefore, at the time of voting the 36 percent proprietary share would have meant 20 (19.9) percent. (Citicorp complied with the American laws when it declared that it had acquired a considerable share in ÁPISZ.) However, the theoretical share of foreigners among the owners would have been only 25 percent since Citibank Budapest is qualified as a domestic firm. Its shares would not have been registered shares.

According to the contracts, at the time of the selling of shares the co-owners had the right of pre-emption, with all of its advantages and disadvantages. In the summer of 1990, in the sale contract, it was still left to be clarified whether the concern of Citicorp in Budapest could or could not sell the ÁPISZ shares on the international (not Hungarian) stock exchange.

According to another, very strict condition coming from the Berger company, ÁPISZ must ask for an offer from Berger whenever it wants to put into circulation any individual product (either from imports of from a domestic source of procurement). ÁPISZ must ask for offers from other sources as well. In the case of equal conditions, it has to give preference to Berger. It is worth saying a few words about the other side of this relationship, too. In its own best interest the Berger company had always fulfilled in every respect the contracts of delivery in the past, and its terms of payment had also been favourable. It is not by chance that it had become the main or dominating supplier of ÁPISZ, or what is more, the one striving for ever more exclusive preference.

The first lesson to be learnt from the activities of Berger and Citibank at the shareholders' meeting on 10th August 1989 can also be seen as a warning: they dismissed the commercial managing director who up until then had enjoyed the Berger company's confidence. This was because he made additional purchases from an outside supplier, without preliminary agreement.

With delaying force

Protests

As a result of the statements coming from the political parties and the self-appointed "economic" politicians, the Supreme Prosecutor's Office and the Supreme Court were compelled to deal with the privatization of ÁPISZ. The date of the trial was set for 10th January 1990. The intermediate period was long, and it was especially long in the fall of 1989 when the campaign against spontaneous privatization had intensified. As a consequence, the introduction of the updated version of the Privatization Act from the 1st January 1990 seemed likely again. On the other hand, the setting of the date of the trial seemed to be deliberate in its timing.

It is hard to deny that, if the Privatization Act had entered into effect, the problem of ÁPISZ would have been solved in such a way that it would have satisfied the demands of those opposing privatization, and no responsibility would have rested with the Hungarian jurisdiction. Instead of the Supreme Prosecutor's Office and the Supreme Court, the matter would have been settled by the act passed by the supreme representative organ—the Parliament—in a manner reassuring for everyone, except for those concerned. The Privatization Act, however, did not enter into effect, and the Supreme Court stated that the registration of the firm was actually unlawful. Nevertheless, it did not invalidate it because, "by an action taken by the firm meanwhile...the violation of law was terminated."[4] Let us add that this had happened two months prior to the date of trial.

ÁPISZ Co. Ltd. modified its Rules of Association as early as 9th November 1989. At the same time it also modified the article that was most strongly objected to: that which provided a way for reducing the stock capital, and the withdrawal of shares by lot, in conformity with the Act on Associations. Prior to that, according to the Rules of Association, the shares falling to the raised portion of the stock capital would have been withdrawn, and then only after that, would have come the withdrawal of the shares of foundation, proportionately and at par value. Indeed, this could not be regarded as a neutral regulation.

What could result from the decision of the Supreme Court? This was the question on which *bona fide* owners had different opinions. Since the court of registration had not even registered the raising of capital, it could not make arrangements regarding the reduction of the stock capital either. In that case, however, the Berger company, Citibank and the employees could not be owners. In effect, there was one signle owner left—Dunaholding—which was already registered officially under this name. However, since the court of registration had not even registered the raising of the stock capital, the transformation of ÁPISZ into an association receded into a rather embryonic state. According to law, only the "small" joint stock company existed. Therefore, the balance sheet was drawn up for a stock capital of HUF 40 million, and Dunaholding reacquired the bonds which it had sold meanwhile. Then, on the day preceding the ordinary annual shareholders' meeting (on 23rd March 1990) the court of registration registered the raising of the stock capital.

At the Supreme Court ÁPISZ Co. Ltd. did not refer to the fact that numerous firms had already been registered at the Court of the Capital (the Budapest central

[4]Excerpt from the decision of the Supreme Court. 10th January, 1990

court) with the same Rules of Association as its own. Some objections qualified as ones related to content, which could be corrected very simply (or had already been corrected). These undoubtedly "came in definitely handy" for Dunaholding and the Supreme Court. The latter could take a stand on questions of lawfulness, and it did not have to spend too long dealing with them. However, it is true that the new (prospective) owners could not have made a decision on the reduction of the stock capital at the shareholders' meeting on 10th August without the registration of the raising of the stock capital by the court of registration. Nevertheless, the Supreme Court disregarded this circumstance and did not make a matter of it since the above-mentioned mistakes had crept into the Rules of Association of the "small" joint stock company. Due to the jurist who compiled the Rules of Association, the court did not have to deal with delicate questions affecting foreigners and employees as owners. Thanks to this the court of registration gained more time to deal with the next phase—the raising of the stock capital.

Owners—among each other

Prior to the decision of the Supreme Court, in early 1990, the owner and the buyers resumed negotiations. Power relations, however, had become more well-balanced than before, while relations between some individuals had become definitely unfavourable. What actually happened in the meantime?

First of all, from among the parties concerned, Dunaholding became, if not a key figure, then at least the one having a weight similar to that of Citibank. Its employees had not had connections with ÁPISZ before, but without exception came from outside. They learned the role of an owner very soon, and this is best proven by the rapid transformation of the company as well as the shaking off of its past as a state-owned enterprise.

Possibly, as early as the moment of its foundation, the holding looked further than ÁPISZ. Similar to the property management organizations of the Ministry of Trade and the Ministry of Industry—Investor and Budapest Holding—it wanted to become the property administrator of the Council of the Capital. The Council, however, became more cautious when it realized that the business relationships and personal conflicts had meanwhile become tense between the holding and Citibank. I am convinced that the latter was also incited from outside. The privatization of ÁPISZ could have been destroyed more surely by the owners than by legal measures. In the absence of disadvantageous consequences for ÁPISZ and Dunaholding, Citicorp would not have left a business that was extremely favourable for it. This is why the opponents of privatization tried to convince it that the ÁPISZ-affair defamed it, and that this could only be eliminated by instituting a suit of discredit. Citicorp followed its best interests: it sought an agreement. Therefore, it resumed negotiations and agreed on the rediscussion of valid agreements. It also fulfilled its co-owners' request to remove Citibank Budapest from among the owners. (Technically, this could be solved simply by replacing it with another Citicorp concern in Hungary.)

Has this quarrel done any harm to Dunaholding? Yes, it has. As opposed to the "compulsory" 20 percent, the Council of the Capital already had a 30 percent proprietary share in the holding. It got rid of its surplus share extremely rapidly when tensions came to light. In addition, possibly the great dream—to become the property managing organ of the council—has been lost forever for the holding. The fact, however, that in spite of several trials, Citibank could not put it into an impossible situation, meant that there were still clients. Nevertheless, the balance sheet is negative.

Numerous misunderstandings spread among the employees. It is significant, for example, that, due to oversubscription, the decision from those wishing to buy shares over HUF 200 thousand, which was related to the repurchase in proportion to the extent of oversubscription, was interpreted in such a way that HUF 200 thousand was the ceiling of subscription per person. Later on, several persons declared that they had announced their intention to buy shares only due to the perceivable expectation. Since the date of paying-in was postponed continuously, the workers' meetings did not reassure everyone. In early 1990 the demands were surveyed again. New applicants replaced those who cancelled their intention. Most of them wanted to buy shares to the amount of HUF 50, 100 or 200 thousand. But there were some subscriptions amounting to a million HUF. In July 1990, when the registration of the reduction of the stock capital by the court of registration had to be reckoned with, i.e. when the payment for shares first became a reality, the news related to preliminary privatization and to the supervision of the privatized companies made the employees uncertain again.

The shareholders' meeting on 24th March 1990 approved of the agreement made by the old and new owners in late January and early February. According to this, the capital of the joint stock company would be reduced to HUF 150 million instead of 100 million. The amount of employees' share property (HUF 36 million) and the share of foreign property (25 percent) were included and unchanged in this agreement.

From twilight into twilight

In the fall of 1990 the press again dealt with ÁPISZ frequently. This was so because, in connection with Dunaholding's plans for the raising of capital, the origin of the firm as well as its relations with ÁPISZ aroused considerable interest. Thus, it turned out indirectly that:

— the reduction of the stock capital of ÁPISZ has not, and will not take place, since this intention of the shareholders' meeting held in March 1990 was abandoned at the shareholders' meeting in October,

— the contracts were renegotiated: neglecting the bond construction,

— the otherwise unchanged foreign property share went fully to the Berger company, i.e. Citicorp is not among the owners of ÁPISZ.

One more thing that emerged—although "between the lines"—was that the Berger company had made the position of the president-manager of ÁPISZ impossible, in a similar way to that of the former commercial director. This resulted in a marked change in the story of ÁPISZ: in effect the management of the firm fell into the hands of one particular owner who would surely behave not as a manager but as a merchant. Presumably, this multiple confusion of functions will not serve the interests of ÁPISZ Co. Ltd. Instead of predictions, however, it is more useful to make a quick summary, which may also be a basis of comparison for subsequent events.

Thus, the registered stock capital of ÁPISZ amounts to HUF 700 million. In the summer of 1990 a property assessment estimated the market value of the firm at two billion HUF. Investors' interest (overseas as well) was extremely intensive. The raising of capital could obviously be reckoned with. Without individual and collective limits, employees could buy shares in a preferential construction (by paying 50 percent in advance and with interest-free credit), on the basis of a decision of the shareholders' meeting on 1st October.

Lessons

The privatization of ÁPISZ differed from the norms: from the time that interest was aroused it proceeded towards its final outcome with extreme rapidity. It did not leave time for those dealing with the demolishing of state property to overtake or catch up with their current practice with their theories. It did not resort to the state apparatus, which hoped for a "wind-aft" from the transformations and privatizations. It did not even wait for approval or for a nod of approval, and in its directing bodies, too, it easily managed without their assistance. In fact, it was precisely them, from whom it deliberately escaped. During the escape it was lucky, since from among the owners the employees and the concerns of Citicorp proved effective as a protective shade as well, when the company needed it. Presumably, the prestige of Citicorp as a future owner influenced the formation of events, and also the decision of the court.

Some lessons can be drawn from the story of ÁPISZ which would be worth considering in a wider circle. Let us begin with employee ownership. It sets requirements together and simultaneously, not only in connection with yield (profit from rising quotation and dividend), but also with regard to the magnitude of capital. It frequently occurs that capital (the company) is broken up—but will the requirement towards yield be fulfilled in such cases?

The example of ÁPISZ shows that the *foreign owner* was necessary for the change of pace. This foreign owner taught ÁPISZ business aspects as well as management and financial techniques, thus preparing the way for Dunaholding. The intellectual know-how which the latter acquired, and which could be further developed, was especially valuable for them. During the debates, their own ideas were also clarified and refined. The foreign candidate seeking ownership demands a "personal" Hungarian owner, even if he cannot "create" him by himself. It was not by chance that, right from the moment of its establishment, the holding behaved as an owner and not as a "remainder" state-owned company awaiting its lot. The preparedness, professional experience and ambitions of the employees of Dunaholding as well as the absolute lack of personal commitment towards ÁPISZ forced out a further clarification of roles (the separation of the proprietary and manager's functions).

However, the change of peak executives at ÁPISZ Co. Ltd., which took place in the fall of 1990 also warns of something else. Nowadays roles are separated and the role of the owner is appreciated; meanwhile the conditions for safeguarding the managers' interests are completely missing.

At the time of choosing an owner ÁPISZ fell into the traps laid, on the one hand, by its own ignorance and by monetary restriction on the other. The company did not have the right of independent foreign trade, and this is why it maintained business relations with large international companies through the Berger agency. Since the demand for the products sold by ÁPISZ keeps increasing without fluctuation, and it has an undoubted superiority of position compared to other domestic firms of a similar profile, the sold volumes would have justified the establishment of direct contacts with the international firms. Hungarian companies and firms, however, are rarely in the position of being able to endanger a relationship of several decades with a supplier.

The privatization of ÁPISZ illustrates fairly precisely the Hungarian system of economic norms at the turn of the decade; it illustrates that the problem of the lack of an owner has come to the surface more intensively than ever, and that the new participants (owners and managers) can exercise their alleged or real licences only to each other's injury. Furthermore, it is easy to criticize a privatization technique, but a really good one or—what is equivalent with it—a just one is unknown to us.

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"ИГРА В ПРЯТКИ"
(ПРИВАТИЗАЦИЯ ТОРГОВОЙ ФИРМЫ "АПИС")

Ш. ПАСТОР

Приватизация торгового предприятия "Апис" вошла в хронику хозяйственных скандалов конца 80-х годов. Доводы, которые были высказаны против приватизации предприятия, могли бы возникнуть и в связи с преобразованием других предприятий: распродажа государственного имущества руководителям предприятий и иностранцам, выбор руководителями предприятий подходящего для них собственника. Следовательно, можно спросить, почему же "Апис" первым попал под огонь критики? Не пытаясь дать исчерпывающего или хотя бы убедительного ответа, можно сказать, что попытка предприятия пойти собственным путем была рассмотрена как вызов и затронула интересы различных ведомств.

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LABOUR CONFLICTS OF PRIVATIZATION

L. NEUMANN

The legal frameworks for privatization secure consultation possibilities for the organizations, representing employees' interests. The trade unions' demands aim at the mitigation of unfavourable consequences on employment and social benefits and at the acquisition by employees of the largest possible property share at the best possible terms.

It is decided in the enterprises if the local trade union becomes a genuine negotiating partner and can preserve the earlier rights. The State Property Agency also takes employees' decisions and evades negotiations on employment and social problems—tolerating even violations by the buyer. It may be feared that this might serve as a model for privatized companies.

Employee representation

In Hungary, similar to all other former socialist countries, one single trade union federation was active up until 1988 and more than 95 percent of employees were trade union members. This high level of unionized workforce, however, did not at all mean that the trade union offered considerable protection to its members. On the contrary, it was intertwined with the ruling party locally and all over the country and its main function was to propagate the objectives of the leadership and to dismantle any disobedience. It is not surprising, therefore, that the idea of solidarity and the institution of trade unions were badly discredited during the four decades of "existing socialism".

Since 1988 new trade unions and Workers' Councils have been forming outside the old power structure. (The latter took their name from an important political formation that emerged during the 1956 revolution.) Their original political role is gradually being played down and they look increasingly like real representatives. However, although units are mushrooming numerically they remain organizationally weak. They are usually in a minority at a given work place and their national membership is just a fraction of that of the old trade unions and their successors. The new and usually quite radical unions must work hard for recognition. Employers often do not accept them as bargaining partners and often violate the freedom of trade unionist organization. Despite the spectacular political changes,

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Paper presented at the conference on "Changes in labour markets and industrial relations in Europe" Slettestrand/Aalborg, Denmark, May 25-27. 1991. The materials on which this study is based were gathered by the author over the past eighteen months in his capacity as a consultant for Hungary's independent trade unions. Attempts have been made to correct for bias resulting from this situation, but its conclusions should be judged with the same critical eye as when assessing the product of any consulting activity.

the new employee representations are organized in secret in some enterprises and the position and methods of the unionists recall those of illegal movements.

Although the interest representation function and demands of MSZOSZ, the successor of the old trade unions, have become more radical mainly in response to the challenge of the new unions and partly because of lost political support, it has been unable to keep its numbers. Beside the impassiveness of the employees the power of the union movement has been eroded mainly by the rivalry between new and old unions. This is felt on the national level—where the main problem is the apportioning of the assets (property) of the former official trade union federation—as well as locally (where it is mainly the behaviour of still active old-guard officials that is most detrimental to the creation of a vital trade union presence). Under such circumstances the employers can easily play off the unions against each other. Cooperation between the various unions is crucial, and in some fortunate cases this has been achieved under the auspices of a formalized forum of consolidation. However, often there is no chance for cooperation since the new union was formed out of dissatisfaction with the old one, and against its policies and its organizations.

The negotiating positions of the unions are not strong on the national level either. A scheme of tripartite consolidation consisting of the Interest Reconciliation Council and its commissions is at work, but its activities bear little resemblance to patterns of corporatist mediation in market economies. The main front lines of bargains are still not between employers and employees; and the (national) Interest Reconciliation Council (with representatives of the state, employers and employees) is only nominally tripartite. As the state itself is still the decisive employer, its role is overwhelming in the Interest Reconciliation Council. In that body, the government ultimately decides what issues are to be discussed and at which phase of decision-making a meeting should be held. The scope of bargaining is limited. So far the new government has, like its predecessors, repressed any genuine negotiations. It may not be an exaggeration to state that, the declarations made by parties in support of the unions notwithstanding, the government would not welcome any strong representation capable of limiting its powers of discretion at the present difficult stage of transition to a market economy.

Legislation governing the participation of employees in the privatization process

The Enterprise Act and the Labour Code inherited from the socialist establishment are known to grant, at least in their text, a surprisingly broad range of rights to "workers communities" with respect to participation in enterprise decisions. Moreover, since the mid-eighties the deputies of employees have been present in owner decision-making through the Enterprise Councils. The 1988 Act on Economic Associations and the 1989 Transformation Act have amounted to a change, or at least intended change, by "forgetting" about the participation of employees or their unions in the transformation process. These laws only prescribe for companies with more than 200 employees, that one-third of the Supervisory Board should be assigned as deputies of the employees. The titles of participation are uncertain for organizations operating as limited liability and joint stock companies. (On the one hand, according to the 1988 Act on Economic Associations the Hungarian legislation relevant to employment is unchanged in effect; on the other hand, however, according to a 1989 amendment of the Labour Code the exercise of participation rights in such companies is regulated by different legislation, that has not been enacted to date.)

In 1988–89, management initiating enterprise reorganization kept quoting the 1988 Act, whereas the arguments of trade unions were aimed at enforcing the rules of decision-making in state-owned enterprises. According to these rules, decisions about the founding of companies or the restructuring of a whole enterprise should be referred to Enterprise Councils or to the founding Ministry where such a council does not exist; also, the unions have the right to express their opinion. Since February 1990 enterprise transformations have been specified in the Labour Code as acts belonging to the sphere in which trade unions can give an opinion.

While the decisions and preparations for privatization are internal enterprise affairs, the authorization for the formation of trade unions is guaranteed by law. However, ever since the State Property Agency exists, it is the final decision-making authority in almost any privatization initiated by enterprises and many privatizations are initiated by the Agency itself. In these latter cases the important decisions are taken by the Agency in nearly every phase. The opportunities for employee participation and the channels of self-government are far from being in place on the level of state administration. Although the resolution of Parliament governing the activities of the State Property Agency (Property Policy Guidelines) states that decisions must be taken considering, among other things, the opinion of the employees of the organization concerned, there is no rule to define the methods, timing and aspects of evaluating that opinion. Consequently, the State Property Agency is free to set its own procedure and involve the Enterprise Council or the unions. This often means that it is up to the officer in charge to decide whether he wants to hear what the unions have to say.[1]

The spinning-off of state-owned enterprise facilities is only one field where the rights of the "working community" have grown since the beginning of the privatization process. It is widely known that the big state-owned corporations were created in campaigns of centralization and many of their units (factories, plants) could operate far more efficiently as independent organizations. For some time, the autonomy of the plant was often an underlying claim among the wage and social

[1] In the meantime the government issued a decree giving detailed procedural rules in the case of transformation and privatization of state-owned enterprises. (119/1991 Korm. rend.)—Ed. note

claims of workers. The assumption was that by getting rid of the "exploiting" centre the way could be opened towards developing facilities and meeting the wage requirements. However, such facilities remain state-owned. Nowadays such actions, too, are closely linked with privatization. The usual objective is to frustrate the headquarter's ideas of privatization and then to implement a method of privatization which is more favourable for the managers and staff of the organization.

Such aspirations for autonomy were frozen in 1985 by vesting the power of enterprise headquarters in the Enterprise Councils wherever they existed. In March 1990 Parliament facilitated the spin-off process. According to the new legislation the Enterprise Council may not veto a decision taken by a two-thirds majority of the votes of employees. The final decision in such instances rests with the Ministry. However, the role of the working staff and/or the trade union is regulated only at the outset and, similar to the procedures of the State Property Agency, they cannot but informally express their opinion or expectations about the decision of the Ministry.

National level negotiations and the points of view of trade union federations

When in July and August of 1990 the government published the document laying down the guidelines of the desired privatization policy, everybody expected that legislators would work hard for privatization and would first consult the representative bodies under the auspices of the Interest Reconciliation Council. The first and rather one-sided round took place early in September in the form of a 30-minute presentation delivered by the competent ministerial official. The working meeting was planned to be held after a fortnight to hear the opinions of employers and employees, to discuss and eventually to bargain. Such a meeting was not held until May 1991, even though in the meanwhile several bills regulating important areas of privatization have been passed by Parliament (including the sale of retail and catering outlets and the so-called Restitution Act on compensation to individuals who used to be owners before nationalization and the formation of cooperative farms). At best, the trade unions could voice their opinions outside Parliament and the Interest Reconciliation Council but could not influence any decisions. However, the government seems to have reassessed the role of the legislation. The provisional Property Policy Guidelines have been prolonged twice by Parliament without discussion or amendment—the excuse being that the agenda is too busy.

The failure of trade unions and other representative bodies at the Interest Reconciliation Council in September 1990 shows what role the government is actually ready to assign to "social partners". Although in December it had asked the trade unions to comment on the draft Property Policy Guidelines, the State Property Agency refused an open discussion about agency procedures. When the unions asked for measures to coordinate the existing ad hoc procedures of the State Property Agency or at least to be informed about customary practices, the Agency simply did not answer this request (made jointly, on this occasion, by experts of different trade union federations).

However, the September 1990 turn provided the analyst with a useful documentation of the objectives of the different nationwide trade union federations. (The September meeting of the then still active Round Table of Unions even issued a joint statement of understanding.) Privatization was accepted by every union to be a necessary and inevitable step. Leftist ideologists active in every federation could not bring home their ideas which insisted on "collective ownership". Nearly every union emphasized the following three issues: social and employment implications; employee participation in decision making; and chances of access to shareholding.

The emphases were naturally not identical in the points of views of the different unions. Workers' Councils demanded that the privatization process must include an "Act of Participation" by which they hoped to consolidate their own uncertain status. They demanded the right to veto privatization plans of the management or of the State Property Agency, and they wanted representation on the board of the Agency. They emphatically demanded an Employee Share Ownership Plan (ESOP), especially as a token of the right of participation in decision-making.

The successor of the old trade union centre (MSZOSZ) is another organization arguing for ESOP schemes. It has even quantified the price discount and credit facilities to be offered to employees. They have proposed that if more than half of the employees of an organization vote in favour of ESOP, the Property Agency should be bound to implement it in accordance with the corresponding facilities. (By the way, this is also demanded by the movement and foundation formed to support the employee shareholding programme.) The union representing civil servants, realizing that its members had no chance of access to employee shares, claimed some compensation for its members, to cover the losses they had suffered over the past decades, following and somewhat extending the logic of usual arguments for employee share. The "invention" of MSZOSZ is to detach assets set aside for social purposes from the enterprises to be privatized and then operate them for their original purpose in the form of foundations.

The main proposition of the independent trade unions (LIGA) is to establish rights of participation in order to enable the trade unions to become bargaining parties in the privatization process, both on the enterprise level and with the State Property Agency. Instead of claiming veto power it tries to propose legal solutions and guarantees for the development of a negotiating, co-determination process. (For example, guarantees in the form of procedural rules; consultants of trade unions paid by enterprises, etc.) ESOP is not a key demand of the League (LIGA), but it has demanded an expansion of the ESOP possibilities to cover other forms of employee ownership (like employee buy-out of departments, or the starting of small business financed from enterprise assets—especially in regions hardest hit by unemployment). The League has also demanded a separation of a portion of the revenues from privatization in order to finance an active employment policy in the form of local and national funds. This demand has been made not only because of the acute problems of financing the measures against unemployment but also in order to introduce the consideration of employment implications at the point of making the privatization decision.

Positions of the government bureaucracy

The status of the State Property Agency was confirmed by Parliament in Summer 1990. The reasoning based on the restoration of the state's ownership rights has granted the Property Agency a status as strong as that which a sovereign private owner enjoys. The question remains, however, whether the bureaucracy of the state will be able to assert ownership interests. Over and above the apparent concentration of power, it is another problem that ownership interests—namely, maximum returns from sale—conflict with other state interests, such as the plan to develop the competitive market of a market economy (should the state stand up against monopolistic corporations or should it enjoy the benefits of selling a monopoly?). There is also a conflict over the state's responsibility for employment and its industrial policy objectives. At any rate, the allocation of incoming international finance seems to be the number one concern of bargaining about privatization. As against the immediate mitigation of state debts (that is, the interests of the treasury) all the other actors are interested in acquiring funds as additional resources and investment in a given enterprise, sector and region. On this basis the managers, employees, local governments and eventually even the sectorial ministries are seeking alliance.

In specific cases of selling an enterprise the role of the Property Agency is decisive from the point of view of the terms and conditions of employment. The contract with the buyer is made and executed by the Agency. Trade unions must ask for its assistance in settling the problems of transition in complementary (syndicate) agreements that show their demands. With the given legal gaps of privatization an enterprise may be sold under an agreement in which no mention is made of the people working there. They are actually not mentioned in the act of privatization of retail outlets of state-owned enterprises. Keeping or dismissing such employees is an internal affair of the enterprise which has been divested of its outlets.

So far, the State Property Agency has appeared to be an adamant representative of the aim of maximum state revenue from company sales. This is synonymous with ignoring labour issues or trade unionist demands. In this approach any concession made to employees (such as accepting the redundancy payment,[2] underwriting employment guarantees, implementing ESOP, etc.) is considered a factor that reduces the sales price and as such should be refused. The Agency represents this position even if the trade unions have already achieved better conditions in their direct negotiations with the buyer. (For example, in one case lawyers of the Agency failed to include the wage and employment guarantees bid by the buyer in the contract. In another case they informed the buyer that he was not obliged to engage in collective bargaining with the trade union.)

Naturally there are exceptions. According to some newspaper reports, employment is a criterion to be considered in the case of enterprises which involve a whole sector (e.g. bus production which, together with its suppliers and subcontractors, accounts for 100 thousand jobs). The ESOPs implemented so far appear to be more like occasional permissiveness and exceptions to the rule. However, even in these cases the concessions of the Agency reflect the efficient lobbying made by the management or the activity of consultants, rather than the assertion of collective interest by a union acting directly against the Agency. The rather low prestige of trade unions is shown by the fact that the government tends to ignore them—not only in national level negotiations but also in actual enterprise matters. Examples could be quoted from the practice of the Agency to illustrate discrimination against independent (minority) trade unions. In the final analysis the current government agencies have about the same idea on the role of trade unions as their predecessors. Recently, right after a meeting with trade union leaders, the Secretary of State of the Ministry of Industry and Trade explained on the television that in his opinion the only task of the trade unions in the privatization process was to provide information for the staff—for example, to tell them what kind of legal framework conducts a joint stock company or a limited liability company.

"Spontaneous" reflections of workers

In the reports published by the media, at workers' meetings, and in casual conversations there is clearly an aversion to and dissatisfaction with the privatization process. Accusations and passions abound. The most popular accusation voices a suspicion that the political and economic leaders of the ancien régime are using it to "salvage" their power and to exchange leading posts for property and holding. To put it bluntly, the former state property is being stolen by managers.

There are few data and still less scientific analysis of the process of "spontaneous privatization". It is nevertheless clear that spontaneous privatization has not actually been privatization. The state ownership has been replaced only by a

[2] In the meantime, a compulsory redundancy (severance) payment has been accepted by Parliament.—Ed. note

very limited amount of private ownership. The owners are usually state enterprises or banks. Moreover, the charge of "salvaging" is impossible to prove by statistical means. The rate of turnover in company managements is still higher than in the sphere of state-owned enterprises. Although everybody has heard about abuses, these indictments and suspicions need to be explained further.

It is striking that whatever the changes and the actual financial position of an enterprise happens to be, people use terms and phrases like "position-salvaging", "sale-price acquisitions", and they refer to the "scattering" of assets by the management. A ready explanation may be found in the demagogy of the spokesmen of the governing parties asking for management change and a "big clean-up". This is suggested by the unchanged use of panels and the casual use of the label "communist". Looking at the ideological impacts we must go back still further. We must not fail to note that the 1948 slogan "the factory is ours" has never been so popular as it is now. The indignation of workers over some cases concerning the "sale-price" is reminiscent of the indignation caused by issues involving right of ownership, whether it is about their own factory or other property of the state. The citizens, whose feeling of responsibility for public property and trade union actions is guided by elementary indignation, can often come up against their own, more or less realized employee interests. Typical cases are those showing resentment for the undervaluation of enterprise assets, which actually means lower performance requirements from management and labour. Moreover, the charge of undervaluation of the enterprise assets is often made at the very time of seeking ownership! Nothing but responsible civil awareness can explain the action of a trade union that successfully torpedoes the sale of a factory to an international buyer while the factory has nearly doubled its sales price. However, at the same time, the objective of the workers in such cases is to get the shares the next time the enterprise is quoted!

It would be a gross simplification—moreover, a reversed ideological make-up of the processes—to attribute any opposition or affections to propaganda alone. From the point of view of employees without detailed information about forming a company, only those facts are palpable ones that are symbolic of the actual benefits and envied position of the CEO: the gossip about his remuneration and foreign bank account and, what is really palpable, the exquisite furniture of his office and his fancy car of Western make. This is contrasted with the devaluation of employee incomes and their shattered employment security. On the other hand "salvaging" of assets is often suspected with good reason in the case of transformations where there is no ground for any legal objection since the property recorded in books is not damaged, but the employees left out of the transaction are losers. For example, this can happen when a limited liability company formed from a few members out of a department carry away all the intangibles and contacts—literally the paying markets of the whole enterprise.

The experiences behind such charges do not always and necessarily come from the privatization of the given enterprise but from the narrower context of differentiation inside the structure of a former state-owned enterprise, the ever deepening gap between management and employees and, more generally, from a society of rapid differentiation in terms of income and wealth. It is quite possible that these processes are in the most part independent of the structural changes of a given enterprise. Managerial incomes had earlier grown at a much higher than average rate in the structure of state-owned enterprises and also in the state bureaucracy.

Questioning the lawfulness of investments made by managers outside the company is an illustration of the fact that the main concern is not the immediate facts of transformation. In other words, the lawfulness of the previous income of managers is considered questionable and so is the remuneration of managers in the present losing and atrophied state-owned enterprises. This is certainly not unfounded. Managerial incomes are not exposed to risks. Managers are seldom called to account for their performance by the Enterprise Council or the authority appointing them. Indeed, the distribution of the burdens of recession and eventual restructuring is uneven. The losers are those who are made redundant and who are the least guilty for lack of competitiveness and loss of markets.

The chances of effective participation

The workers' opinions quoted above also show that the employees are quite uninformed about the transformation of their own organization. Company sales are in most cases decided without their knowledge, in negotiations involving current managers and prospective owners. In enterprise reorganizations (such as decentralization into limited liability companies owned by the organization) the terms and conditions determining the jobs and pay of employees are developed in the negotiations of corporate and location managers. The Enterprise Council, the trade unions or the employees themselves at workers' assemblies are usually informed of the results of negotiations in order that their approval can be obtained.

While Enterprise Council decisions are always maintained at least formally (since this is a guarantee of the autonomy of the management vs. state bureaucracy), the participation of the trade union is often completely omitted. A frequent ploy of the management, carried out in order to exclude the Enterprise Council, is to ask a prior authorization to draft a plan transformation and to proceed according to that plan (assign consultants, invite competitive bidding, strike an agreement with the State Property Agency, etc.). The Council and trade unions, not having been informed about the progress of negotiations, face a *fait accompli* at the moment of signing the contracts.

Some independent unions were formed precisely because of the perceived or actual grievances suffered from privatization. However, their initial militant vigour may be thwarted if managements simply refuse to accept them as negotiating parties. It makes no difference that the encroachment is obvious and that a court decision will eventually be taken. What does matter is that in the meantime the privatization process will advance to a stage where the unions will be unable to control it. Another general consequence of their shortage of information and ignorance is that the trade unions always lag behind the events. The agreements are already about to be executed by the time they can express their expectations. At this stage it is easy for the management or the State Property Agency to ward them off by referring to the damage that would be incurred if the agreement was to be revised. The inadequacy of the laws of participation with respect to the State Property Agency has been noted above. As far as the accepted practice is concerned, some aggressive trade unions fight to achieve a negotiating position. The invitation and hearing of representative bodies is seldom initiated by the Agency.

Information should be the precondition of any trade union action. Top managements controlling the preparations for privatization and, more recently, the Property Agency, justify their refusal to give any relevant information by referring to the need for business confidentiality, and this argument is hard to contest from an outside position. Some capable trade unions use different skills to get as much information as possible about privatization plans and alternatives. The validity of information and plans eventually presented by the management is justly doubted by trade unions. When the trade unions are lucky, a part of the management (middle managers, specialists) might object to the prepared plan and help them with proper information. These instances, however, involve rather *ad hoc* coalitions of middle management and the trade union, and are not a pure assertion of trade unionist interests. They usually occur when the negotiations between managers have been wrecked and the trade unions are given the chance to enter the scene as an outside supporting force of one of the parties.

The Enterprise Council is a key actor in privatization initiated by the enterprise. Consequently, the unions try to influence the decisions of the Enterprise Council. If they can manage to assign suitable employees as deputies (or replace the old ones) or if they have a specific mandate from their voters, they can represent their interests effectively. A deputy of the employees on the Supervisory Board of a company that has already been transformed into a joint stock company or limited liability company can also play an important role in the actual sale or in fund raising.

In most of the cases in-house negotiations are held among top managers and managers of the different divisions. This is so, even when not only managerial positions but also employment and income conditions are affected by the terms of privatization. The spin-off of rather prosperous departments in the form of limited liability companies is a typical source of such conflicts between different groups of employees, where the workers left behind in uncertain positions accuse those who are leaving of "creaming off" the assets and markets, feeling that these removals harm their own chances. (With the absence of a comparable bid for the privatization of the entire facility there is no way to prove the wasting of assets—a typical accusation on such occasions.)

As a rule, employees and their trade unions can achieve a more significant role in the process of spin-off of facilities or plant divisions of an enterprise. The manager of the prospective spin-off unit does not mind delegating the right of initiative—especially as in this case he does not risk his own position. Experiences show that following the failure of an attempt to spin-off the managers can expect to be degraded or dismissed. The manager of a department continues to be a key individual even if the transaction is initiated by the staff. On more than one occasion, staff have gone on strike in protest at the removal of such managers.

The basic objective of the unions should be the achievement of an equal negotiating position and participation of their elected representatives in the privatization process, as assertion of employee interests in the agreements to be concluded. To achieve this goal they ought to attend each and any stage of negotiations about the reorganization and/or sale of their company and represent employee interests, including direct negotiations with the international partner. However, this is very rare. Without legal guarantees, the degree of acceptance as a negotiating party depends largely on the skills and aggressiveness of a given union.

Trade unions must often fight to ensure that mention is made of the staff in the agreement of sale. It is already considered a success if the syndicate agreement contains promises of wage increases, terms of retraining and training or, eventually, guarantees of employment. In the best of cases the agreement provides for maintaining all the jobs for a certain period of time. A special struggle must be fought for the continuity of the rights laid down in the collective agreement. International owners are not always willing to sign a collective agreement in the privatized organization and they are not always prepared to maintain the level of social benefits of the state-owned enterprise. The institution of a collective agreement is jeopardized also by decentralization through transformation to a limited liability company without any actual change of owner, because it is believed that a strong employee representation is unlikely to survive in a small organization. Therefore the trade unions try to agree in advance on the process of negotiations by first signing a blank contract on the level of the original enterprise; this is then followed by an agreement which the limited liability company level is bound to execute.

Trade union efforts that tried to achieve allowances for the event of redundancy were quite successful in state-owned enterprises before privatization or transformation. However, in the relative economic stability of 1990, trade unions managed to revise or renegotiate the collective agreements that offered a prolonged period of notice, severance payment, early retirement, retraining allowance, etc. for people shortly to be made redundant. They were less successful in clarifying the process of massive lay-offs (e.g. selection method, regulation on unfair dismissal) and the authorizations of trade unions.

In state-owned enterprises facing privatization the trade unions, in a clearly successful "movement", managed to separate the social purpose part of enterprise assets (holiday homes, health and children's facilities), and these assets have been newly set-up in the form of foundations. This has ensured the survival of their original function and averted the risk of privatization or profit-oriented utilization of such institutions. This solution has been attractive also from the management's point of view considering the tax benefits arising from contributions to foundations.

One promising approach when the buyer was a professional multinational firm and the emerged Hungarian trade unions managed to make contacts with the trade union of the buyer's foreign organization. The need for international solidarity is based on the understanding that it is a mutual interest that the import of finance, technology and know-how must be accompanied by the adoption of standards of international industrial relations as well.

On the Employee Share Ownership Programmes

It is apparent from the expectations of the national trade union federations that the idea of ESOP is clearly on the agenda in Hungary. Experts recommend the US model of ESOP. In this scheme the employees can buy shares in their own organization with favourable credit conditions, during the course of privatization. The experts, politicians and the government agencies have been bargaining over the degree of facilities to be involved for quite a while. Although the bill concerning ESOP has not yet been submitted to Parliament, employees have already become shareholders in privatized companies and in several privatization projects the issue of employee shares has been planned. In the clearest form the employees were offered certain preemptive rights and sometimes preferential discounts in the public issue. The number of such examples is limited, and so is listing on the stock exchange (public Ltd. company). Employees, typically the managers, bought shares at competitive prices in several foreign trading enterprises that had been transformed into private limited liability companies. These companies are ones with an exceptionally high earning capacity and the information edge available inside the enterprise could be utilized.

It has also been possible to issue employee shares at a discount price with the permission of the Property Agency. This is provided for by the 1989 Transformation Act in the case of an international buyer. Currently, 20 percent of the sales price is rechannelled from the treasury to the company for the purpose of development and/or financing the issue of employee shares. According to the 1988 Act on Economic Association the distribution of shares at the time of transformation is legally not that transparent. According to the original intent the famous Article

244 was supposed to allow for the conversion of 10 percent of the fund—raised by an active company closing a successful financial year—into employee shares free of charge or at a discount price. At the time of foundation and after the valuation of assets, a simple financial technique is used to separate "assets above equity" for this purpose. Finally, a possible approach leading to employee shareholding may be the issue of bonds by profitable state-owned enterprises, provided that the State Property Agency approves the conversion of such bonds into employee shares.

Given the profitability of the firm in question, all three approaches depend on the approval of the State Property Agency. The Agency is granted this power by the valid Property Policy Guidelines. However, the application of these guidelines is unpredictable. The Agency might allow an enterprise to distribute 10 percent of its assets, whose value has been reassessed, practically free (or, to be precise, sell to employees at 90 percent discount), while for another it might insist on the full face value, and yet in a third case it could bluntly refuse employee ownership altogether. The criteria for these decisions are not transparent and their rationale is not clearly articulated. However, there is mounting evidence that the degree of discount and the approval of legal and accounting methods depend on the power of influence of enterprises, authorities and consulting firms. It is easy to identify the surviving old system of bargains and lobbying with higher authorities, and the cobweb of exceptional approvals in the background of all-in prohibition. Prohibition in itself is understandable if we take into account the fact that the sale of assets at competitive prices and the reduction of state debts are declared principles of privatization. Prohibition may also be reasonable if a buyer offering an exceptionally high price rules out the application of employee ownership. On the other hand, employee shareholding as part of the incentive system of the actual employees is an acceptable idea especially where the skills, intellectual assets and commitment of the staff are indispensable for the success of the organization. This philosophy has not been adopted in the current system, where the terms of approval are more reminiscent of the title concept of distributing a legacy for good.

Employee shares sold at a very high discount may be a reward to management for successful privatization, a sort of a share from the privatization income earned by the state. It is usually the people with higher incomes who benefit from the rules of in-house distribution of discount shares. They can afford to buy substantial amounts of shares and then capitalize the heavy discount on the market. There have been some examples of egalitarian distribution; however, it is more typical to set out from the income proportions in the enterprise. The years spent with the enterprise cannot be considered as a distinguishing factor except as a barring condition. Distribution can be polarized still more acutely than by income differences; for example, where employee incomes contain a high ratio of tips or other informal earnings. There also exist drafts of regulations contemplating a distribution of the preferential shares in a proportion relative to the number of subscriptions in case of oversubscription, without any guarantee for observing the proportions calculated on basis of income and years in service. The programme launched with the slogan of equal chances and dubbed as the "social technology" to persuade the general public could, when implemented in a company, easily produce opposite results. Éva *Voszka* (1991) is most probably right to consider the ESOP the "wooden horse of Troy" of managerial ownership.

Conclusion

Just one year after the change of political system chances are that the Hungarian trade unions may be absolutely squeezed out from their negotiation positions on the national level as well as from local and company level negotiations. There is a widely-held view that there is a primary political interest in maintaining some degree of national-level reconciliation of interests as one means to control the turbulence of economic discontent. The institutional basis for such reconciliation remains unsolved and, moreover, the problem of representation at the enterprise level has proven more difficult. The government or the political parties are not in a position to do much more than support trade unionism in principle and guarantee the rights of unions in law. It is very likely that society would not tolerate a policy of undisguised aversion to trade unions at a time when the negotiating positions of employees are already limited by objective economic facts like the tilting of the labour market from the state of labour shortage to that of unemployment, when the cost sensitiveness, slimming endeavour and employer awareness of managers are growing alongside recession, when state subsidies are declining, and when privatization is the order of the day. In the popular new management ideology the definitely positive values include the "hard liner" industrial relations approach, enhanced work intensity, and lay-offs which, moreover, do not put any additional cost burden on an organization.

Therefore it is an important issue as to how the state is going to interfere with the conditions of the world of work: either as a public power codifying and maintaining the rules of the Labour Code or as an owner-employer occasionally appearing on the spot? As the dominant *employer* in the initial stage of the transition from state socialism to a market economy the state is highly visible as a model employer for future privatized companies. What kind of model will this be? The question has yet to be answered, but in its first year in office as a *seller* (with regard to labour) the government's initial steps have not been encouraging. By accepting privatization proposals prepared by managements in ways that violate the legislated rights of participation, by carrying out administrative measures for which there can be no legal appeal, by refusing to pay compensation for redundancies and refusing to discuss employment guarantees, and by not requiring future owners to engage in collective bargaining, the Agency gives precedents that can easily become the models of employment conditions to be developed at privatized companies.

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ТРУДОВЫЕ КОНФЛИКТЫ В ХОДЕ ПРИВАТИЗАЦИИ

Л. НЕУМАНН

В статье рассматриваеця роль работников предприятий и профсоюзов за два первый года существования в Венгрии Государственного имущественного агенства (ГИА). Рамки закона дают представителям трудящихся возможность выступать в роли консультанта, высказывать мнение как в ходе приватизации отдельных предприятий, так и на государственном уровне.

На начатых в рамках Совета по согласованию интересов переговорах требования, выдвинутые представителями различных профсоюзных федераций, касались достижения благоприятных позиций на переговорах, учета проблем занятости и улучшения шансов трудящихся на приобретение трудовой собственности. (Уже после завершение данного исследования, летом 1991 г., эти переговоры дали некоторый результат, правительство выпустило постановление о порядке процедуры учета мнений трудящихся. Может быть, с начала 1992 г. появится возможность приступить к проведению программы передачи трудящимся собственности, наподобие американского плана распределения акций среди служащих (ESOP), в ходе преобразования государственных предприятий и в случае уже приватизированных компаний.)

На уровне отдельного предприятия то, явяется ли роль отдельного профсоюза формальной или же он оказывает воздействие на процесс приватизации и выступает как реальный партнер, добиваясь принятия более благоприятных решений в сфере занятости, заработной платы, условий труда и прав профсоюза, а также в том, чтобы в случае продажи акций работникам предприятия они могли бы приобрести их на более выгодных условиях, зависит от умения профсоюза вести переговоры. Однако подготавливающее приватизацию руководство предприятия часто мешает этому, не предоставляя профсоюзу соотвецтвующей информации. В тех случаях, когда в качестве продавца предприятия выступает непосредственно ГИА, оно использует свою сильную позицию государственного ведомства при принятии решения со стороны работодателя и отказываеця вести переговоры с профсоюзами и учитывать в своем решении требования работников предприятия. Однако претензии работников предприятий и профсоюзов часто вытекают из их сознания собственников, особенно в тех случаях, когда они критикуют недобросовестность сотрудников государственного ведомства и прежде всего руководствующихся собственными интересами менеджеров.

В статье делаются выводы из опыта частичной продажи акций трудящимся. В большинстве случаев нельзя говорить ни о повышении возможностей оказывать влияние на принятие решений, ни о не зависящей от имущественного положения равенстве шансов на получение собственности. Распределение льгот при покупке говорит о более сильной дифференциации, чем дифференциация доходов, и часто под видом продажи собственности трудящимся скрываеця намерение менеджеров стать собственниками.

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PRIVATIZATION AND REPRIVATIZATION IN HUNGARIAN AGRICULTURE

I. HARCSA

In the recent 2–3 years questions related to agrarian privatization—respectively reprivatization—have been given distinguised attention. On the basis of developments in this field the assumption may be ventured that the tendencies observable in the agrarian sphere may have an impact on the whole process of systemic changes and privatization. The study briefly surveys the views related to agrarian privatization and reprivatization and, taking into account international experience, it makes an attempt at outlining certain economic and social consequences.

Introduction

It can be regarded as a Hungarian peculiarity, that the most heated political debates and radical proposals aiming at a solution to the socioeconomic crisis arise in the formerly relatively successful agrarian branch of the economy and in connection with the settlement of land property relations.

One can state without any exaggeration, that in Hungary, of all the questions connected with the privatization, those dealing with the problems of the land ownership have come to the fore.

At the same time it can also be stated that Hungarian agrarian development cannot be considered independently of the general course of the change of social system. If we do look at this development separately the tendencies which can be experienced in the field of agrarian privatization can be regarded as being of indicative value—we cannot just regard them as a special feature of a given section. In other words, one can risk the assumption that the observable tendencies of the agrarian sector might effect the whole process of the change of system and privatization.

Yet this supposition can be reversed as well, by saying that the specific features of the Hungarian change of system are contained in the way in which it handles—among other things—the land question.

It is difficult to say what kind of factors caused the set of problems related to agrarian privatization to come to prominence to such an extent.

It is possible that the broad basis of small-scale agricultural producers, which in the last decade embodied a feasible life strategy and mentality, played a part and encouraged certain circles—mainly the politicians of the Smallholders' Party—to follow this direction of development.

It is even harder to predict how society and those affected will react to the concepts and new rules of the game, framed in the political sphere. For the time being the events which have occurred so far can only be summarized, and on this basis a hypothesis can be formulated.

Economic background—with worries

Questions related to the transformation of the agrarian sector and its critical situation—including the ones of privatization and reprivatization—have aroused many sharp debates over the period 1988–1991. If the developments of the last two or three decades are looked at, it may appear somewhat surprising that the success branch of the Hungarian economy, agriculture (successful even by international standards), has fallen into such a grave situation, and also that the troubles requiring solution have become key issues.

At this juncture, it can be said that the agrarian policy which—under the given circumstances—had been successful in the course of the recent decades, could not be continued. The structure of the economy—within it that of agriculture—and the mechanism which made it function, proved to be incapable of adjusting to the changed conditions.

However, in addition to the general troubles which often go together with development, numerous new elements have appeared which make it particularly difficult for the agrarian sector. One of these new elements originates from the change of the system and is connected with the transition to a market economy. One basic requirement of market relations is the presence of well-defined owners in the sphere of economic life. In the "masterless" Hungarian economy the question of ownership was meaningless of the state socialist periods. Thus the solution of this problem has now erupted with considerable force, and, consequently, it must be determined who possesses the land.

Further serious troubles have caused tensions which are related to the structure of the estates. As a result of the agrarian policy of earlier decades, agriculture became bipolar. There were, on one side, big farms considered as "socialist latifundia"; on the other side there were auxiliary and household farming plots with an area of 1–2 hectares or even less. The proportion of private holdings between 2–10 hectares was relatively low.

The troubles deriving from the size of the estates were mitigated for a long time by different forms of integration that took shape between the small and big farms. But at the end of the eighties even the advantages originating from the integration of small- and large-scale farms were insufficient to soften the troubles which rose from the rigid agrarian structure. The structural crisis—interwoven with the problems of *overproduction*—completely shattered the agrarian economy, which previously was capable of functioning properly. The tensions rising from this overshadow the debates that are taking place on the issue of agrarian privatization.

Hungarian agriculture always has had to meet two demands:

1. to secure the supply of the home market

2. to export a sufficient quantity for the partial financing of industrial imports. This latter requirement is well characterized by the fact that the export of agricultural products amounted to 30–50 percent of the total product.

In recent years however, serious trouble has been caused by the fact that both the domestic and the international market have narrowed down. Somewhat simplified, it is characteristic in the international field, that "Hungarian food wants to be exported to a market, where there are people who can pay for it—yet these people do not need more; whereas others who need it, are unable to pay". (*Csáki and Rabár* 1991) Presumably this nature of the things will determine the absorptive capacity of the international market in the following 10–15 years. Therefore, the agrarian policy of the future must be elaborated in line with this. Another determinant feature is that the developed countries are able to support their domestic agrarian sector to a degree, which the Hungarian economy cannot afford and will not be able to afford in the foreseeable future.

Consequently, in the export of Hungarian agricultural produces the prices which must be accepted are those imposed by the developed countries.

A certain room for manoeuvre might present itself if the Hungarian export subsidy could be made sufficiently flexible. However, the present-day practice fails by far to meet the demand of flexibility. "Quick adjustment also has institutional obstacles. Large-scale farm production using industrial methods not only needs huge capital investment, but conserves the structure of production and technology as well, and is only profitable if a reliable, stable demand for a large volume exists. The market of the rich, where we have to sell, does not provide this security. A new export policy would be necessary, instead of the traditional one. It should strive for large volumes, it should be continuously flexible, be able to make use of transitory booms, offer local specialities, and fill in the gaps of supply". (Csáki and Rabár 1991)

From all this the implication is that agricultural big estates—partly because of their size, partly because of the given interest relations—are not in a position to produce in a flexible and competitive way. This situation is undoubtedly irritating and gives rational ground to the ill-feeling directed against the big farms—especially from the "Smallholders'" Party.

At the same time some experts draw attention to further anomalies of bipolar agriculture. They start from the fact, that—for the sake of supporting the Hungarian agricultural branch—"...on average nearly 40 percent of the GDP produced in the material branches is subtracted in the form of taxes, whereas in agriculture it amounts to only 20 percent. At the same time, it must be added that this big difference is not characteristic of the big farms (they have certain tax allowances too) but of individual activities. Altogether 1.7 billion Ft, (i.e. 2.6 percent) will be paid in as tax out 64 billion Ft of the agricultural GDP coming from individual and auxiliary activities." (*Illés* 1991)

This reasoning also implies that the progress of privatization would deprive the state treasury from very serious budgetary revenues. Still, it seems to me that the above-mentioned numerical proportions—though factual—do not adequately mirror the real relations, let alone draw attention to the existing trouble.

"Western patterns—western worries"

In the course of the debates dealing with the agrarian crisis and land ownership, the requirement has been frequently expressed, that for the sake of achieving European integration, an agrarian policy (and along with this, property relations) must be brought about, which lays the foundations for the earliest possible joining of the EEC. However, numerous delusions and illusions emerged because of the lack of information about establishing relations with the west.

The modern farm estate can be seen as the most attractive of the western patterns, and therefore worthy of imitation. Its popularity with many Hungarian politicians comes partly from economic and partly from social considerations. However, it essentially came to the fore because of economic considerations. The farmer estate has the ability to adapt itself to changing conditions due to its size, and consequently it has proved to be an efficient organizational form. At the same time, the creation of numerous farmer-estates brings into being a class of owners or tenants which is not interested in monopolizing the market. The most relevant social aspect is that the broadening of the stratum of farmers could again form the basis of a rural middle-class—a process that was broken off in the late forties. The widening of the stratum of farmers would be a stabilizing factor from the economic and social aspects for everybody living in rural areas.

Researches dealing with agrarian relations in western societies do not show nearly such a favourable picture. On the one hand the facts demonstrate that in the west the size of the farmers' estates is far from being optimal. As a consequence, "The failure of the Sicco-Mansholt-plan proved that the historically fixed, outdated landownership structure—originating from the static role of land property and retrograde rigidity—is able to stubbornly resist the endeavours of modernization. The aim of this plan was the transformation of the land property structure, but the costs lagged far behind the objectives and results. For example, the Six succeeded in enlarging the average property size between 1970–80 by only 1 hectare (from 12.7 to 13.7) but it was 17 hectares in the Nine as well. Nearly 80 percent of the estates remained less than 20 hectares". (*Tanka* 1990; *Fermel* 1987)

The fact that the price level of the agrarian produce of the Common Market countries regularly surpasses by 70–90 percent the agrarian price level of the world market, is due to the decisive, historical fact of the existence of a proportion of small holdings and the generally sub-optimal size of the estates that have deteriorating performances.

It is undeniable that the high costs of production cannot be simply pinned down to one reason—namely the non-optimal estate size in the West European countries. At the same time, it is a fact that due to the subsidies the surplus of agricultural products grows constantly. In other words, the farmers shape their current production in such a way that they take into account the subsidies and financial aids, so that their income will reach the optimal level.

They have to do this because of the technical and technological competition, but remaining in the race has a very high price judged in terms of the costs. One opinion believes that the competition could finally lead to over-mechanization, which in itself strongly increases the production costs. (*Fekete* 1990)

A further worry is that the farm is not sufficient for securing a livelihood. Therefore the farmers have to find some subsidiary earnings and thus they can be regarded as part-time farmers. However the facts demonstrate that while the agricultural population is decreasing as a whole, the number of part-time farmers is stable. Consequently, their number as a proportion of all those occupied in agriculture is increasing.

One of the most important developments of recent years is that the governments of the Common Market countries have revalued the role of part-time farms within the framework of a modified agrarian policy. The essence of this revaluation is that on the one hand, it is increasingly more difficult and costly for the state to subsidise full-time farms; on the other hand the competition in production forces the farmers to use techniques and technologies, which are damaging to the environment. The aspects of protection came tó the fore and consequently a solution had to be found in the given situation. Governments were thus strongly influenced by the huge surplus of products produced at the given prices and the troubles caused by them.

In the wake of the revaluation the earlier just tolerated part-time farmers now incorporate a desirable type of enterprise. These estates cannot use technologies that damage the environment simply because they have a shorter supply of capital than the full-time farmers. Consequently the yields too are lower and thus they do not produce such a surplus as full-time farmers. A further advantage is that the produce can be sold as environmental-friendly because it does not contain any material detrimental to health.

Historical retrospection on the development of Hungarian land ownership relations.

Some experts, and public opinion as well, are inclined to regard the present-day agrarian structure—and within it the evolution of land ownership relations—as a product of the last four decades. They disregard the fact that the socialist change of system at the end of the forties made "use" of the weakness of the former historical basis in order to achieve its aims. In the period preceding the forties agriculture was also bipolar in the sense that latifundia and small holdings prevailed and medium-sized farms were few in number.

The land-hungry peasantry expected land-reform and got it in 1945. At that time 5.6 million acres of land (3.2 million hectares) was distributed between 642 thousand families. On average, the allotted area was 5.1 acres (2.9 hectares) per family. 28 percent of the new landholders had previously been agricultural servants, 40 percent wageworkers, 30 percent smallholders and 2 percent came from other occupational branches. This landreform soon proved to be a historical trap and the majority of the new smallholdings were unable to survive.

Then the same Communist Party, which was in 1945 an enthusiastic supporter of the land reform, tried to prove with similar vehemence the uselessness of the dwarf holdings. Then, after coming to power, it forced the collectivization of agriculture with the aim of creating large estates. They grasped all means, from politico-economic means to the use of aggressive administrative measures to bring about a cooperative system of a "socialist" character.

As a result of these endeavours the new landholders left agriculture in large numbers. Thus, from the summer of 1949 until the end of March of 1953 more than 1 million hectares of land came under state administration. The unsuccessful first attempt at collectivization at the beginning of the fifties was followed by a newer one in the early sixties. With it came into being the land property relations which have remained characteristic up to now. On the one hand there were the agricultural big estates, where the average area of state farms reached up to 7,608 hectares, and the cooperatives 3,822 hectares. On the other hand there were the household and auxiliary plots with an average area of less than 1–1.5 hectares. Thus it is not accidental that some experts have been inclined to discover a fairly great similarity between the relations now and forty years ago.

Parallel with the formation, then with the consolidation of the big farms, there came a decrease in the ratio of the agrarian population and the traditional stratum of peasantry was significantly reduced.

In 1949—to no small extent due to the land reform—the proportion of the agrarian population was over 50 percent. Now, it is about 13 percent of those who are (full-time) employed in basic agricultural activities.

Nevertheless, we cannot regard the strong decrease of the agricultural population as a specific feature of recent decades.

In the second half of the last century, after the abolition of serfdom, many dwarf holders became bankrupt (between 1870–1890 more than 100 thousand). (Harcsa 1977)

In recent decades a similar course of events has taken place in other countries as well. In this respect it is worthy to pick out the Finnish example, in view of the fact that the economic structure of the two countries showed a great deal of similarity until the late forties.

After World War II a land reform took place in Finland as well, and as a consequence of it the proportion of small holdings (under 10 hectares) increased considerably, from 66 percent to 72 percent (although this was only for a short time).

The ratio of this holding category soon began to decrease until it had reached 58 percent by the end of the eighties. Still greater was the decrease in the category under 5 hectares; in 1950 there had been nearly 250 thousand holdings, whereas in 1980 there were only 30 thousand. (*Matti, Andorka and Harcsa* 1987)

The increasing proportion of small holdings around 1950 was unique in the group of OECD countries and the Finnish experts explained it by referring to the fact of belated development.

The decay of the smallhorders' stratum not only happened because of the enforcing power of market relations, for state policy played a role as well.

The Finnish state aimed at the reduction of the number of dwarf holdings, similar to other western countries. To this end the system of subsidies first had to be changed. Even at the beginning of the eighties there were 30 different forms of subsidy and aid in force which served to support the farms. These supports amounted to 90 percent of the net income of the farmers. The subsidy system had been modified in such a way that only part of the sum meant for this purpose went to the farmers—the other part was used to reduce consumer prices. With this step food-consumer prices were decreased by one-third. (Matti, Andorka and Harcsa 1987)

Conversely, in Hungary there were regulations which—with the merger of big farms—encouraged the concentration of land into the least possible number of economic units. The legal provisions strongly increased the proportion of indivisible land property within the cooperative farms. All this essentially restricted the trade of land and in this way the monopoly of land was in the hands of the big agricultural farms—in other words, the state.

The Land Act of 1989 brought a change by enabling private persons to acquire land (maximum 3 hectares). Moreover, it opened up the possibility of leasing the land.

One result of all this has been that the categories of land property and land use have become strongly mixed up. According to the cadastre—in May 1989—31.7 percent (2.9 million hectares) of the arable land was owned by the state, 61.0 percent (5.7 million hectares) in the use or possession of cooperative farms and 7.3

percent (678 thousand hectares) was in the form of individual or auxiliary holdings. (Tájékoztató 1991)

An area of 5.7 million hectares cultivated by the cooperatives represents 35 percent (2 million hectares) membership property i.e. property that was owned by the members when they entered the cooperative. However, this 2 million hectares of area consists of more than 1.3 million plots averaging 1.5 hectares.

In the "whose is the land?"—question an often recurring problem is—what amount of redemption have the former owners got the land they brought with them into the cooperatives? Facts show that this sum is rather low indeed; between 1974 and 1989 12.5 billion forints were paid out to the former owners.

For a better understanding of present-day relations, a short mention must also be made of the main characteristics of the part-time, small-scale agricultural production which has mainly gained ground in recent decades.

Part-time farming on a family basis has a long tradition in Hungary. It had a significant meaning prior to the "socialist" change-over of the system that took place at the end of the forties. In recent decades the attention of experts has been drawn only to the characteristics of the given period, and it rarely occurred to them that this form of production might perhaps play a part in the process of transition. It is in this sector that there could be—even if under adverse circumstances—a certain room for manoeuvre towards a minimal autonomy—which implies that some small-scale enterprises will be maintained. For the majority of people involved in this sector it has played an important role as an additional source of self-sufficiency and livelihood.

On the basis of recent research it can be asserted without any exaggeration that small-scale farming is assured a future in its traditional form for the rural population, and at the same time it will provide a suitable "scene" for the rural families to adapt themselves.

Small producers have always had to adjust themselves to changing circumstances. Hence the character and role of small-scale production has also changed—though in the technique of adaption there are still many traditional elements.

Parallel with the change of the character and social role of small-scale production there has been a modification of the theories for analyzing this phenomenon. In the first phase of collectivised agriculture (in the fifties and sixties) ideology, and a great number of experts, held the opinion that it was chiefly expedient to maintain small-scale production pursued within a family framework. This was because the peasants, with their backward approach, could be more easily organized into the collectivized big farms. Furthermore, the loss of production that would be likely to occur in the transitory period could be replaced by the goods produced by one family.

At the end of the sixties the large agricultural farms were consolidated. However, due to the effect of the developing reform-wave, there was a strengthening

Table 1

Division of areas used by cooperative farms, according to property rights 1968–1989

Year	State	In the possession of Cooperative	Members and those having the same legal status[a]	Total
			Hectares	
1968	1521,324	5,169	3954,992	5481,485
1975	247,484	2502,917	2854,470	5604,871
1980	195,318	2921,968	2550,026	5667,312
1985	226,432	3227,281	2240,015	5693,728
1989	216,146	3471,311	1991,734	5679,191
			Percentage	
1968	27.7	0.1	72.2	100.0
1975	4.4	44.7	50.9	100.0
1980	3.4	51.6	45.0	100.0
1985	4.0	56.7	39.3	100.0
1989	3.8	61.1	35.1	100.0

[a]Partners in matrimony, living together with a member, being the widow of a member, aged persons entitled to land rent, and persons with usufructuary right.

of the recognition that the symbiosis of big- and family farm was not a transitory phenomenon.

After the restrictive regulations associated with socialist ideology it was recognized by the leadership of society, too, that agricultural small-scale production had an important role not just because it helped the well-balanced food supply of the country, but it also had a serious meaning from the point of view of complementing incomes and creating new resources.

Some experts qualified the phenomenon as "postformation of peasantry". The relative flourishing of small-scale production was not so much regarded as the survival of traditions, but rather as one of the alternatives of rural living conditions. It had a rational basis in that the 1.2 million workers living in rural areas and attaining lower earnings than the urban workers, tried to make some income simultaneously from industry and agriculture; consequently "standing on two feet" gave them greater existential security than depending only on one sector.

It was an inevitable consequence of this endeavour that the labour-oriented way of life survived and spread among the broad masses. At the same time the prosperity of the inhabitants of rural areas (especially in the seventies) was due to this fact (building of houses, being supplied with public facilities, etc.)

The beginning of the eighties brought further new developments and it is appropriate to pick out two decisive tendencies. One of them is connected with the gradual deterioration of the "performance" of the state economy, then its collapse at the end of the period. One consequence of this process was the lack of sources for the primary economy and this lack continuously worsened, though it was somewhat delayed (by the raising of foreign credits), gradually encroached onto the lives of families as well. As its effects grew so too did the worries of living, and in the given situation agricultural small-scale production again gave some scope for easing the situation. It meant in this case, that a considerable proportion of the small-scale producer families increased the production of goods.

However, mention should also be made about the effects of the modernization-process, because this put up the value of the consumer goods which go together with the modern way of living, and so it boosted the demand for these goods. Meeting demands of this character naturally required additional resources and this circumstance gave incentives to the population to undertake more efforts.

Together all this pushed the small-scale producers towards the augmentation of the production of goods. The character and measure was however very diverse in the different layers of small-scale producers. This circumstance induced a strong process of differentiation, and one effect was that certain layers no longer tackled small-scale production merely as a strategy for increasing livelihood or as an alternative, but as a full-time entrepreneurial activity.

This new phenomenon brought back memories of the "interrupted bourgeois development", the idea of which had largely been discussed in the researches of Pál Juhász. The essence of these views is that farming on an entrepreneurial basis is primarily a characteristic of the offspring of the earlier better-off peasants, who as a result of favourable conditions try to continue the way of living of their bourgeois-peasant forefathers.

The concept of Iván Szelényi is very near to this view. He—partly on the basis of the scrutiny of income and social mobility in 1983 carried out by the Central Statistical Office—found the theory of "interrupted bourgeois development".

The Compensation Act relating to land

In the last two years—as a result of debates and certain compromises—the positions of the different parties were considerably re-defined with regard to land property and to questions related to the transformation of agriculture in general. The recently adopted Compensation Act has already been drafted on the basis of various concessions, and consequently the question of land privatisation and reprivatisation are also included in this Act.

The situation prevailing on June 8, 1949 has been taken as the basis of the law and it refers only to living persons. However, if the aggrieved person is no longer alive, the heirs of the injured—grandchildren included—will also be compensated. (If they too are no longer live, then the spouse is entitled to compensation.)

The measure of the damage will be determined as a lump sum. In the case of land this sum amounts to Ft1000 for one gold crown (the old unit for land valuation). The underlying value of the compensation contains the value of farm-buildings and movables belonging to the area.

The Act is regressively graded with regard to the measure of the compensation. In addition there are special provisions concerning the land. For a value of up to one thousand gold crowns (about 50 hectares) a 100 percent indemnification will be paid. The land will be returned only to those who observe the obligation to use the land for agricultural purposes and do not withdraw it from agricultural cultivation.

The law states that a land basis must be reserved for the workers and employees of big farms. The size of the land basis must be so determined that a per capita share should be allotted to the value of 30 gold crowns (approx, 1.5 hectares) for each member of the cooperative; and 20 gold crowns (approx, 1 hectare) per employee of the state farms. The members who qualify are those who were employees on the 1st of January 1991, and since that time have been members or employees of the farming association.)

The indemnification takes place with the use of compensation notes. The compensation note is a special bond, which cannot be circulated on the stock exchange, but can be utilized in the course of the privatization of state property for buying assets, shares, and business shares. These also comprise tenement dwellings that are owned by the State and self-governments (i.e. local councils). Apart from that an annuity can be claimed as well, paid at monthly intervals.

After the law takes effect, claims must be filed within 90 days.

Opinions about the likely consequences of the agrarian privatization

The outlines of agricultural privatization have generated many critical opinions. In this respect the position of the MOSZ (National Association of Agricultural Producers) has the sharpest wording, by stating that. "...The March 12 pact of the parties in the coalition does not lead toward social consensus and the solution of compensation. In fact, it wants the membership of the cooperatives to pay the price of the pact." (Alkotmányellenes... 1991)

MOSZ holds the opinion that the basic precondition of the convertibility of the compensation notes into land should be local residence and agricultural occupation. It reckons that the members of cooperatives would get only 1.5 hectares of land, and this seen as being detrimental. According to the opinion of agrarian experts not the upper, but the lower limit should be determined, in order to promote the creation of viable estates for those who want to till the land individually.

Some experts have tried to sketch the circumstances which might occur with the disintegration or transformation of the cooperatives. Consequently—among other things—the influence of privatization on taxation came to the fore as well.

It must be noted that the prevailing system of taxation of individual agricultural activities makes those involved nearly free of tax. This invokes the danger, that "... with the accidental acceleration of agricultural privatization the agricultural income as base of assessment and with it the whole tax and social insurance contribution (40 billion forints) will disappear. Furthermore, differences of such a degree would mean disproportionate discrimination between sectors which would encourage perhaps a privatization of such a kind, and which would be motivated merely by tax differences and not by the improvement of efficiency." (Illés 1991)

We can take it for granted that this problem was dampened by the introduction of a land tax. However, without this the foretold danger would undoubtedly exist.

Apart from all these things, the introduction of the land tax could act as a restrictive factor and some experts draw attention to the worries originating from it. If, namely "...the new (old) owners have to pay a land tax, then the net proceeds of the land will not cause them great satisfaction. This is because the rent will be counted on the basis of personal income tax. The oversupply position could push the rent under the existing level of ground-rent." (*Huszár* 1991)

Looking at these difficulties, it is not accidentally that there is an opinion that the privatization of agriculture would cost the state budget as much as did the collectivization.

According to the opinion of the experts[1] of the Agrarian Association, the Compensation Act will cause serious troubles, because it will start unhealthy processes in agriculture. Thus it can be assumed that the descendants of the former peasantry—many now living in urban areas—will not choose the compensation notes (which anyway would be sold haphazardly at a below nominal value) but will stick to the registration of the land property. The former owners hope that they will be able to lease the land which they get back, and the cooperatives might be possible partners in this process.

The first disappointments will appear when it turns out that under the given profitability of agriculture the tenants can only pay a nominal rent. On the other hand, even this relatively low amount of rent will increase the costs of production. This will further add to the difficulties of agriculture, which is also struggling with other factors linked to cost problems.

The hundreds of thousands of new "smallholders"—who do not accept the compensation note, but reclaim the land property—will have to make the following choices:

[1] A considerable number of the opinions collected here come from Tibor Nagy Husszein, secretary general the of Agrarian Association.

1. When living in an urban area they can count on a secure livelihood. However, they might ignore the fact that they can only enjoy a modest income after the smallholding is recovered as compensation. This is because they will regard the small estate as a part of their wealth which, although in the short run they do not have the prospect of making considerable proceeds, they have the possibility of waiting for the rise of land prices and thus can sell it at a favourable time on the market. If, on the other hand, we presume that land prices will be depressed in the long run—for different reasons—and only low prices can be obtained for the land, then this better-to-do urban smallholder stratum will no longer be interested in selling the land. This circumstance would be instrumental in freezing the trade of land and conserving the proprietary structure.

2. Those new "urban" smallholders who are less well off or even impoverished—and due to their financial situation cannot wait for long—have two possibilities: Either they do not chose the low rent, but accept the low price offered by the tenant, which in the short run still brings somewhat more proceeds for them; or they squander the unexpected allow to become "inheritance."

This circumstance will stimulate the trade of the land, and it will also promote the creation of the new medium-size, and especially large-size estates.

The possibility of the development of new medium and large farms is based on further quite well-founded suppositions. The conclusion can be drawn on the basis of previous examinations which show that the present-day agrarian intelligentsia, and in a great part the leaders of the cooperatives, are descendants of the former middle-peasantry. Consequently they are interested in the compensation—i.e. in the recovery of the land taken away from their parental generation.

Concerning farming, two factors will have a significant role under the new circumstances:

1. the amount of capital necessary for farming,

2. the professional and marketing requirements necessary for the upkeep of the intensive production of commodities, and the necessary personal relations (which can be called "relations" capital).

With regard to both "types of capital", the actual agrarian intelligentsia and leaders of big farms are in a most advantageous position.

The interested agrarian leaders and the intelligentsia (and those, who due to the agrarian compensation will obtain land) will have two alternatives:

1. They can remain within the framework of the cooperatives based on the association of landowners, but can make use of the favourable material advantages—and those advantages arising from their professional knowledge—in order to buy up land from those fleeing from their smallholdings. By doing this they will be able to gradually change the internal proportions of the land property relations within the cooperatives and might become landowners with decisive power in the cooperatives within the foreseeable future. (This is one possible way towards "the rebirth of the green barons".)

2. However, they can decide that—for different reasons—they do not need the cooperative farmes and feel strong enough to modify their careers by taking up independent farming.

Whichever variant they choose, the end result may be that, within a foreseeable period of time—say, between 5–15 years—a new stratum of big landlords might come into being. As a result of this, the Hungarian structure of land estates might become bipolar once again; on one side there will be the mass of smallholders, who till the land themselves and are unable to reach the status of "middle peasantry", and on the other there will be the stratum of new landlords.

What dangers could arise from an estate structure that comes into being in such a way? Historical and recent experiences show that from the point of view of market competition it is an unfavourable circumstance if, in a given economy, the small and the big farms represent the decisive size of the estate, and the proportion of the middle peasantry associated with the medium size farms is relatively low. (The latter owning between 25–100 hectares.)

The excessive proportion of smallholdings (not including those used for intensive horticultural cultivation) is unfavourable from at least two aspects: partly because this size of holding cannot provide a proper livelihood, and partly because—due to its size—it can only take part in the production of commodities in a limited way.

The large proportion of big estates involves another danger. This is that the market-mobility of this type is fairly limited, and consequently is not really interested in market competition. Yet another unfavourable circumstance is that the big farm is most profitable if it pursues monocultural, large-scale and fully mechanized production, putting aside the maintenance of labour intensive crops. Together, these effects mean that a smaller labour force will be needed and thus the rural areas will be less able to sustain their population.

Considering the dangers, the experts of the Agrarian Association support a law of compensation which will promote the development of middle-peasant holdings, i.e. medium-size farms. For this purpose they want the members of agricultural cooperatives to get more land than 1.5 hectares; in this way the "viability" of middle-peasant farms will be "naturalized".

These types of estate could provide a proper basis for the emergence of medium-size farms organized on a family basis. Due to their size and character they will be able to move in a more flexible way on the market, and consequently they will have more interest in the competition of the market than the big or small farms.

So far we have not dealt with that stratum which is in a peculiar situation—namely, the stratum living in the distressed industrial areas and which, due to changes in the industrial structure, is experiencing high unemployment. This primarily involves the workers employed in the mining and metallurgical branches in the northern region and in Transdanubia. Researches have shown that these groups of workers contain the highest proportion of those who originate from the agricultural strata.

On the labour market the position of these first-generation workers belonging to the professional groups of heavy industry is unfavourable because they do not have convertible technological skills. Consequently, it is almost impossible for them to find employment elsewhere. In such a situation compensation might come as a solution which "saves" them. Thus the recovery of the land could mean an uncertain and thorny path out of their critical situation and with the lack of other alternatives many of them may actually choose this solution. Making use of the ties of kinship which have remained, they try to resettle in their place of origin and restart farming.

This solution is strengthened by certain political tendencies which, sketching a picture of Garden-Hungary, promise the abolition of unemployment in rural areas. According to this theory, with the revival of hundreds of thousand of smallholdings a safe livelihood will be provided to the masses of families living in the countryside. Taking into consideration, however, the existing difficulties of agriculture in selling its products, the realization of this idea is highly questionable. The facts show that neither domestically nor abroad can the market be broadened to such a large extent (at the moment it cannot even be broadened by a minor extent) that it could offer a solid basis for the emergence and birth of new smallholder groups.

The practice of small-scale production which has evolved in recent decades proves that the concept of Garden-Hungary—with regard to the quantity of the production—has come near to the limits of its possibilities and cannot provide further livelihood for those hundreds of thousands who migrate back and wish to be re-integrated into small-scale agricultural production.

The international tendencies also indicate that beside full-time engagement in agriculture, part-time farming could be a realistic strategy for sustaining a reasonable livelihood.

It can be assumed, however, that only the qualitative elements and conditions can be improved (by mechanization, the creation of productive and commercial integration, etc.) and there is only a narrow possibility for broadening the circle of participants.

For this reason the option of part-time farming might be considered only in the families where the minimal requirements of livelihood are secured, e.g. from an old-age pension or some other source. Re-settlement with the help of rural relatives can be imagined only in such cases.

By considering the domestic endowments and international trends, the conclusion can be drawn that the emergence of viable middle-size farms in large numbers is illusory and therefore so too is the policy urging it. This statement is also backed up by the circumstance that part-time farming took roots in Hungary to a considerable extent; this—because of the size of the smallholdings—is a very favourable productive form. In addition, since the farms have incomes from other sources as well, by "standing on both feet" they can more easily endure the uncertainties coming from the booms and depressions of agriculture. This feeling of security can be regarded as a decisive factor among present-day smallholders.

Consequently, in the future a question might arise—on the basis of the widespread domestic part-time farming—concerning the way in which conditions could be created for making this operative form efficient and competitive. In this respect experiences observable in the western economies might present numerous points of orientation as well.

If the multitude of medium-size farms (between 50–200 hectares) comes into being the question arises—how can these farms fill the gap caused by the integration of big farms. Thus it goes without saying that the hundreds of thousands of part-time farmers cannot exist without a proper integrational background.

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ПРИВАТИЗАЦИЯ И РЕПРИВАТИЗАЦИЯ В ВЕНГЕРСКОМ СЕЛЬСКОМ ХОЗЯЙСТВЕ

И. ХАРЧА

В последние два-три года вопросы, связанные с аграрной приватизацией и реприватизацией, вызвали весьма острые споры. Определенные политические силы прекрасно понимали, что продовольственное хозяйство является стратегической отраслью, и поэтому считали, что эта область — "подходящий полигон" для политических битв.

Концепции различных политических сил отличались прежде всего в вопросах собственности. За спорами о собственности стоят существенные различия представлений о будущей структуре сельского хозяйства. На одной стороне стояли представители партии мелких сельских хозяев, выступавшие за создание сотен тысяч семейных ферм. А остальные партии стояли в основном за создание сельского хозяйства со смешанной структурой предприятий.

В ходе споров выяснилось, что — прежде всего вследствие недостаточной информации о западных фермерских хозяйствах — в определенных слоях бытовыли весьма идеализированные представления о семейных фермах.

Что же касается будущего, то решающим здесь является то, в каком направлении будут воздействовать на развитие такие касающиеся аграрной структуры основополагающие законы, как закон о возмещении ущерба и кооперативный закон. Дискуссии привели к исчезновению многих иллюзий; например, что тысячи семей найдут работу на возращенных земельных участках и таким образом будет решена проблема сельской безработицы, а также что дети переселившихся в свое время в города бывших крестьян создадут в массовых размерах процветающие фермерские хозяйства.

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NOTES

PROSPECTS OF AND LIMITS TO THE SECOND ECONOMY

I. R. GÁBOR

"...it looks so obvious", Iván *Szelényi* said in an interview in 1989,[1] "how economic decline or collapse could be avoided... Simply by giving a free hand to that 25 percent of Hungarian citizens whose desire is a private undertaking, incredible sources of economic dynamism could be released."

The main thrust of my presentation here is *not* to challenge this emphatic statement about the *role* Hungary's actual and potentially small (or, as Szelényi calls them, "socialist") entrepreneurs should play. Szelényi's statement might be correct. What I want to point out is that in the light of recent experience it needs to be *qualified*.

Also, it might be true to say, as Szelényi does, that "Both the old and the new élites are hesitating over the extent to which they wish to have a new national bourgeoisie". However, it should be noted that their hesitation *by itself* does not explain the initial difficulties experienced in the implementation of full liberalization of private enterprise and in the mobilization of its capacities. *Part* of these difficulties signals the *imprints* that the past decades of state-socialist development have left on the second economy as a particular type of private economy.

In order to make it clear what I mean by these "imprints", I shall refer to the *shortage economy* nature of the first economy (the state sector), and also to the particular, *partly competitive, partly complementary relationship* that has existed between the first and the second economies.

Due to these two, closely interrelated systemic characteristics of the Hungarian state-socialist economy, the state was left with the following *triple dilemma*: It felt compelled to (1) stimulate private *activities* while trying to keep earnable *incomes in parity* with comparable wage rates in the public sector; (2) stimulate private *accumulation* while seeking to restrict *income differentials* deriving from capital investments; (3) preserve the *market-sensitive and self-financing* character of small farms and industrial plants while integrating them with monopolistic organizations of the first economy to restrain *entrepreneurial autonomy and entrepreneurial profit*. The consequence of these dilemmas, or inconsistent priorities, was that *periodical shifts* were bound to occur in the official treatment of the second economy.

[1] "Polgárosodás Magyarországon: nemzeti tulajdonos polgárság és polgárosodó értelmiség" (Embourgeois development in Hungary: national propertied bourgeoisie and the intellectuals becoming bourgeois). *Valóság*, 1, pp. 29–41.

This varying treatment, coupled with the conditions of a shortage economy, produced an environment for producers and entrepreneurs in the second economy that contributed to the *erosion of business morality.* Indeed, those acting in the second economy tended to strive for quick enrichment instead of pursuing a longer-term business policy. Moreover, the said conditions forced the participants in this economy to build up *bribed connections* in order to get the necessary inputs, and to moderate uncertainties due to unpredictable fluctuations in government policies. These fluctuations, in turn, contributed to making business *investments* in the second economy marginal, and the proportion of families making their living *solely* by second economy activities insignificant. Finally, while restrictions were normally called forth by the perception of excessive income differentials, it was *mostly* those with exceptionally high incomes who had the financial reserves and personal connections necessary to *weather* restrictions.

Under these conditions, the ambiguous process of reembourgeoisement over the past decades has evolved a *special type* of private entrepreneur. He is at once *semi-proletarian and semi-bourgeois* and, compared with his Western counterpart, *more of a "bourgeois" and less of a "citoyen"* or civic orientation. He has learned how to take advantage of the extensive system of corruption—a "third economy", that prevailed in their relationship to state organizations—rather than learning how to prevail in market competition. In addition, business links between *private* firms remained sporadic, while a large part of private economic activities were in many ways "integrated" by the *bureaucratic* sector. These specificities now manifest themselves in an orientation which is both *pro*-market and *anti*-market at the same time.

Small wonder, then, that the *new liberal* policies of our day have not yet been able to yield any substantial change in the mentality and behaviour of our entrepreneurial stratum. It suffices to refer to a recent investigation which has revealed that, although the number of registered private entrepreneurs increased remarkably from the end of 1989 to the end of 1990, in the same period there was a fall in their tax contribution. The findings suggest that, despite more liberal conditions and regulations, registered entrepreneurs have pursued a successful strategy of *hiding income* from taxation. The new identity of entrepreneurs trustful of the stability of new institutions and operating in the full light of legality appears not yet to have been born. Moreover, today we can even observe signs of *fears of liberalization*, and not only among the growing masses of large enterprise workers who see their employment security threatened, but also among "socialist entrepreneurs" in the second economy.

Motivated by the perception of these anxieties, growing attention is being paid in the sociological and political science literature to the urgent need for a sufficiently *strong and large middle class of entrepreneurs* as a necessary conditions for political stability in a market economy.

Ironically, but understandably, similar to the unquestionability a few years ago of the preponderance of state property, the current weakness of the Hungarian middle class of entrepreneurs again brings forth *'third-roadism'* i.e., a search for a historically untested alternative path of modernization. This parallel, however, should not be overstated, for whereas *earlier* third-road ideas envisioned some sort of a mixed economy which should be neither capitalist nor state socialist, their *current* proponents openly admit the adoption of Western-type capitalism and political democracy as a desirable goal. At the same time, they refuse to believe that, under the unfortunate condition of a weak national bourgeoisie, it is directly attainable here and now. Typically, they advocate *protectionist policies* providing preferential treatment to Hungarian investors and private entrepreneurs in order to block the road to a neocolonialist type of dependence on western capital managed by a strong and powerful comprador bourgeoisie. Instead of modernization, such a road, they think, would lead to sharpening social conflicts and possibly a dictatorial political turn.

Again quoting Szelényi, he spells out quite clearly in the same 1989 interview: "there is no economic prosperity, no national independence, and no system of democratic institutions without a national propertied bourgeoisie... A national bourgeoisie has to emerge from the ranks of present-day small entrepreneurs, of a petty bourgeoisie slowly learning the laws of the market in the second economy... The sellout of state property to foreign capital cannot but result in a neocolonial, dependent type of development, and in the reproduction of our social backwardness". Moreover, from his further argumentation it becomes clear that he finds the major obstacle to the rapid development of the sector of Hungarian private entrepreneurs in the *managerial bureaucracy* of the large enterprises and in the competent *professional class*'s advocacy of multinational capital. By contrast, I would like to suggest here that it is the ambiguous attitude of today's Hungarian *small entrepreneurs* towards liberalization that is posing such an obstacle.

Szelényi's arguments are, of course, justifiable. I would also deem it crucial to the prospects of modernization in Hungary to win the firm political support of the Hungarian middle strata, including entrepreneurs now on their way to becoming bourgeois. Also, I agree that direct foreign investments, instead of proving to be vehicles to prosperity, may block or discourage the emergence of domestic entrepreneurs or drive a significant part of them out of the market. Thus such investments may delay or even reverse the already ongoing process of bourgeois development.

Moreover, given the dwindling capacity of wages to sustain minimum living standards and the uncertainty of employment security, those employed in the *large-scale* sector may be particularly hit by the shrinkage of opportunities for *part-time* participation in the second economy. This may generate *paternalistic* nostalgias among them, which, in turn, could make them prone to entering, even if temporarily, into *alliance with those entrepreneurs* whose efforts are aimed at delaying the state's withdrawal from the economy.

That the anticipation of such a temporary alliance between private entrepreneurs and those employed in the large-scale sector is not entirely unfounded was demonstrated by the wide public support Hungarian taxi drivers won during their street blockade in October 1990. They justified their rebellion not as an act of self-defence but as an espousal of public interest—an interpretation that was eagerly confirmed by the trade unions.

Nonetheless, the ambivalence of present-day Hungarian private entrepreneurs towards liberalization is *much too deep-rooted* to be eliminated simply by placing restrictions on the influx of foreign capital. And, even more importantly, there is nothing to support, either in theory or on the strength of experience, hopes that are pinned on modernization strategies coupled with the kind of protectionism advocated by third-road theorists.

Therefore, what can we hope for, or is it futile to entertain any hopes at all?

It appears to me that the intended policy of liberalization can be adopted consistently and can fulfil the expectations it arouses, only if it can be complemented with industrial policies aimed at promoting *cooperation* within the private sector rather than protectionist policies discriminating against foreign entrepreneurs. With the absence or failure of policies that are aimed at fostering cooperation, the targeted, and in any case desirable, shrinkage of the *bureaucratic* sector would probably leave the *private* economy in some sort of a "cooperation vacuum"; it would be atomized to such an extent that it would become *incapable of offsetting* the decline in the output and labour demand of the bureaucratic sector.

To be sure, competition and cooperation appear irreconcilable only to doctrinaire minds. For evidence of their co-existence one can refer to the unexpected achievements in the 1980s of industrial regions like the Emilia-Romagna Province of Italy or, say, Baden-Württemberg of Germany. As is well-known, the success of industry in those regions, registered largely by small firms, comes not so much from a life-and-death competition between atomized entrepreneurs, but rather from *comprehensive links of subcontracting* based on cooperation and trust, as well as on *local industrial policies* supportive of such cooperation.

The examination of these success areas, however, raises a theoretically exciting and pragmatically crucial final question, namely: under conditions of transition, is it at all possible to elaborate *any kind* of local industrial policy and to have it accepted as valid by those concerned? After all, it was some kind of *well-established corporative* institutional setting that in the aforementioned success areas of other countries allowed the interested parties to negotiate and reach effective consensus on the local industrial policies to pursue. Can we, then, expect such consensus to emerge in a situation in which, precisely because of the long suspension or detour of bourgeois development, there are *no* historically established corporative institutions representing local industrial groups?

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BOOK REVIEWS

MARTOS, B.: *Economic control structures: a non-Walrasian approach.* North Holland Publishing Co. Amsterdam 1990. XV+241 p.

Béla Martos has written a book which deals with standard problems in a non-standard way. This becomes particularly clear if we realize that, dealing with control structures, the book inevitably studies information structures as well. Nowadays economics of information stands at the centre of our science. This subject examines the implications of asymmetric information, when various decision makers have different information. This leads to situations which were unimaginable in orthodox economics but quite well-known in real life.

Another feature of the book is its non-Walrasian approach, presently very popular in economics, especially in Western Europe. The so-called disequilibrium theory—or the Theory of Equilibria with Rationing, TER (as Martos calls it)—dismissed the omnipotence of price mechanism and supplemented it with rationing. Correspondingly, signal quantity signals (bounds on sales and purchases) were added to the traditional price.

Finally, let us note that the application of control theory to economics has become a standard part of economics, especially in macroeconomics.

In Martos's book, however, these concepts appear in contexts that are different from usual ones. For example, Martos does not use stochastic models to describe asymmetric information, and he does not even use the adjective asymmetric. He does not derive the behaviour rules of the decision makers in an optimization framework; rather, he relies on empirical observations to support his guiding principle, called 'control by norm.' Finally, he departs much farther from Walras' world than does the TER: he describes the economy as a dynamic process taking place in real time. In addition, he admits more inefficiency and friction than is usual in TER.

I hope that this short introduction has given some of the general flavour of the book, so let us now turn to a more detailed review.

I would like to start with a brief historical survey. The idea of *control by norm* (under various names) appeared in the works of Simon, Hicks and Lovell in the fifties and the sixties. The basic idea is very simple. Suppose that an economic unit produces certain goods for stock. If the level of stock is higher than normal, output is reduced; if the level of stock is lower, then output is raised. It is noteworthy that each of the foregoing models used inventory control as an actual example. However, it can be equally extended to production to order, and other types of control.

Kornai's (1971) *Anti-equilibrium* criticized traditional economics for neglecting disequilibria, information problems and dynamics—to name only a few of a long list. Seeking to demonstrate the possibility of an alternative approach, he proposed a new family of models, *Autonomous functioning of the economic systems.* To put it simply, Kornai set out from the observation that modern economies are simultaneously regulated by several different control mechanisms, the price and the planning mechanisms being only the most important ones. He described a third mechanism, called the autonomous (vegetative) mechanism, which works without price and plan signals, at a lower level of the hierarchies.

As a first attempt, *Kornai and Martos* wrote a paper under this title, which was published in the journal *Econometrica*, in 1973. In fact, in the paper control is modelled by stock signals, extending the ideas of the above example to a set of interdependent producers. This pioneering model was followed by a whole series of related models. Some of them were collected in the book *Non-price control* (NPC) which was edited by Kornai and Martos (1981). Here I mention only those models that will be needed in the following.

Bródy grafted prices onto the original model, (each price depends on the excess of the corresponding stock, and each output depends on corresponding profitability.) *Kornai and Simonovits* modelled the production for order, where some part of the stock signal is replaced by order signals. Both models were shown to be stable. Martos compared different models, looking for equivalent controllers.

The present book is a new attempt to model the functioning of the economic mechanisms, developing the ideas of NPC. While NPC contained thirteen papers by eight authors, the book under review was written by a single scholar. As a result, the present book is much more unified than NPC is.

And now let me turn to the book itself. The book consists of three parts, and each part is divided into chapters.

Part I is an "Introduction to economic systems and mathematical control theory". Apart from *Chapter 7*, this part is more or less a perfection of the corresponding ideas of NPC, and therefore we will not deal with it in detail. Martos outlines the motivation for writing the book, then describes instruments and goals. (*Chapter 1*) He defines the basic categories (e.g. real sphere vs. control sphere) of an economic system (*Chapter 2*) and then outlines the principles and experiences of economic control. (*Chapter 3*) Turning to control structures, Martos formally defines vegetative control and coordination (*Chapter 4*), systems control (*Chapter 5*), and presents the so-called state equations (*Chapter 6*).

As *Chapter 7* is the centerpiece of the book, we shall devote more space to its presentation. This chapter deals with the abstract theory of stability and viability. It is to be underlined that the author does not accept stability of control as the main objective, and he stresses the importance of the transitions. Further, he introduces a quite general framework for viability of the system, which refers to the feasibility of the state and control paths. For example, certain variables like outputs and inventories have to be non-negative in each time-period. Here we find the first major theorem of the book: Viability Theorem (7.54 on p. 75) proves under quite general assumptions that control paths of a whole interval generate viable state trajectories. Moreover, the theorem "computes" this viability interval. A general method replaces the *ad hoc* methods used by former studies.

Part II is devoted to control without coordination. It starts with *Chapter 8*, which outlines the common real sphere and the common form of the behavioural equations of the various control mechanisms without coordination. Martos works out an abstract reduced form with a corresponding stability theorem (Theorem 8.31 on p. 92), to which most of the concrete models and their analyses can be reduced.

Chapter 9 discusses the stock signal (Model S). It is a dynamic linear production model, where (i) the stocks not only connect the subsequent periods to each other, (ii) but also serve as signals. For example, (i) the speed of change in the stock of steel *is equal to* the output of steel *less* the *sum* of inputs to all industries (including steel and household 'industries'). Similarly, (ii) the speed of change in the output of steel *is equal to the negatively weighted sum* of the speed of change in, and the deviation from, the norm of stock of steel. Analogous relations hold for other output and input stocks and the corresponding output and transfer decisions. Applying the abstract stability theorem to model S yields a very general stability condition. The general viability theorem can now be applied. The model describes a buyers' market working with a vegetative non-communicative control mechanism.

Chapter 10 discusses the order signal (Model B). It is a dynamic linear production model, where the vector of output stocks is replaced by a matrix of orders. For example, the speed of change in the backlog of orders of steel from coal industry *is equal to* the order of steel from coal industry *less* the transfer of steel to coal industry. Turning to the behaviour equations, the speed of change in transfer of steel to coal industry *is equal to the weighted* sum of the speed of change in and the deviation from the norm of backlog of order of steel from coal. Similar relations hold for other backlogs and input stocks. Applying the abstract stability theorem to model B yields a complex stability condition, which holds for the empirically known A matrices. Again, the general viability theorem can be applied. The model describes a sellers' market working with a vegetative control transactional communication mechanism.

Chapter 11 combines stock and order signals (model SB). General stability and viability results are obtained. The model describes an *orderless* market where some buyers and sellers cannot realize their intentions simultaneously.

Chapter 12 discusses the commercial stock signal (model C) where traders buy from producers and sell to consumers. There is probably no need to go into the details of the model. For us it is sufficient to emphasize that this model is more complicated than the previous ones.

Chapter 13 describes the supply-side price signal (model P, using Bródy's ideas), where a special calculative price is determined by the negative feedback to the corresponding output stock. Relying on the price vector, a profit margin (or value added per unit product) is calculated, the dynamics of which yields that of the output. (To avoid complex calculations, here the input side is assumed away.) Leaving aside the corresponding stability and viability conditions, we mention that this model represent an interactive control mechanism.

Chapter 14 gives the summary of part II. A particularly interesting point is discussed under the heading "...why precisely were these models analyzed?". This issue is most often neglected by mathematical economists. Martos, however, gives quite frank answers to the question. a) Some models were "not hard to analyse" but "...were discarded for their artificial economic interpretation". "b) Other models were faultless..., but did not offer more lessons than other simpler models". c) Models using coordination were left out in part II. d) "Non-viable systems were sorted out at once." e) Finally there were models which the author could not analyze (pp. 159–160).

The author was able to demonstrate that the Leontief-economy can be stabilized and is viable for five different vegetative control mechanisms. The markets were non-Walrasian in the following sense: they applied non-Walrasian signals, and non-Walrasian prices; apparently useless stocks survived in equilibrium state; orderly as well as orderless models worked similarly. At the same time, Martos is dissatisfied that he was not able to find the necessary and sufficient stability conditions for several models. Moreover, he could not analyze the dependence of the viability domain and the reaction coefficients. Finally, the author claims to have demonstrated that certain fields of control do not need coordination, i.e. state intervention.

Part III (Equivalent controllers, partial coordination) deals with two problems already studied in NPC: (i) "When can we consider two controllers fitted to the same real processes to be equivalent in their operation?" (ii) "How can we construct price signal models which are equivalent with another model using quantity (stock) signals only?" (p. 171). *Chapter 15* outlines the Laplace transformation to be used in the equivalence analysis. *Chapter 16* analyzes the equivalence of controllers, and shows that even a modified stock signal model SM is not equivalent to model P. *Chapter 17* considers partially coordinated equivalent controllers (model E). Three structural variants of model E emerge: (i) Variant EP, coordinated price setting, consistent with either centralized or interactive mode. (ii) EP, either coordinated production decision or secret technology. (iii) EM, mixed case. *Chapter 18* summarizes part II.

Martos reconsiders TER in an afterword (*Chapter 19*). A short characterization of the so-called disequilibrium theory is followed by a four-point comparison: (i) Both TER and the Theory of Quantity Adjustments (TQA) want to explain non-Walrasian phenomena, but the former looks for foundations for Keynesian economics, while the latter is interested in modelling the control mechanisms of the modern economies. (ii) Both theories consider non-price signals, but TER concentrates on perceived constraints and effective demand, while TQA considers stocks and orders. The former are artifacts, the latter are directly observable quantities. (iii) Turning to the organizational arrangements, the introduction of rationing by TER involves some coordination, while the simplest models of TQA are able to function without coordination. (iv) Finally, considering the real spheres that appear in the two theories, we can state that TER works with general production possibility sets, while TQA is confined to linear technology, i.e., it cannot yet model scarcity, choice of technology etc.

Bibliographical notes to each Part clarify the relationship of the monograph to its predecessor. An impressive list of references and a useful index complete the book.

Though Martos's book is very well-written and very precise, it still contains some minor lapses.

Martos has written a very interesting book which should be read by those who are interested in the mathematical modelling of the economic control and information mechanisms. The book demonstrates that new insights can be gained by leaving the world of the Walrasian or non-Walrasian equilibrium theory.

A. SIMONOVITS

KŐRÖSI, G.—MÁTYÁS, L.—SZÉKELY, I.: *Gyakorlati ökonometria* (Practical econometrics). Közgazdasági és Jogi Könyvkiadó, Budapest 1990. 481 p.

"Between mathematics, statistics and political economy we find a new discipline as mediator which, for lack of a better term, may be called econometrics."

"Econometrics sets as its goal the verification, empirically and numerically, of the abstract laws of theoretical political economy or, in other words, of "pure" economics. Thus pure economics is turned into a science in the closest sense of the term." It was with these words that Ragnar *Frisch* announced the birth of the new discipline in a Norwegian mathematical periodical in 1926. The Econometric Society was founded four years later and the periodical of the society, *Econometrics*, is now in its 59th volume. Eventually, in 1951 the first comprehensive work was published in London: *Econometrics* by the Dutch Jan *Tinbergen*; for a long time this was the handbook for everyone.

In his foreword to the book under review the eminent Richard *Quandt* justly praises the authors with these words: "The treatment is up-to-date, the familiarity of the authors with the literature is imposing." Beyond a great many articles from periodicals and mathematical guides, they refer to several dozens of books, mentioning every important author whose work on econometrics has been published in English or Hungarian. However, it is precisely Frisch and Tinbergen who are missing. In today's textbooks and handbooks these two names are seldom found; the same is the case with *Haavel*, who was the first to point out in 1944 that economic phenomena frequently obey several laws simultaneously (simultaneous equations). What has happened to econometrics?

First of all, in theoretical economics, the scholars of the schools that have emerged, disappeared and again blossomed since the beginning of this century, have never had a strong urge to build up their models from quantifiable notions, and particularly not to empirically verify their basic assumptions. Thus, theory and econometrics that serve practical purposes (e.g. economic policy) have developed along different paths. The teachable theory and the teachable econometrics use different mathematics and make students recite their lessons accordingly. Soon after its inception econometrics became engaged with mathematical statistics which, though a completely exact branch of mathematics, is at a loss with what to do with phenomena that seem quite natural to a practical economist (and are considered facts). For example, important economic data series (such as the components of national income) move together simultaneously and have a combined impact on another one (e.g. on the movements of imports over time). Also, the saving propensity of households classified in the same income bracket may still be significantly different. If an econometrician experiences such things, he has to compile a new model, perhaps from other data series, and it is not certain that this can be made to correspond with any known theoretical model or even satisfy the demand for consistency with everyday experience. No wonder that econometricians were advised by some to discard the fig-leaf of theory and by others to go over to another branch of mathematics (e.g. to the still little developed systems theory).

Meanwhile, statistical methods underwent a miraculous development: extremely refined, yet easily teachable, easily programmable standardized methods were born for the analysis of time series—i.e. they paid no heed to economic viewpoints. Responding to the challenge of the age, for some time they changed econometrics from the science of learning the economy into the science of prophesying. Thus it became the favourite tool of governments and international organizations, an area on which it is worthwhile spending money. However, not one of the disciplines of economics—not even econometrics—predicted the oil price explosions of the seventies or the recessions of the eighties. This somewhat perplexed the profession and prompted it to self-examination. This could have set back econometrics for a long time, but what actually happened was different. Namely, econometrics had by that time become deeply embedded in the computer and software business (or conversely); it became involved with conferences, institutions, faculties, international work panels etc. This happened to such an extent that nowadays no self-respecting young market researcher or would-be manager produces a marketing study or a financial plan without feeding some compiled data series into the computer and running them with some ready-made programme package. He can also publish one or two tables or figures on which, as the result of model computation, he may now safely build the text of his treatise. Sharp competition, particularly at times of recession, can harm not only business morals: the discipline of econometrics has been affected by massive applications and a concomitant lack of knowledge, slovenliness and, frequently, deliberate carelessness—and this in a subject which suffers from grave internal problems even without the aforementioned distortions.

The book written by the trio Kőrösi–Mátyás–Székely is not intended to make these people see reason. Otherwise it is not addressed to beginners, but to mature practical researchers who know their trade, i.e. mainly to heads of research groups who are responsible for the formulation of the task to be examined, for the planning of model computations and their direction, and for the checking and interpretation of the results. *Practical econometrics* is permeated by the respectable approach that—econometrics being so problematic a method—let us at least be honest. Honesty implies two things in this context: what econometrics does should make some acceptable (theoretical) economic sense. However, this interpretation can only be accepted if the extremely strict rules of mathematiccal-statistical methods are observed at every step, and their correct observation has also been checked. It follows that not every research project can be successfully completed and that a negative result will not always be a "result"—it might also be a failure which one has admit.

The authors thus offer researchers a very narrow path—so narrow that it may sometimes break. Of course, another approach is also conceivable, one that provides greater freedom: to heed theory less and give more respect to economic facts. This would mean that events from economic history or the elements of case studies, describing states, a new model would have to be constructed for each case and the appropriate mathematical methods would have to be found or, in some cases, even created. Yet the book does not wish to renew econometrics, only to put the existing practice in order.

To see what this is all about, let us consider, as an example, the simplest current type of econometric model. In this, as a variable to be explained, let us say, investment demand is given and let us, for example, assume that its size depends in every period on three explanatory variables: profit, the price of investment goods and the rate of interest (many other assumptions are conceivable). We want to know whether demand for investment can be produced, for each date in the past, by summing up the explanatory variables (multiplied by some coefficient) and perhaps some constant, and one random item of prescribed property. The determination of the coefficients and of the random item (parameters) is called estimation. The coefficients show the size and direction (positive or negative) of the impact of the individual explanatory variables on the resultant variable. Yet, according to serious textbooks, this very simple and transparent model may suffer from at least eight illnesses which, if not discovered, remain hidden and lead to false conclusions. In order to find these illnesses diagnostic processes elaborated by mathematical statistics should be used, with so-called statistical tests at their centre. These help to confirm or discard the hypothesis about the given (favourable or unfavourable) properties of the model.

The structure of *Practical econometrics* is determined by the procedure of the authors who review, one after the other, the most important models used in modern econometrics (with the exception of those describing cyclical phenomena). They give the solution (the estimating procedure), then show the possible defects, describing the diagnostic procedures for their disclosure, together with the correct order of their application. They give advice on possible therapy (or give the reference), and also on what is, and what is not worthwhile trying in a given case. One thing is certain: in general, the construction of the model, or at least the computations, have to be started again from the beginning (or almost the beginning), including perhaps the collection of data.

The authors believe that "The choice of the model and its idea also include the observation that no single model may be considered as the only possible and *ab ovo* true one... Even if we accept that several models may be tried to describe the phenomenon examined, and even if all of them are defective, then perhaps that restriction may be accepted... which treats every model as one that may *also* be specified with mistakes, and which maintains this suspicion as long as the model has not survived every phase of checking." (p 257)

In order that this process should not be a blind alley, and that the person applying it should not lose his way in the meantime, the authors try to propose procedures that can be linked to each other or which quickly lead to such a situation. Three illustrative chapters in the annex to the book show how these methods work. In order to do this they show models that serve to produce the macro-saving function of the Hungarian economy and help to examine the production and stockpiling behaviour of enterprises. The closing chapter reviews tested programme packages and is based on the experiences of well known Hungarian experts (who are listed at the beginning of the book).

No "recipes" of models can be found in the book. Although there is a great demand for these, the serious authors of this book regularly refuse to meet them, and justly so. In the present state of econometrics the same model or estimation procedure which yields a good result with some ensemble of data, will be useless for another ensemble of data related to the same subject. This is why the work of Kőrösi–Mátyás–Székely does not exempt anyone from the pains of choosing a model (specification). Thus it may be used, like the famous *Merck Manual*, by the practitioner. That is, it may provide invaluable and thorough information and guidance for an experienced econometrician, while providing security for those navigating between the Scylla and Charybdis of present-day econometrics.

Unfortunately, the rather self-effacing Introduction ("... econometrics is a marginal area which...") does not provide guidance on how this book should be used. Nevertheless, this should not deter the reader: this book can be used most profitably by first reading it from the beginning to the end—not skipping anything—and only then returning to the parts which are particularly interesting for the reader. It is a special merit of the book that it does not enter into too complicated mathematical explications (it does not deviate from the subject in general, either), and applies throughout uniform notation which greatly facilitates reading. Also praiseworthy is the carefulness of the authors in ensuring that there are only a few errors in the text and even in the formulae, and those that can be found are not significant. However, for the sake of a well deserved, second edition, here are a few of them: on p. 103 the verbal definition of residue is inexact; the name of the ALNH model discussed on p. 134 is only explained on p. 140; in contrast with the statement on p. 136, the F-test is not discussed in Chapter 5, but in Chapter 15; from the equation on p. 151 the vector $(\beta, 0)$ is missing. In places the work of the reader is made difficult by the not quite exact and rather brief, subject index. (Who will look for the meaning of the definition LM under Lagrange?) Also, some important definitions are relegated to the footnotes (e.g. see the definition of canonic correlation on p. 385). Sometimes an earlier statement should be reiterated or at least mentioned with some words which help to facilitate the recalling of the most important properties of the mathematical subject just treated (e.g. of a matrix with special properties).

The apt and witty graphs of Győző *Bércesi* will surely be enjoyed by every reader.

K. LÁNYI

BLANCHARD, O.–DORNBUSCH, R.–KRUGMAN, P.–LAYARD, R.–SUMMERS, L.: *Reform in Eastern Europe.* The MIT Press, Cambridge, Mass. 1991.

In the spring of 1988 Gregory *Grossmann*, a noted American Sovietologist, rightly stated that: "Perestroika has not significantly changed the Soviet economy up to now, bot it has fundamentally changed the life of western Sovietologists." Gorbachev has profoundly stirred the still waters of the Brezhnev era and has shaken the central party and government bureaucracy. More and more *resolutions* have poured out concerning the transformation of the economy. Not disturbed by these resolutions, the economy has continued to slip into ever graver crisis. Since then, both in the Soviet Union—if this formation still exists when I am writing these lines—and in the other Eastern European countries things have taken another big turn. The communist systems collapsed with such vehement speed that analysts were not left enough time to explain in satisfactory depth the reason why the collapse actually happened. In addition, and what is even more important, the new political forces that have come to power were unprepared for the highly complex and unprecedented task which fell upon them: i.e. to devise a programme for fighting the economic crisis, curbing inflation and restoring financial equilibrium. At the same time, they had to put in clear terms the way in which the centrally managed economy based on state ownership could be transformed into a developed market economy based on private property.

The new governing policy makers and experts of Eastern Europe have not been too active in elaborating comprehensive programmes for economic transformation (the economic policy programmes of Leszek Balczerowicz, Grigorij Javlinskii, Vaclav Klaus or Mihály Kupa can hardly be called comprehensive—although the *one-page* programme of the Albanese government at least avoids the criticism of being verbose). The eminent representatives of western economics have been even less active. True, most of them became absorbed in the tricky problems of Eastern European changes, but their views can be found in one or two articles in periodicals—only a few of them have undertaken the writing of longer works. As far as I know, the first was János *Kornai* with his "passionate pamphlet" (*The road to a free economy.—Shifting from a socialist system: the case of Hungary* (1990) W. W. Norton and Co. New York.) The two other significant works are by David *Lipton* and Jeffrey *Sachs*: ("Creating a market economy in Eastern Europe; the case of Poland," *Brooking Papers of Economic Activity*, 1: 1990, pp. 75–133 and "Privatization in Eastern Europe: the case of Poland", *Brooking Papers of Economic Activity*, 2: 1990, pp. 293–360). The one other publication is that by five renowned authors, and it is this which is the subject of this review.

In slightly less than one hundred pages the authors undertook a big task: to attempt to review the important problems of stabilization, liberalization, privatization and structural transformation in the Eastern European economies.

Before discussing the individual chapters in detail, the genre of the book has to be defined. This is not at all easy. The authors have made efforts to bring about an outline of a "scenario" for the economic transformation of an Eastern European country; in this sense, their work may be considered as a programme. Their efforts can best be traced in the chapters on privatization and structural transformation. However, the parts dealing with stabilization and liberalization are characterized—beyond certain elements of a programme—by argumentation of the "if...then" type. Thus, the analytical, descriptive and normative elements get rather mixed.

This unclear genre of the book certainly derives from the fact that the authors discuss the solution of tasks facing "an Eastern European country"—on the assumption that this is an average or typical entity. Yet when reading the book, the suspicion arises that the authors' ideas were mainly influenced by the experiences of the Polish reform and, to a lesser extent, by those of the Soviet and East-German reforms; not only this, they have relied on writings about those that have been published in the West, and have then tried to reach general conclusions from them. Such an approach is not quite unjustified as there are a great many similarities in the operation of Soviet-type economies. However, when the transformation of an economic system is treated—in addition, transformation under highly complicated political circumstances and dangers—the derivation of an abstraction from the concrete countries in question tends to weaken the argumentation and results in uncertainties regarding the genre—this has happened in this book.

Stabilization and liberalization

According to the authors—and in this we can fully agree with them—economic transformation of the Eastern European countries is most directly menaced by rampant inflation. Yet how can the brakes be put upon inflation and the economy stabilized—within it first of all the financial system? The answer is simple: obviously, with the application of a "standard stabilization package" (pp. 2–7). It is the authors' conviction that the stabilization programmes—beginning with Germany in the 1920s, South America in the 1970s and 1980s and, beyond them, Eastern Europe in the 1990s—cannot propose essentially different solutions. In other words, the chronic deficit of the state budget has to be eliminated, prices have to be liberalized together with foreign trade, the exchange rate of the domestic currency to foreign ones has to be set at a realistic level, and state subsidies have to be cut. The latter is not an indispensable condition of the success of stabilization if the revenues and expenditures of the state budget can be balanced without the subsidies. Nevertheless, elimination of the subsides is advisable in the framework of the stabilization package because subsidies distort the price system. Also, such cuts are painful for large masses of the population; thus it is better to get over the worst, together with the other painful interventions.

It is to the authors' credit that they give separate attention to the question of how much Eastern Europe is different from the other "cases of stabilization"—ranging from Peru to Israel. They point out the important factor concerning the Eastern European economies—i.e. that stabilization here is much more difficult owing to the overwhelming weight of state property, the extreme distortions of the price system as well as the extremely monopolistic structure of the economy. Thus, the danger of failure is much greater than in the economies quoted as examples. Because of these features they deem it important that the stabilization programme be comprehensive and carried out in the shortest possible time.

The true value of this chapter is found not so much in the recommended solutions to stabilization, but in the fact that the authors take the interactions between the steps in stabilization one after the other, reasoning clearly, in an almost didactic way, also considering possible side effects and recommending solutions to ward of the side effects. For example, they discuss in detail the credibility of the whole of the stabilization programme and of the individual steps in the process. They call attention to the fact that too drastic stabilization measures—e.g. exaggerated devaluation of the domestic currency—announced with the aim of making the programme credible, may easily undermine precisely its credibility. This would especially be the case if the government could not consistently stick to the steps outlined because of a grave decline in production, a sudden increase in unemployment and the political resistance evolving in their wake. The authors believe that the credibility of the programme is not merely an aesthetic property, but one of the most important elements of the programme itself.

A separate section discusses the problems of "hot money"—that is, the cash and savings accumulated by the population and not covered by commodities. This is indeed a grave concern in the cases of the Soviet Union, Bulgaria and Romania, and to a certain, though decreasing, extent in Poland; but this danger is not so pressing in Czechoslovakia, Hungary and the former GDR. However, the argumentation that wishes to justify a (partial) confiscation of money deposits in a country with "uncovered" money in order to curb inflation does not sound at all positive to the reader. Nevertheless, it is an essential problem for every Eastern European country whether stabilization should entail strict regulation of wages in the state sector or liberalization should also extend to this field. The authors quote several examples for both cases and eventually opt for a transitory regulation of wages—then for its complete elimination. Yet they correctly point out that a genuine solution will only be reached if enterprises are managed by responsible owners and if the managers are appointed by the responsible owners.

Privatization and structural transformation

The most exciting chapter of the book discusses the problems related to the transformation of state property into private property—and this is the central problem of changes in Eastern Europe. The authors' approach is here unambiguously normative. They do not dwell very long on the question whether private ownership is a more efficient form of operating national property than state ownership; they treat it almost as an axiom. Their starting point is an explanation of why the *fastest possible* privatization is needed and not whether privatization is at all necessary in Eastern Europe. Although one can agree with most of their conclusions, one cannot completely agree with the argumentation intended to support them. The authors emphasize that fast and comprehensive privatization is needed primarily because without it the managers of state-owned companies would spontaneously privatize, in collusion with foreign partners, and in the process they would only observe their own private interests. This is perhaps the only place where the authors actually refer to Hungary (and Poland). In these countries, according to them, spontaneous privatizations have led to grave misuses, to undervaluation of the assets owned by the state and to sales at low and unrealistic prices. This problem has indeed been serious in Poland, though—having learnt the latest ideas of the Polish government about privatization (which greatly rely on privatization initiated by the firms), we are inclined to think that the earlier passionate criticisms are supported by feelings rather than by facts. In Hungary, however—apart from a short political campaign—this problem has not dominated the debates about privatization.

I think that the eminent western experts are mistaken in their thoughts on this question. What I believe to be an even greater mistake is that, while they depict the "horrific dangers" of spontaneous privatization with vivid colours, they do not perceive the real danger which would indeed support their standpoint, which urges rapid privatization. In other words, they do not mention that the gravest heritage of the Eastern European centrally regulated economies is that they are *politically regulated* ones, where the actors of the economy do not possess economic autonomy and thus bear no genuine responsibility for their decisions, either.

In the last resort, it is this which led to the fatal decline of Soviet-type economies. The coming to power of the new political systems—multi—party systems and parliamentarism—does not automatically mean a separation of politics from economy. In Hungary, and also in several other Eastern European countries, it can be observed that the persistence of dominant state ownership and the coming to power of historical—conservative trends is very compatible with the interference of the political power in almost every field of the economy. The main danger is thus not so much spontaneous privatization—although legal instruments have to be employed against its unlawful forms; rather, the danger is that the transformation of a significant part of state property into private property will not take place. In addition to this and equally harmful is a situation in which privatization will not mean anything else but that those in possession of the political power will make efforts to buy themselves faithful subjects and supporters by letting state property pass into certain hands chosen by them.

If we see these dangers as real ones—and we have every reason to—from this point on we can agree with the authors that the fastest possible privatization is needed in order that the *most democratic* ownership relations possible can come about. From this it immediately follows—and the authors recommend it as the most appropriate solution that the ownership rights of a considerable part of state property have to be distributed free of charge among the whole of the population.

In the economy democracy is not enough for happiness. It also has to be ensured that the privatized property should be operated in the most efficient manner possible. In some cases this may involve the closing down of enterprises or some of their departments, the regrouping of capital and the foundation of new firms. In addition, it is also necessary for the owner to control the managers of the firms and remove those who are unsuitable for the job. These tasks cannot be performed by individual citizen—owners; therefore, adequate institutions have to be created for the purpose. According to the authors privatization holdings or privatization agencies may be able to play this role. The enterprises to be privatized in the framework of free distribution of property ought to be entrusted to them—not directly to the population. However, as a result the population would share equal proportions in the shares of the holdings.

The authors consider the holdings to be transitional formations which would remain as long as all the firms belonging to them are not sold to private investors. The completion of sales would be linked to a deadline and the enterprises remaining in possession of the holdings after the deadline—say lo years—would have to be sold through auction or liquidated. According to the authors, the heads of the holdings would be appointed by the government and they would be backed by a consultative and executive body consisting of foreigners and citizens. One can agree that the holdings owned by the population should be professionally competent organizations, independent of the firms belonging to them and thus possessing enough power for their reorganization and sale. At the same time it is questionable whether it is advisable to link them—through their leaders—directly to the government. Through these links it would be precisely the same state political influence that would gather momentum with the firms belonging to the holdings—the very situation which they ought to get rid of.

The idea that the government should appoint managers probably derives from the already mentioned—and in my opinion erroneous—starting point that whatever is linked to the levels below the central state power is in the hands of the beneficiaries of the former communist system, and what derives from the government can only serve democracy and a market economy. In addition, the authors may have hought of another real problem when making their proposal on the organization of holdings. Namely, somehow it has to be prevented that the leading group of any particular holding can sell the firms transitorily in their possession at any price. These people do not risk anything—thus even minimum revenue is pure gain for them. However, the direct subordination of the leaders of holdings to the government is not a solution to the problem. It seems it would be more appropriate if the holdings were to be formed by domestic and foreign private firms. These would deploy their own capital in the venture and they would then earn any profit deriving from the efficient operation of the property of the holding, or from its sale. This profit would be in proportion to the capital contributed.

The authors argue—and in may opinion correctly—that the greater the number of privatized holdings competing for the share-investments of citizens, the more efficient the operation of the individual holdings. Yet they also point out that the number of holdings will be limited by the scarcity of professional competence. This is because the number of domestic and foreign entrepreneurs well-versed in the efficient management of enterprise property will presumably be very limited.

The method outlined is not considered by the authors to be a unique one covering the whole of privatization. They recommend it only in cases in which large companies are placed in private hands. Besides, they too support "small privatization"—i.e. the selling, through auction, of smaller plants, servicing, catering and commercial establishments and the selling to tenants of dwellings at low prices. In these cases, however, they prefer decentralized auctions to those centrally directed by the government. This would also mean the distribution of a part of the shares that are to be freely handed out (i.e. 10–30 per cent) directly among the employees of the firms, and a further part would be given to the social security and pension funds to be newly created.

One of the greatest merits of the book is that the authors clearly declare: privatization and the transformation of the economy and of enterprises are two processes that are essentially different in content; this difference is mainly with regard to the *time dimension*—even if the respective time scales are not quite independent of each other. The former is a process which can be implemented relatively rapidly, implying the establishment of institutional frameworks for ownership relations, of institutional forms of private property, and the definition of the owners and their rights. However, the structural transformation will take a longer time—according to the authors probably decades. From this it also follows that from privatization alone a rapid and sudden improvement of the efficiency of firms moving into private hands can hardly be expected. This can only be expected after protracted structural changes. Yet these structural changes cannot take place if they do not develop in the sphere of private firms, in the wake of decisions taken by responsible owners. Without responsible owners there can be no "creative destruction" in the Schumpeterian sense—i.e. unviable enterprises and plants will not cease to exist, nor will new ventures start.

The structural transformation of enterprises is not merely a question of ownership relations; it also greatly depends on the rate and quantity of accumulation of capital that can be freely invested. In order that this process can take place in the fastest possible manner—simultaneously with the development of efficient enterprise management—it is important that the savings of the population should be stimulated by rational monetary policy and by advantageous conditions for the investment of savings. Structural change thus implies not only the successful functioning of enterprise properties, but also the establishment and transformation of money and capital market structures.

According to the authors, capital investments by foreigners in the Eastern European countries will not play a significant role in the earlier phases of economic change. However, they will be very important in the course of structural changes. They note that serious foreign investors tend to wait for more secure ownership and management conditions before risking the investment of large sums of capital. These investments have to be vigorously encouraged by the Eastern European countries by the establishment of firm institutional conditions for the transformation. Without foreign investments structural changes can only be slow.

Finally, the structural changes of the economy will initially cause unemployment to soar Nevertheless, the authors, referring to experience to date, believe unemployment will gradually abate and fall to less than 10 percent. The authors put the initial unemployment between 10–20 percent.

The book "Reform in Eastern Europe" does not provide ready recipes for carrying out the transition from socialism to capitalism—yet it raises several important ideas. It directs attention to essential interrelations which are worth considering by everyone actually taking part in the transformation—whether the person be a leading government official or an entrepreneur, or a citizen making a small investment. If the book is read from this point of view and not as a programme of reform—as was certainly intended by the authors—the few hours spent on reading the work will not be time wasted.

I. MAJOR

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*We acknowledge the receipt of the enlisted books. No obligation to review them is involved.

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Róbert HOCH, b. 1926. Academician. Head of departmant at the Institute of Economics, Hung. Acad. Sci., formerly deputy director of the same institute. Author of "Commodity production with or without attribute" (Acta Oec. 40 (3–4)) "Open economy and domestic consumption" (Acta Oec. 37 (3–4)) "The maxi and the mini. Reflections on the Hungarian debate on large firms" (Acta Oec. 35 (3–4)) and several studies and articles, among others on the reform, privatization in English, Russian and Hungarian.

Éva VOSZKA, see Vol. 42, Nos 3–4.

Sára PÁSZTOR, b. 1948. Cand. of econ. sci. Economist. Formerly researcher at the Institute for Financial Research. Author of "How open the Hungarian economy is: an international comparison" (Acta Oec. 1980: 25 (1–2) and several studies on export structure, export concentration, foreign trade in Hungarian.

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R. István GÁBOR, see Vol. 40, Nos 3–4.

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