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POST-COMMUNIST TRANSITION AS INSTITUTIONAL DISINTEGRATION: EXPLAINING THE REGIONAL ECONOMIC RECESSION

K. Z. POZNANSKI

The most important aspect of the so-called transition from a communist economy is that each reforming country has immediately entered into massive recession. Only a systemic deterioration could cause such a negative economic turn. State agency was at the core of the communist-type system and the role of the state remained central during the transition as well. It was the weakening of the state in the process of its own reforming—or reinventing—that was responsible for the growing economic pains of the late communism. Further decline in the state's ability and/or willingness to manage economic affairs forced Eastern European economies into an even deeper distress. The greater the damage to the state capabilities, the more severe the recession, as comparison of Poland and Russia amply reveals. In contrast, where the state, while being reformed itself, remained firmly in charge, as in China, converting the communist system into the capitalist one has been recession-free.

There are many different conceptualizations of post-communist transition, but it can be said that most of them are open to question. In fact, the commonest way of looking at the transition process is possibly the most inadequate. The historic transition in Eastern Europe (broadly defined to include the European parts of the former Soviet Union) is generally viewed as a positive process of institution-building—that is, of bringing back competitive markets and private property. However, this conceptualization has not served the post-communist reformers well when making policy choices, though admittedly there are other, less benign reasons for such choices. These errors are in large part responsible for the initial establishment of some rather unstable, half-reformed economic systems, and these negative systemic outcomes have in turn led to the disappointments of the early stages of transition. In particular, they can be blamed for the unprecedented region-wide recession, which has shaved off about one quarter of the national product of Eastern Europe.

I take a contradictory view: transition, if viewed properly, should be seen as an open-ended process that may assume a positive institution-building form; however, transition may also turn into a negative institution-degrading process. We should not think about the transition exclusively in terms of a replacement of communism by capitalism; this immediately creates positive images of change because we tend to associate capitalism with efficiency and progress and communism with waste and regression. There is nothing wrong with this image if taken as a general proposition, but to succeed with a specific analysis, instead of focusing on

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markets and property (the two categories used to define the differences between communism and capitalism), one should look at this systemic process in terms of what is happening to the two other institutions found in both of these systems: state agency and civic order (i.e. society).

From this alternative perspective, transition cannot be judged as anything but a largely negative development, for it has simultaneously caused a major weakening of both the state and society. States have become more autonomous or alienated by allowing the private interests of their officials to override public interests not only in growth, stability, and equity but also in safety. At the same time, societies have turned from civic to selfish drives, making effective operation of the state much more problematic. Transition has been a negative—regressive—process, not only due to this state/society degradation but primarily because some degrated markets and property have only just been able to emerge. While these economies are moving towards capitalism, markets are plagued by undue political influence, excess speculation, breaches of contracts, etc. In addition, property, while increasingly in private hands, has initially become grossly undefined and generally insecure.

I find this state-society approach superior to the one centred on markets and property, since markets and property can function only if embedded in a healthy state-society setting. Sound markets and property require extensive competition and stable ownership, which only come with effective state regulation of business dealings and an effective enforcement of property rights. Perhaps even more important for the soundness of markets and ownership is that society accepts competitive outcomes—possible loss and reward diversity—and displays respect for property as well. Thus, when state and/or society deteriorates, the foundations of private markets are fractured as well—which is exactly what has happened to the economic systems in transition countries.

Those who take the view of transition as a move from communism to capitalism cannot usually reconcile their positive position on systemic change with the striking fact that at the time of this systemic change all the economies of the region have gone into unprecedented recession. As a general rule, the presence of this recession is denied or downplayed on the grounds that much of the decline in output is overstated by imprecise statistics; the latter suffered from manipulations by the planners under communism and are now unable to capture the qualitative change brought by transition. Typical explanations of the recession are hard to square with the economic realities of the transition, but, quite surprisingly, this line of reasoning usually goes unchallenged. Only when the alternative view—which concentrates on changes in state and society—is adopted can one reasonably address some of the discomforting aspects of economic performance in transition economies.

Taking this position, I argue that no single factor other than the parallel collapse of state and society, combined with the reappearance of deformed markets and unstable property, can explain the recessions that have erupted in transition countries. Nothing other than an institutional implosion can account for a recession

as massive as the one that has ravaged post-communist Eastern Europe. This is far worse than any modern recession, including the Great Depression in the 1930s. This well-remembered episode in the capitalist past can be also linked to an institutional break-up, though of visibly less severity; this explains why the Great Depression was less damaging (though not on all accounts, since investment, in general, has suffered less during the post-communist transition).

The transition process has not been uniform in the region, and there are certainly major differences in both the conduct of reforms and the pattern of recessions in the respective countries. While all states in Eastern Europe have entered their own crises, some important differences in the exact mechanisms of these respective crises are apparent. It can be demonstrated that, depending on the nature of the state crisis, the severity of respective recessions also differs. The countries where systemic change has been more radical have seen their economies deteriorate more than those with a more measured or conservative approach. Moreover, whenever the systemic process has been more chaotic, the economic results have been worse than in those cases where reforms have proceeded in a rather systemic way. Consequently, the worst cases of recession have been in those economies where reforms have been the most radical in speed and chaotic in fashion.

The relatively limited crisis of the state can be linked to radical changes in the name of creating a "minimum state", conducted in a rather organized way by a still-coherent state. This has undoubtedly been the case in Poland, where the (crafted in a liberal fashion) "shock therapy" programme was intended to achieve exactly this. Poland is for this reason the country least damaged by recession. Hungary seems to fall into the same category, for the reformers here acted with a similar minimum-state vision in mind, though Hungarian measures have been, at least initially, more conservative. The significantly worse, nearly catastrophic recession which has hit Russia and Ukraine can in turn be linked to the much more radical and, at the same time, chaotic changes which have taken place while the state has virtually collapsed due to the evaporation of its authority.

In order to succeed without a massive recession—i.e. to cut recession down to a manageable size or to avoid it altogether—transition economies did not need a sudden weakening of the state, as actually occurred, but careful reform of it. There was nothing unusual about a powerful state under communism, because all modern economies are characterized by powerful states, and as markets expand so do states. Rather, what was, if one could use this term, "non-modern" about the communist state was its peculiar type of behaviour with respect to other economic agents: both enterprises and households. The communist state was not doing the right type of things, and these had to be changed in the course of transition while keeping the state—in part because of the needs of the pro-market reforms themselves—very powerful in order to provide a largely different set of services required for the market to operate properly.

Instead of taking the view of the early reformers—i.e. that transition entails a substitution of states by markets—the process should be viewed as a parallel restructuring of both states and markets. After the collapse of communism as a political system, a different, though not necessarily lesser, state was needed, and different, not necessarily more, markets were required. Transition entails a restructuring of states into agencies which are to be compatible not with the hegemonic party—as its superior—but with a market. It is not that markets had to be invented, since they already existed under communism, but rather that they have had to be further articulated. In short, transition involves moving from the existing, largely informal, and defective markets with low payoffs, to formal and effective markets where rewards are generous and diversified.

Opening remarks: false conceptualizations and fictionalization of reality

It is truly amazing what has recently happened to the general attitude within that group of professional economists involved in the study of East European economies. With the departure of communism, the profession's evaluation of the regional economic situation has completely changed from a very negative assessment about both the economic system and the related economic performance to a very positive evaluation of both. The communist state-run system was typically blamed for a confusing form of decision-making and for what was perceived to be an increasingly disappointing regional economic performance; the latter was frequently described as economic stagnation. Then, with all former communist countries moving into transition, the region suddenly started receiving a favourable evaluation for its reformed institutions and for an economic performance it had apparently started to produce.

Communism was correctly criticized for running an inefficient and, in some ways, irrational system; however, even with all these imperfections, it delivered some measure of economic growth right up to its last days. If official statistics are to be trusted, the economies grew everywhere (except for Hungary, which spent the last ten years of communism with an overall flat level of national production. Poland is another special case, since it was the only communist country in the region that registered a serious economic crisis under communism, though this happened some time before the end of the system (during 1979–1982). Later, Poland's economy expanded year by year at a respectable rate, though the quality of production—due to limited imports—was at the same time falling visibly. The same technical (qualitative) deterioration was taking place elsewhere in Eastern Europe, meaning that real economic growth was less than suggested by production figures alone.

This regional growth slowed considerably just before the post-1989 transitions officially started; however, this cannot be blamed on communism, since these

slowdowns took place during an interim phase. In some places, like Poland, major reforms had taken place shortly before the 1989 transfer of power from the communist party, and many of these changes—often quite bold (e.g. reduction in farming subsidies and price supports)—had a disturbing effect on production. Bulgaria suffered economic slowdown before 1989, largely due to adverse developments in its agriculture (in part due to migration by members of the Turkish minority, mostly engaged in farming). The sharpest pre-1989 downturn took place in Romania, which was not due to reforms, as in Poland, but rather to disarray in the state administration.

Even if the above statistical observation was incorrect and the late communist economy, as some argue, was suffering from a region-wide recession in disguise, this does not impact my main point. Even with the performance as bad as some would suggest, the regional economy after 1989, when post-communist changes were initiated, took a negative turn which was far worse than the one attributed to late communism. It is doubtful that any of these critics would go as far as to claim that post-Soviet Russia has suffered less than Brezhnev's or Gorbachev's Soviet Union. But while the early post-communist performance looks like a catastrophe—again, even this interim period is ignored—there is very little, or no talk among mainstream economists about the emerging replacement—i.e. some form of capitalism—as being equally or possibly even more irrational than the communist system used to be.

To understand this attitude it is necessary to examine the dominant view on the transition from communism—that is, the view shared as much by the post-communist reformers as by the broad public. From this perspective, the process of undoing communism is viewed narrowly as a process of remaking a complex system of institutions. Importantly, this process is defined as a straightforward substitution of (communist) states by (capitalist) markets, which itself is assumed to ensure systemic improvement. Accordingly, the progress of transition is measured in terms of shrinking states and expanding markets, particularly the spread of private property and the decline in state holdings. When reformers indeed engage in the replacement of states with markets, of course there cannot be any lack of measurable evidence that transition is a success.

When transition is defined in such purely positive terms—as a sort of "salvation", or final solution to various systemic problems from the more or less distant past—it easily becomes incomprehensible that switching from presumed-inferior states to assumed-superior markets may produce the opposite. In addition, when some major economic distress comes along, such as the massive post-1989 recession which has accompanied the transition from the start, there is a tendency to dismiss it as an illusion linked to the very nature of transition. Alternatively, it is admitted that it is a real economic phenomenon but one which is not directly linked to the actual policy choices of the post-communist reformers. Instead, this negative

outcome is blamed by mainstream economic opinion on the initial conditions, left as an inescapable legacy of the now-defunct communist system.

Reality of recession. Using official national accounts, one finds that even the luckiest countries of all, such as Hungary and Poland, suffered an initial loss of their total production—close to twenty percent continuously in three and two years respectively. Others, such as the Czech Republic, saw their national income go down by almost twenty-five percent three years in a row, and in Bulgaria and Romania the total incomes fell by close to thirty percent for four and five years respectively. When transition started in East Germany, the loss was even worse, totalling as much as thirty-five percent in a single year, and when the former Soviet Union initiated its reforms, its cumulative output losses often reached fifty percent (e.g. Russia and Ukraine), or sometimes turned out as high as sixty percent (e.g. in the post-Soviet Lithuania).

Although, I will concede, that there are serious measurement problems with national accounts, these problems are not impossible to overcome. Furthermore, importantly, when some other more reliable indicators are applied, there cannot be any doubt that the recessions have been very real—and undeniably very bad. If one prefers not to look at official national income figures, there are some physical data on production that undeniably show a sudden downturn, such as in agriculture (e.g. in Hungary, where real—corrected for inflation—output was down by 50 percent as late as in 1997) or in certain heavy industries (e.g. coal-mining in Poland, where output fell by 40 percent through 1993). A parallel decline in pollution can only be attributed to this fall in production (given that environmental laws did not instantly become stricter or more enforceable nor could anybody have managed so quickly to put anti-pollution measures into place.

Sharp demographic deterioration is another, possibly even more trustworthy piece of evidence indicating the enormous depth of the post-communist recessions. For instance, the officially reported shortening of lifespans cannot be blamed on statistical inadequacies, as there cannot be any serious incentive for people to over-report death. The reports on lifespan shortening are quite alarming, particularly in Russia, where the average span among males, after making some gains late in the eighties, showed a decline of five to six years (bringing it to the level typical of the most impoverished countries). Statistics on fertility losses, which are also hard to doubt, provide further proof that transition entailed a demographic crisis, and thus itself cannot be treated as anything else but crisis.

Even those who accept the recessions as real often refuse to address the issue of recession itself on the basis that it has been quickly made irrelevant by the subsequent recoveries, which are presumably spreading to all corners of the region. This view is fuelled by the fact that many have already recovered from the recession and show strong production growth and healthy budgets that are often admirable by European standards. One of these economies is the Polish, in which recession lasted for a little less than two years, and in which annual rates of

national product growth have since been in excess of five percent. Other countries have shown healthy, steady recovery as well, such as Slovenia and, somewhat slower, Slovakia. Poland is most often mentioned in these positive accounts, because there is a tendency to view Poland as the country which, from the start of transition, has paved the way for the region.

Some other recoveries have already managed to move from one recession to another, in particular Bulgaria in 1996–97, where a ten-percent decline in national product was reported; not only Romania in 1996 but also the Czech Republic in 1997 showed respective declines, and in Hungary in 1995, only minimal growth was experienced. Importantly, in many critical cases, like the populous countries of Russia and Ukraine, recessions have not yet been arrested, though they started almost seven years ago. In the case of Russia, with an already suffering economy, it was lucky to delay further decline for two years; Russia took another major hit in the mid-1998 downturn, highlighted by a remarkable fall of the ruble by one third and a huge run on dollars. While the currency and prices have stabilized, it is expected that the national product of Russia will again show a negative rate for the whole of 1999.

Incomplete explanations. With the attitude of denial within the economic profession regarding the post-communist recessions comes a widespread lack of interest in studying the phenomenon. Very little has been produced by economists in terms of theoretical accounts, and most of what has been done is of doubtful value. Furthermore, statistical analyses—attempts to test theoretical arguments—are also very few and quite inadequate. Of all the countries in transition—and suffering related recession—only Poland has received some kind of decent coverage and debate (e.g. *Berg and Sachs* 1992; Poznanski 1993). The Russian case of recession, on the other hand, despite its most striking nature, has not been studied with much intensity at all.

There has also been no effort made to place this region-wide downturn in a comparative perspective, save for the occasional references to the Great Depression. The latter has been the case analyzed most often, with the analysis itself having a profound impact on the discipline of economics. There is presumably something to learn about the post-communist catastrophe from the lessons of the Great Depression, but no such lessons have been sought out. This is mainly because the few comparisons attempted have largely been approached with an intention to prove that there is actually no common features between the two to talk about.

When recession is not denied or ignored, there is a tendency to provide implausible explanations which seek to detach the collapse of production from the course of transition—i.e. to blame the reforms themselves. Even though in most economies of the communist system there was some growth (albeit with the help of subsidies) until their end, there is a tendency among the mainstream analysts to blame the post-communist catastrophe on the communist past. In its final phase, the communist system was greatly distorted, although not enough to cause a re-

cession of its own; it is still, however, said that the communist system left regional economies so heavily distorted that once these countries entered the transition process they pay for these distortions with production decline, higher inflation, and growing unemployment. The mistakes made by the post-communist reformers were assumed to have the effect of making the downturn in economic performance much more pronounced.

In reality, however, the regional catastrophe is not a fatal, or unavoidable, event but a consequence of severe mistakes made by the reformers in large degree due to a misconception about the nature of transition. Seen as something which could be substituted by markets, states needed some critical reform—instead they were allowed to deteriorate. Since the state was still the essential element of the overall system at the end of the communist period—i.e. the opening of transition—by damaging the state's capacity, the overall system was damaged as well. The state could neither fulfil its proprietary functions towards the outgoing public sector companies nor could it properly conduct the reforms needed by the emerging private sector. This state crisis, universally found in the region and always quite extensive, is the principal reason for the economic catastrophe.

Initially, when transition economies were taking their first steps in systemic reform, there was some doubt about the role of the state in provoking economic downturn. This was because the production decline seemed to be temporary and thus possibly accidental. But the continuous extension of economic troubles—most strikingly manifested in Russia's recent slip from a terrible recession (which appeared to have been arrested) to another uncontrolled fall—has forced economists to rethink the role of state. There is, however, a tendency to treat Russia as a separate case of transition and, consequently, there is a reluctance to consider the state as an important explanatory variable. While society is increasingly seen as partly responsible for Russia's economic perplexity—for the same reason of presumed incompatibility—there is a reluctance to extend this view to other parts of Eastern Europe.

Conventional argument: recession by conversion of imbalances

From the start of deliberations on post-communist transition, liberal thinking managed to set quickly both the agenda and the approach for this historic process. This was quite understandable, because the communist system's ideological source, Marxism, had lost much of its remaining appeal with the collapse of communism. The demise of communism also elevated its major opponents, who happened to be liberal thinkers. This is not to mention the obvious fact that turning to liberal thought for help during the transition seemed only natural, since the transition process has been aimed at strengthening both markets and property, which liberals concentrate upon.

Liberal controversy. Although the transition issue seems to have been "hijacked" by liberal thinkers, this does not mean that the deliberations have lacked controversy. On the contrary, a lively debate has emerged between two currents of liberal thinking: the neo-classical and the evolutionary. The former is the mainstream tradition, in which the focus is on the rational individual as the basic unit of analysis and on equilibrium as a desirable state. The latter also takes the individual as the basic unit of analysis but does not assume the individual to be rational, and its focus is on disequilibrium. Importantly, while neo-classical economists consider institutions as given or irrelevant, evolutionists take institutions as a core of their economic analysis.

Table 1

Major theoretical approaches to post-communist transition

Building elements	Liberal approaches		Statist approach
	Neoclassical	Evolutionary	
Origins (communist collapse)	Total fragmentation of the system (imperfect state)	Partial fragmentation of the system (imperfect state and market)	Bureaucratic paralysis (imperfect state)
Transition (Post-communist reforms)	Automatic return of markets (linear systemic progress)	Past-dependent reconfiguration (open-ended change)	Reform of state agency (free policy option)
Destination (final system)	Complete markets operated by advanced capitalist economies	Unique types of sytems	Genuine developmental state (governing of markets)

These two approaches differ greatly in their account of transition, beginning with the critical question of initial conditions faced by reformers (*Table 1*). Briefly speaking, the neo-classical view presents the starting point as the one in which the former communist system, with its apparent irrationalities, has left a desperate economy in ruins. What is left is a non-existent—also called "destroyed" (*Balcerowicz* 1995)—market with a once overpowering state in a condition of chaos. By the evolutionary account, these economies entered transition with weak, albeit not defunct, economies that are strong enough to demonstrate some growth anyway. The state is viewed as a pale version of the original, while many elements of the market, though mostly in an imperfect form, are already in place.

Another difference between these two views (for the third, less-articulated position on transition, which I call "statism", see, for instance, *Amsden et al.* 1994) refers to the conceptualizations of the reform—or change—processes themselves.

For neoclassical economists this process entails an almost automatic "return" of markets—with "good" prices—to fill the void created by the "withdrawal" of the state. The process is fuelled by natural human propensities, such as an interest in profits, a will to prosper, or desire to save for the future. For evolutionists, transition is a protracted process where states are not substituted by markets; instead, both are subject to reforms, with the state and market complementing each other.

The other important difference refers to the respective views on the final systemic outcomes of transition. In the neo-classical version of liberalism, it is assumed that reformers have a relatively free choice with regard to the ultimate system. This choice is limited only in the sense that some normal, working versions of the existing markets found in advanced capitalist economies are in the pool (including the once-abandoned early forms of highly competitive—i.e. free of monopolistic practices—markets before welfare state capitalism arrived: see Balcerowicz 1995). In the evolutionary view, reformers are constrained by the communist legacy and thus some novel forms of capitalism are likely to appear (even highly deficient ones).

The neo-classical view has become the leading liberal platform, defining both the style of transition analysis as well as its overall tone and spirit. It is true that numerous attempts have been made by neo-classical economists to admit the presence of transition, but in most cases they only call it a statistical illusion caused mainly by the fact that a decline under transition is apparently more detectable than a growth of production. As the argument goes, during transition production declines only in the state sector (which is assumed to report its figures more or less accurately. The private sector in which there is growth, however, tends to "underreport", partly due to a defect of statistical services but also, and most commonly, due to its tendency to operate in an undercover way (mainly for the purpose of tax evasion). This is not a very convincing point, however, since at the outset, when recession emerged, the state sector was dominant and the private sector was negligible.

Admittedly, there is also a group of neo-classical economists which admits the reality of recession and seeks an explanation for its emergence; by and large, however, these are self-serving arguments with questionable intellectual—or theoretical—value. It is not only surprising that this catastrophic event, unheard of in modern history, is given very little attention, but equally intriguing is the fact that of the few attempts made, many are totally wrong, while many others are at best impressionistic. This remark refers also to the most prominent line of thinking that has developed mostly among the radical reformers—namely, the advocates of so-called "shock therapy" (i.e. the combination of a rapid deregulation of prices, harsh deflationary measures, and a commitment to fast privatization).

Conversion theory. The line of thinking about the sources of recession which has gained most prominence in this light has been what I prefer to call "conversion theory". Crafted in the neo-classical tradition, this concept presents recession

as a product of hidden imbalances left over by the communist system and thus it is treated as an inevitable phenomenon (e.g. Berg and Sachs 1992, and *Berg* 1993). These macroeconomic imbalances involve: repressed inflation, which results in shortages; hidden unemployment, or jobs performed by workers with negative marginal productivity; and unnecessary production. All of these conditions are related to specific state regulations (i.e. price—fixing, employment plan-targets designed to assure full employment, and free credit for inventories to prevent deficits—see *Sachs* 1993).

The core of the argument is built around the notion of unwanted production, understood as a kind of production that could only exist under state planning. Most common is the position that, under the state planning, there were many goods produced for which there was no real demand—i.e. the demand came from the state rather than from consumers (this production has been called "pure socialist production" by Balcerowicz (1995), or "unwanted production" by *Winiecki* 1991). In another version, this excess production is linked to the apparent over-building of the industry, linked to planners' obsession with heavy manufacturing (*Aslund* 1995). (In the Russian context an argument is made that, in fact, the entire economy was over-built during the late communist era due to a temporary windfall gain from oil/gas exports, see *Gaidar* 1997.)

Recession is inevitable, since transition by definition entails deregulation, or the withdrawal of the state from performing co-ordinating functions; as a result, once-hidden imbalances somehow have to be revealed—i.e. forced out into the open. Hidden inflation thus becomes open so that prices begin to rise until aggregate supply and demand eventually balance out. Disguised unemployment becomes visible as well, for excess labour is laid off and unnecessary production is terminated as well; as a consequence of this overall output goes down. Typical signs of economic recession appear along the way—such as inflation, unemployment, and production decline—though they are greatly misleading as they actually mask generally positive economic changes.

This form of general recession is unconventional for it does not represent any real cost to society; in other words, it is a cost-free economic recession. Conversion actually leads to a change not in the size of the overall costs themselves but in the form in which they are manifested in statistical sources. The difficulties related to hidden inflation—i.e. the search for goods by producers and consumers—are replaced by the equally burdensome inconvenience of rising prices. Unproductive employment now becomes clearly redundant with no negative impact on the production level at all. Meanwhile, the elimination of unwanted production for which there was no consumer—as opposed to state—demand cannot cause any loss in value, or aggregate welfare, either.

The conversion of hidden imbalances into open ones is advantageous, since now economic imbalances are at least properly signalled. More importantly, such conversion leads to easy, if not to say instant, recovery (Balcerowicz 1995). Since

prices and wages now set themselves, it improves the economic signals perceived by agents and makes their choices more rational. At the same time, by being plunged into the competitive game, economic players—i.e. enterprises—find themselves with additional resources at their disposal. These resources come from defunct, surplus production and can be more usefully re-deployed in considerable quantities. This is due to the fact that only desired production is allowed and under equilibrium conditions there are stronger incentives to use them solely for productive purposes.

Recovery from a fictitious recession can only be fictitious, so that the conventional economic language of recession/recovery becomes even more awkward. Conversion entails more in the way of normalization—i.e. the transformation of an unhealthy economy characterized by distorted signals—i.e. prices—into a healthy one where the signals are correct (for more, see a quantitative study by *Lipowski* 1996). Once these economic signals have finally become truly reliable indicators (reflecting conditions of supply and demand), agents start acting rationally and the general equilibrium condition can eventually be achieved as well.

Given the nature of the post-communist (also called "transformational", see *Kornai* 1994) recession/recovery, deregulation should proceed as fast as possible, since it shortens the whole cycle of production downturn and production upturn. Due to the no-cost nature of recession, there is no gain whatsoever from extending hidden imbalances by allowing the state to stay around. Besides, as has just been said, an automatic recovery from a fictitious downturn in production is assured once the conversion process is complete. From this perspective, conversion theory has been quite useful in the hands of those supporting radical transition on other—i.e. economic or political—grounds.

Some researchers have attempted to prove that recessions, though inescapable, tend to be weaker in economies that adopt radical measures. Leaving aside East Germany, which for reasons of apparent non-comparability may be excluded from our analysis, Poland has been treated by these economists as an exemplary economy. It is said that the radical programme introduced by that country, referred to as "shock therapy", resulted in the most superficial and briefest recession recorded in any of the transition countries. The Czech economy—in which, many argue, a fairly similar programme was introduced—also apparently experienced a relatively weak recession in relation to the region as a whole.

Factual problems. It cannot be denied that both the Czech and Polish governments adopted programmes that, at least by some standards, were more radical than those introduced by many other states. However, when we add East Germany to our equation, their attempts pale by comparison with the ultra-radical approach of the latter. Following the logic of the conversion theory, one would expect East Germany to have made an even better showing. Instead, however, East Germany suffered a much worse recession: the fall in production experienced by this state, although occurring over a much briefer time period than elsewhere, was at least twice as sharp as that registered in the other two countries (keeping in mind that, unlike

any other transition economy, for very peculiar reasons, East Germany adopted a policy of sharp currency appreciation that greatly added to its economic recession).

Russia's particularly poor results are regarded as a product of that country's gradual approach to reform, and are more precisely attributed to the abandonment of its original radical programme. The other under-performing economies—Bulgaria and Romania—are put in the same gradualist category. Registering the longest lasting and sharpest fall in output of all the states in question, Russia does fall far behind, say, Poland, but by certain measurements it trails another radical reformer: East Germany. East Germany experienced the worst recession of all the transition states in the sense that it recorded the sharpest fall in output over the shortest period of time (its above-thirty-percent decline took place in just one year). While the Bulgarian and Romanian recessions have lasted longer than the East German recession, the aggregate fall in production recorded in these two countries is close to that of the region's seemingly most radical state—i.e. East Germany.

Many studies carried out to support the arguments of conversion theory have excluded not only East Germany but also China. This is also for reasons of apparent non-comparability (though China, as a former state-run economy undergoing transition, is undeniably, at least in this sense, comparable). If China is included, however, even more confusion is created, since one is now dealing with a post-communist economy which has passed through a period of transition without suffering the effects of recession. On the contrary, it grew very fast with no interruption, with very limited inflation and, at least until recently, with insignificant unemployment. This would suggest that, contrary to conversion theory, it is not true that post-communist transition has inevitably led to deep recession. It also challenges the claims of conversion theory with regard to the virtues of radicalism, for China has avoided recession by pursuing, as I will further demonstrate, gradual change (for a similar account, see *Naughton* 1995).

These reservations cannot be easily dismissed, since the typical arguments about China's incomparability do not make sense unless we understand by incomparability that China is so different that its approach—though it has shown itself to be very successful—is not applicable under East European conditions. But even the latter is not so obvious, and this refers to all of the main points which suggest that China can be excluded from a comparative framework. For example, many economists stress the obvious fact that China is politically unique in that the communist party has retained its monopoly on power. It is apparently for this reason that the country has been able to pursue a slower—more gradual—trajectory of reforms. But, of course, this conclusion directly contradicts the tenets of conversion theory, according to which gradualism in transition cannot lead to economic success.

Several economic arguments with regard to China's incomparability have been forwarded as well, one often-raised point being that the more rural nature of the Chinese economy has made it easier to achieve production gains whilst limiting systemic change. This may be true, but a number of other economies, namely Albania's, have not necessarily achieved a more industrial profile than in China but have somehow not been excluded from comparative studies. If it is true that farming is more suitable for transition reforms, then in countries other than China agriculture should show a better performance than industry, and farming should possibly achieve growth, with industry going into temporary decline. But, unlike in China, East European economies have seen their agriculture suffer a major decline, often worse than their industry.

Besides, and most importantly, the arguments for the exclusion of China fail to address the only relevant factor—namely, the extent of pre-reform economic imbalances. In terms of conversion theory, the only economic factor that counts is the presence of hidden imbalances, for only these imbalances can cause a recession. To claim that conversion theory does not apply to China, one would have to demonstrate that, unlike communist Eastern Europe, China was free of hidden imbalances. Yet this could not have been the case because, due to its similar statist nature, China's economy under communism had to suffer from hidden imbalances. In fact, there are reasons to believe that China at the outset of reform was more distorted than most of its East European counterparts; this, of course, makes China an even more legitimate case for comparative study.

To sum up, conversion theory presents recessions as the inevitable products of the communist legacy (i.e. hidden imbalances) of the transition states. These are recessions only in name since they entail no real cost to society and are effectively dealt with by policies of radical deregulation which, by nature, entail rapid systemic change. The conventional theory that blames recession on these legacies can at best only partly explain recessions, for the actual decline exceeds what could be reasonably attributed to correcting such hidden imbalances. Finally and most importantly, this argument is powerless when explaining the recession-free case of China's transition, which happens to be (as will be demonstrated later on) gradual, not radical as in the recession-ridden economies.

Institutional explanation: central role of state agency

While largely missing the point, conversion theory continues to rule the day, both in academic studies and in casual discussions. This is, in part, because it satisfies the widespread need to further the "persecution" of communism, which has largely gone from economic reality but not entirely from collective memory. It also meets another need: to escape the possible responsibility for the various failings of

the post-communist period (given that what came after communism was expected to quickly cure the economy). But there are other, no less important, reasons for the theory's durability: namely, that it has never been rigorously tested, except for few rather superficial quantitative examinations (limited, as already said, to a narrow group of countries, basically Poland, where many of the specific arguments on this sort of "recession by conversion" were originally formulated).

Methodological problems. The conversion theory of recession does not offer a satisfactory account of post-socialist recessions, largely because of its inadequate methodological foundations. These foundations are largely borrowed from the neo-classical paradigm, which is scarcely capable of addressing the kind of complex processes which are characteristic of post-socialist transitions. Thus, while conversion theory defines the initial conditions of recession—i.e. the communist legacy of the past—only in terms of internal disequilibria, other, and probably more important, unrelated deficiencies were present. I am talking about various forms of dysfunctional, often almost institutionalized, behaviour that existed at the end of communism—namely, a disrespect for law or a negative attitude to state authority.

Furthermore, conversion theory, in keeping with its neo-classical logical foundations, defines the post-communist transition as essentially a form of deregulation or change in the mechanisms of coordination. In other words, it focuses on procedures through which the prices of products and productive factors—such as labour and capital—are set. Such thinking in terms of the quality of prices, and how signals—i.e. prices—are established, is as characteristic of neo-classical economics, as is its tendency to ignore property rights. By overlooking property-related aspects, conversion theory disregards an immensely important potential cause of recession—namely, changes in the ownership structure. Any change in this area must affect the motivations of actors and, thus, economic performance (when the state is mentioned in such an approach it is not in its property function but in its role as coordinator).

To bring these missing elements into proper focus, an alternative explanatory model is developed below; this is a model which, building on certain elements of conversion theory, employs the tools of institutional economics, where property rights are seen as a central economic category. Neo-institutional theory (e.g. *North* 1990) could certainly provide a suitable framework for such an excursion, for it offers major insights into how institutions work. Of even greater help, however, is evolutionary economics, especially when one considers its more dynamic outlook—that is, its interest not only in explaining how institutions function, but also in analyzing how institutions are shaped and reshaped. Furthermore, the evolutionary approach, unlike neo-institutional economics, pays attention to values that drive human actions and thus defines the quality of ownership structure and other relevant institutions (see, for example, *Schumpeter* 1962).

From the perspective of the evolutionary approach, there is only one logical thesis regarding the cause of recession: downturns as dramatic as those registered

in the majority of transition economies could only have had their roots in some sort of systemic crisis. In this context, such an explanation departs from neoclassical conversion theory, which in its interpretation of recession does not refer to any kind of systemic crisis at all (except in claiming that indecisive reforms—and resultant systemic debacles—may make inevitable recessions worse). If anything, the conversion argument presumes that transition represents a systemic improvement, namely in the form of a shift from an inherently inferior state to a superior market-directed economy; it is this which helps to trigger an illusive recession.

If we are to go beyond the confines of non-institutional conversion theory and include institutions in our analysis, the only reasonable way to proceed is to come up with an accurate definition of the actual systemic make-up of post-socialist economies at the time when they embarked on the path of transition. The answer is simple: from the moment they began to open up all these economies, in addition to suffering from hidden imbalances as conversion theory claims, they have been characterized by the omnipresence of the state. Indeed, at this juncture, the state (except in the case of the two partly reformed economies, Hungary and Poland) is almost entirely responsible for determining the economic system, acting as the coordinating mechanism and the principal owner of capital. (Combinations of various types of these two elements constitute an economic system, as stated by German institutionalists from the so-called "order school", and more recently restated by Kornai 1992.)

State crisis. Keeping in mind this simple fact that the state was the core of the late communist system, the only important source of systemic crisis at the time—and thus of recession—would have been that the state went too far in abandoning its role of performing its two basic functions. To put it another way, the sources of economic crisis lay in a crisis of the state, and its disintegration can only be attributed to a too radical effort by reformers to remake it. Certainly this sudden economic downturn could not have been because of a market crisis, for the market was only just emerging at the time. Even if such market elements were ridden by crisis, the weight carried by the market was too small at this stage for that crisis to have had a great impact. In fact, the crisis of the state as a core institution helped to wreck the emerging markets, for markets cannot effectively operate without effective states.

The arrival of recession and its depth are thus related both to the moment when—due to radical measures—the state lost too much of its capacity and to the depth of such a loss of efficiency, both in terms of ability to pursue policies and adequacy (or, rather, inadequacy) of such policies. The same theoretical reasoning could be applied to the pre-1989 downturn in economic performance, since the state was already losing some of its effectiveness in the late stage of communism. By making this point, my alternative recession theory departs further from the conversion argument, which considers the state's withdrawal from economic affairs as a positive element. Generally speaking, with its conviction that the state is a

threat to markets and thus dispensable, conversion theory does not speak about state over-withdrawal as a theoretical possibility.

Claims that the post-communist withdrawal of the state might have been excessive may strike the reader as "counter-intuitive, given that the state had been the cause of the problems affecting the economies in question while under communism. Theoretically speaking, however, even the undeniably inefficient state of communism could have been further undermined, so that some transition economies could initially have ended up simply with a less efficient version of the old system (which, undeniably, had taken greatly diversified forms—Poznanski 1996). But even those countries that immediately abandoned the traditional system could have adopted a system—which one could call capitalist—that would not, at least initially, have been more effective than the previous one. There is no reason to assume that even the worst kind of capitalist regime must always be seen as superior to any type of communist order, even the most effective such regime.

The above hypothesis on the over-withdrawal of the state might also appear to be inconsistent with evolutionary economics, upon which this theory claims to be based. To be sure, supporters of evolutionary theory are highly suspicious of the state and in favour of markets, which might be interpreted as a theoretical argument in favour of quickly dispensing with the state. The above hypothesis, however, is concerned with the ways in which the state provides room for markets. In actuality, this is the only aspect of evolutionary theory which deals with the issue of optimal transition strategies. Behind it lies a warning given by evolutionary economists against so-called "constructivism", or radical state-directed systemic change.

If taken seriously, the anti-constructivist argument of evolutionary economists leads to only one conclusion—namely, that the state, as one of the principal elements making up the system at the starting point, should be allowed to withdraw at a slow pace. One should not think that the concern of evolutionary theory is with the dangers of collectivism and that this applies only to attempts to dispense with the market in wholesale fashion and not to a wholesale removal of any other system, including the state-socialist model. As much as a market-dominated system is desirable, it is only a state-based system which agents are used to. Therefore, if the state is quickly ejected from that system, agents will no longer be capable of making rational decisions.

Comparative approach: typology of state over-withdrawals

A true challenge is to develop our argument in a way that would best explain why actual recessions registered by statistics have varied in the extent of their damaging effects, depending on the economy in question. Given the general understanding of recessions presented in this study, it would follow that cross-

regional variations would have to be explained by referring to the different forms of state-crisis that have appeared. As is the case with conversion theory, the simple distinction between radical and gradual pathways is not very useful here. A modified, or different typology is needed: namely, one that stresses not only pace (i.e. speed) of transition but also the extent to which transition is organized.

In conversion theory, a gradual approach is often seen as being inconsequential (that is, a process which lacks both focus and credible commitment from the state). This is precisely why, as the theory claims, gradualism will make post-communist recession worse than the hidden imbalances which, inherited from communism, are virtually inevitable. Theoretically speaking, however, it is perfectly possible for a gradual process of transition to proceed in a coherent—organized—fashion. Moreover, a radical transition towards a market-type economy does not always have to be organized and it may proceed just as far, or just as easily, in a completely disorganized way.

Table 2

Typology of state over-withdrawals

Level of radicalism (and political circumstances)	Character of the process	
	Organized	Disorganized
Less radical (political continuity)	*Ideological shift* Poland, Hungary	*Corruption* Bulgaria, Romania
More radical (political discontinuity)	*Unification/disunification* East Germany (Czechoslovakia)	*Collapse* Russia, Ukraine

There is a fundamental dividing line between those transition models in which the process of institutional change is organized and those in which it is disorganized (i.e. chaotic). The term "organized" should not be equated with some fully state-controlled process, since self-organization in the absence of the state is theoretically possible as well. The post-communist transition, however, only follows an organized path if the state remains firmly—but not completely—in control. This is because, in an economy initially based on the state, a process of transition—even towards a market-based economy—cannot proceed in an organized fashion on its own. By the same token, transition becomes chaotic when the state loses control over systemic change and events proceed on their own accord.

Given this basic distinction, the over-withdrawal of the state can take two obvious systemic forms: organized over-withdrawal and disorganized over-withdrawal. In the former case, the state, without losing its coherence—i.e. its ability to control the process of transition—engages in excessive self-limitation (or withdrawal). Of course, the fact that the state is still quite capable makes such an attempt at

limiting state involvement more effective. In the latter—chaotic—case, the state over-withdraws due to an unintended loss of coherence—i.e. because of an unintended self-destruction that also forces state capacity below a reasonable level, as dictated by the needs of transition. To repeat: self-withdrawal and self-destruction are the two basic ways in which the state can over-withdraw and thus they also represent the two alternative causes of early recession (see *Table 2*).

To further develop this categorization of transition pathways, an over-withdrawal through self-limitation can take two different forms, one of which may be called ideological. One clear example of such an approach is Poland in 1990, when the former anti-communist opposition established its first reform government under Mazowiecki; Hungary also had a former-opposition government. Various motives lay behind this path, including the desire of the still-coherent state in some of the countries in question to ensure that the collapse of the communist polity was made irreversible. Another motive was to avoid a third-way version of transition, in which powerful unions co-operated with an activist, or populist, state. Besides, reformers—in line with the views of classical (and also evolutionary) thinkers—regarded the agency of the state in its minimalist form to be the best means of supporting the economy.

Belonging to a second, separate sub-category of over-withdrawal through self-limitation is transition through reunification, as occurred in East Germany. Here, the much more restricted, though perfectly coherent state apparatus of West Germany was imposed on an East German economy accustomed to a more activist, if not overgrown, state system. Despite its greater efficiency, faced with the enormously complex problems of transition the West German state was not capable of instantly ensuring proper interventions by the state. An alternative strategy involving a more gradual type of reunification, especially in the economic sphere, was dismissed; this alternative would have enabled the state to withdraw in a less drastic, and probably more organized fashion.

The Czech case can be viewed as combination of the above two types (though there are reasons to regard this case as coming closer to the East German one). There is evidence that Czech reformers tried in a number of ways to follow the Polish model, or even to outdo it (at least in rhetoric) by taking even bolder steps than Poland did; by taking more aggressive steps, however, the Czech economy has come closer to the East German case. Analogies between the two countries go even further. The eventual break-up, or disunification, of Czechoslovakia led to an inevitable downsizing of the state apparatus in both the Czech and Slovak parts; this resembled what happened in East Germany due to its own reconfiguration—i.e. the reunification of the country.

Over-withdrawal through self-destruction can also take two forms. One involves the dissolution of the state by means of corruption, as occurred in Bulgaria and Romania. State attributes are seized by individuals—usually officials—pursuing their personal interests through illegal means or taking advantage of exist-

ing legal loopholes; they might also adopt a criminal path (quite visible, for instance, in Bulgaria, where many former secret police members ended up as influential figures with easy access to the state). Because they trade political influence within the state apparatus for material rewards that benefit them, no truly coherent state policy exists. Although the state here appears on the surface to be as large—and therefore as influential—as it was before transition, in actuality the state largely becomes a hollow structure, which it certainly was under late communist rule.

In another case of self-destructive over-withdrawal, the state is undermined through the virtual, though not complete, collapse of its apparatus as an independent agency. Russia serves as a good example here, but so do many other former Soviet republics, such as Ukraine. The focus of power in Russia has largely moved away from the state to non-state agents, with those in public position having little to trade with state clients. In this sense it differs from self-destruction through corrosive corruption (where, as indicated, officials still have enough influence to trade it for personal advantage). Another equally important difference is that in Russia the means of violence upon which states base their authority are taken over by external forces—e.g. criminal gangs, renegade military units, and self-protected business figures.

To sum up, to the extent to which post-communist recessions in Eastern Europe are real, they can be attributed to a serious systemic decline related to an underlying crisis of the state. Since these state crises stem largely from excessive limitations on the state's economic role, in this special sense all the recessionary cases in question may be defined as involving radical-type transitions. The over-withdrawal of the state with regard to both its coordinating and ownership functions has taken on a different form in different economies. Nevertheless, all of them, as a group, differ from the case of China, the only country where—as will be shown—the state has not undergone any crisis during the entire course of its transition towards capitalism. This, presumably, can explain why China has been the only former communist economy that has experienced strong economic growth rather than a strong recession.

Actual transition experience: specifying principal pathways

The differences between the four types (models) of early radical transition in the recession-ridden economies can be better understood by looking at what actual changes took place in the systems of the respective countries. To gain the fullest possible insight, we need to examine these states not only at the level of internal deregulation, as conversion theory does, but also with regard to the opening of trade (i.e. liberalization) and the privatization of state assets. These factors will all be analyzed below (albeit in an abbreviated fashion due to lack of space). What I

offer below is rather a "road map" for further comparative economic research into the causes of post-communist recession in the region.

Internal deregulation. A good illustration of the radical nature of internal deregulation in all the recession-affected economies has been the reduction in the once notorious state subsidization (well captured in Kornai's concept of communist economies as soft-budgeted "shortage economies"). In all of these cases, the extent of subsidy reduction during the early post-communist reforms was very high, at least in the sense that enterprises did not have enough time to make proper adjustments without making cuts in production. The actual mechanisms employed to reduce state assistance differed considerably from country to country, with major differences closely following the four major types of state over-withdrawal discussed above.

De-subsidization was initially most drastic in East Germany, where all subsidies were cut to state-owned enterprises waiting to be privatized. In addition, all enterprises undergoing privatization, or waiting to be privatized, found themselves cut off from bank credits, which caused an even deeper liquidity crisis. This was because banks were also "shut off" as part of the unification process. The East German banking system was demobilized, with the aim of later splitting it up and placing it under the control of the two leading West German banks. Some time was spent on integrating East German operations into West Germany's existing banking structure. No fresh credits were issued in the meantime, though the balance sheets of the incorporated banks were restructured (mostly in order to facilitate the privatization of enterprises).

In Poland, direct subsidies were drastically reduced, though mostly for conceptual (i.e. ideological) reasons—that is, mainly in order to balance the state budget (thus reflecting the leading priority of deflating the economy through a number of severe measures applied at once; Poznanski 1993). Ending subsidies was expected not only to reduce pressure on the budget but also to force greater financial discipline on state enterprises. This latter priority was aided directly by the commonly shared view that the source of the communist debacle was represented by so-called "soft-budget constraints"; thus, by getting rid of this condition there would be a rapid demise of the state apparatus, rather than a reduction in the size of budgetary transfers combined with a change in the formula for subsidization (for a summary, see Poznanski 1998).

De-subsidization was combined with state-imposed restraints on credit in Poland, a move triggered by almost the same motives as those behind the cuts in budgetary assistance. Due to the concern to keep the money supply down and harden budget constraints, quantitative state limits on issuing credits were simultaneously imposed with state-formulated interest rate targets. This restrictive strategy further worsened the liquidity position of enterprises already suffering from a reduced flow of their own, internal financing (coming from the profits). Default on inter-firm payments by some economically weaker—or less reliable—firms has

made the situation for some firms even worse, with the state apparatus unprepared to solve this debacle quickly by implementing creative financial measures.

In the corrupt model of over-withdrawal, as in Bulgaria, the role of subsidies was also significantly diminished—not so much in terms of the amount of money spent as in the effectiveness of such subsidies. While budgetary spending directed to companies continued, corrupt state officials did not in every case assign money to those businesses in greatest financial need. Furthermore, there was no means-testing structure in place and no interest in developing such tests. The amount of money allocated was mainly based on personal calculations of possible gains from directing funds to the receivers willing to provide kickbacks. A considerable amount of the cash allocated now ended up in private pockets rather than being spent on enterprise restructuring.

Although credits continued to be issued, they also fell into corrupt hands. The practice of extending credit to associates for personal gain—in exchange for a share of the value of a given loan—wrecked the banking system. At any rate, banks, which were virtually unable to distinguish between legitimate and dishonest requests for financing, withdrew from competitive allocations to close-client operations within the holding framework, leaving many enterprises in the cold. While Poland has been capable of eventually improving its financial condition, Bulgaria has failed to cure its banking system. The latter continues to be weakened by corrupt practices—this factor itself has been largely responsible for Bulgaria's renewed recession of 1996–1997.

Russia also radically reduced its subsidies, but for its own reasons, reflecting the overall nature of its adopted path of state withdrawal. In this case, the near collapse of the state has inflicted excessive damage on tax collection, with the largest sources of tax revenue, such as the raw material/energy giants, exerting sufficient influence to avoid having to pay the bulk of their outstanding taxes. In addition, a large proportion of revenue due to the state is diverted to private accounts under a system in which apparently one-third or even half of the budgetary allocations are not properly accounted for. This loss of revenue has produced a huge budgetary shortfall which has paralysed subsidization (to the extent that there have been insufficient resources even to pay public employees' wages on time).

The Russian banking system has been unable to provide any relief to the struggling companies, since its initial interests have been centred elsewhere. In large part, Russian banks have emerged as a vehicle through which revenue siphoned off from enterprises has been directed to other ventures, often towards the acquisition of heavily under-priced state assets or speculation in commodity markets. Given Russia's high-risk environment, the investments of banks have been centred on state-backed commercial securities issued to repair budgetary imbalances. The latter have often yielded enormous rates, thus providing an additional opportunity

for banks to aggressively siphon off—via the state—financial resources from taxpaying enterprises.

Trade liberalization. The most extreme case of removing an economy's protection shield from foreign competition occurred in East Germany, where, during the process of reunification, the lower tariffs employed by West Germany in its trade with the European Union were introduced into the East German economy. East Germany, one should add, also experienced a drastic appreciation of its currency after adopting the unrealistically high rate of conversion from the East German mark to the West German mark. In this latter move, as earlier indicated, East Germany radically departed from the practice of other transition economies, where national currencies were sharply devalued in the early stages (with the choice of a superficially favourable conversion rate for the East German currency driven by the political concerns of Kohl and contrary to the opinions of major West German financial figures).

In Poland, foreign trade liberalization also took place in an organized fashion, though more for conceptual reasons than anything else and mainly out of the conviction that the opening up of trade would increase competitive pressure on domestic producers. It was expected that with this change, deficit-making companies would be eliminated and downward pressure on prices—and inflation—would materialize as well. Liberalization of the external sector was executed mostly through sharp, unilateral tariff reductions which reached extremely low levels for a country at Poland's stage of development. Accompanying this act of de-protection was the decision to abolish the state's trade monopoly without providing any compensation in the form of quantitative restrictions (contingents) common in market economies—at least in those economies at comparable levels of development.

The Czech approach was also quite radical, though not in terms of custom tariffs, which were kept at a high level with additional "import charges" also being imposed. What further exposed the Czech economy to foreign competition was its policy of holding its exchange rate at a fixed level despite an initially sharp rise in inflation. This policy was intended to stabilize the economy, but it also lowered the cost of imports and led to steady current account deficits. The door was opened even wider for imports when tariff concessions began to be offered on a frequent basis to direct foreign investors, mostly attracted by sales of state property. This latter factor continued to fuel the appreciation of the currency even after the Czech government, faced with imminent crisis, decided in 1997 to execute a one-time sharp devaluation.

No less severe has been the impact of the corrosion of customs systems in those countries which took the disorganized route, such as Bulgaria, Romania, and, possibly even more so, Russia and Ukraine, where the state began to issue preferential licenses for duty-free imports. Many of these privileges were provided to influential state-related organizations but also to some newly established private entities in the hands of well-connected former officials. At the same time, powerful

criminal organizations have been able either to bribe customs officers by putting them on their payrolls or simply to intimidate them through threats of force. The number of cases in which customs documents have been falsified or goods simply smuggled across borders has greatly increased.

Capital divestment. While different on many accounts, all privatization approaches may also be regarded as radical, mainly in the sense that whatever their particular form they have caused an initial suspension or dilution of the property structure. For this reason, privatization in particular countries has invariably caused a loss of interest—or ability—among managers in fully mobilizing capital resources. It should be kept in mind that in the world of rational expectations, such a weakening of property rights is possible even without any practical steps—actual asset transfers—being initiated. If credible, a mere declaration of the state's intention to fundamentally alter the property structure, even without giving any proper details, can have the same effect as the state taking actual concrete steps in this direction (Poznanski 1996).

The privatization process in East Germany appears to have been the most radical—though a relatively disciplined case—with a newly created state agency—set up by the West German government—taking over the property of all enterprises. For the duration of privatization procedures, the existing management was suspended and the agency took over all decision-making authority. This itself damaged production, magnified by the fact that insiders—managers and workers—were almost completely excluded from the acquisition of enterprise assets (while most of the households lost their apartments through parallel re-privatization that returned property mainly to former West German owners). This was a case of almost complete expropriation designed to benefit West Germany. Moreover, this process was subsidized, since the agency ended up with sales revenues well below its operational costs (including various subsidies to buyers).

The Czech case is in many ways similar to that of East Germany: very radical and greatly detrimental to the motivation of managers and workers. As in East Germany, the state immediately reclaimed ownership of all enterprises and prevented insiders from gaining any preferential treatment in asset acquisitions. Rather than organizing sales, however, the Czech state decided to distribute capital to all adult citizens free of charge and to allow citizens to freely chose where to allocate their vouchers. This represented a completely experimental and unprecedented (at least on such a scale) scheme, although it was executed in a very rigorous way. While the state engaged in distribution, the operations of enterprises were largely brought to a halt. Afterwards, when the scheme was completed, with assets widely distributed, managers did not feel much pressure to return to economizing on capital resources.

The Russian approach was also radical, as it was initially based on the Czech model of "democratic capitalism", though it envisioned that the purchase of additional assets by managers/workers would be allowed. The Russian programme offered state enterprises a choice among a few privatization options, one of them

being a partial buy-out by the insiders. Unlike the Czech programme, however, Russia's privatization was executed in a disorganized fashion, for the state began to disintegrate and various interest groups took over. Distribution to all citizens was prevented by insiders using inflated money and credit issued by phony banks to purchase extra assets above their voucher allocation. All this was done without proper attention being paid to legal aspects, and as a result a very unstable property structure emerged.

Poland's privatization process was also radical although, unlike in the above cases, this was mostly due to the rhetoric employed by the state and not so much because of its actions. The state could not agree on any specific model of privatization, though it declared its stiff opposition to the labour-managed version of capitalism and thus precluded any form of mass distribution of assets to citizens. Still, it declared its intention to complete the process within a few years, mainly through a British-style sales of assets. Given the boldness of other steps (e.g. de-subsidization, trade liberalization), these fast-paced plans for the divestment of public assets sounded credible. This was enough to cause a rapid and virtual suspension of already greatly destabilized property rights, to which—predictably—enterprises responded negatively (Poznanski 1993).

Hungary comes close to Poland, since its privatization has also been based mostly on sales, though it has been even less favourable to the idea of voucher privatization than Poland (Poland initiated a limited programme of the Czech-type in 1996). Like Poland, Hungary started at a relatively slow pace and, similarly, the state's decision to quickly divest affected all Hungarian companies, not just those actually targeted for sales. In fact, many of them were already engaging in ownership changes during the last years of communism, taking advantage of laws that allowed for cross-ownership among state-owned companies. This process of recombination of property accelerated during the early stage of transition, helping to reduce additional risks but also taking a lot of the manager's energy away from production itself.

To sum up, severe post-communist recessions are a result of the state radically and simultaneously withdrawing from performing many of its basic functions. One such radical act of withdrawal involved de-subsidization, which left many state-owned enterprises on the brink of bankruptcy before they developed resistance to market shocks. The opening up of foreign trade, while pursued in many different ways, was also pursued in a radical fashion, exposing enterprises to excessive threats from imports and causing an erosion of their profits. By embarking on unusually rapid and often mostly experimental privatization schemes (e.g. the never-before-tried "voucher" programme in the Czech case), states reduced the motivation of enterprises to meet their challenges.

Recession severity and subsequent recovery: extending the central argument

If the above-discussed theoretical model provides, as it seems to, a plausible explanation for post-1989 recessions, it should also be capable of explaining the recoveries that have followed in many of the cases analyzed. What demonstrably went wrong would have to be rectified for the particular economies to turn around—hence, again, the central role of the state is assumed in explaining success in arresting recession. And, logically, this success is to be related to the type of transition model—or pathway—embarked upon by a given economy. Presumably, depending on the type of state over-withdrawal, countries would find it easier or harder to enter recovery, and they would make their recovery sustainable or, conversely, fail to keep it alive. Accordingly, depending on how a country entered into recession, it would take different changes in a state's behaviour for recovery to materialize.

Given the logic of my main argument, the only good explanation for recovery is the return of the state, i.e. the resumption of the role expected of it at a given stage of transition. In the countries in question this change in the state's behaviour has not involved a return to the literal pre-transition role of the state during the communist era. Of course, it is not that a return to a state with all its omnipotent and political features is necessary, for this is not what has been required for recovery to begin. Nor has such a literal return been possible, since in the new, greatly changed conditions of these countries there is no longer any room for such an omnipotent state with a rigid political structure. A return of the stronger state has been indispensable, but at the same time the return of a different, reformed state that is compatible with the expanding markets.

The state which has returned in these countries is rather different from the one that withdrew at the outset of the transition, mainly because two parallel processes have taken place during the reforms. On the one hand, by giving up some of its prerogatives, the state has created the room necessary for markets to operate successfully. On the other hand, the state itself has become subject to change; this is an aspect of post-communist reforms which is not fully appreciated, particularly by those who view transition simply as a substitution of states with markets. In reality, at the same time as its powers are diminished in some areas, the state is empowering itself to a new role in regulating markets (e.g. moving from interest rate control to open market operations, or giving up price controls in favour of aggregate demand management).

Major cases. The return of the state proved easiest to achieve in East Germany, which would also explain why its economy was the first to recover, after only about a year-long decline in production. In this case, the return of the state was easy because an effective state apparatus, that of West Germany, was already in place. It took a relatively short time for this apparatus to re-equip itself for the task of restarting the East German economy. Such a return did not require any major

reorganization of the state, save for the creation of an agency for privatization. In other agencies, adding personnel and sending personnel to East German offices—a massive operation in itself—was sufficient to handle the additional tasks related to East Germany. All this was helped administratively by the fact that West Germany had had, for a long time, various contingency plans—including special laws—in case of eventual reunification with East Germany.

The most visible manifestation of the return of the state in East Germany was a rapid increase in the level of subsidization channelled from West Germany to the new lands. The degree of subsidization and the related burden on the budget—and, of course, on taxpayers—is certainly the right indicator of the size of a state as an economic agent. In this case, a sharp increase in the role of the state was made possible because the state was able to introduce additional taxes (called "solidarity taxes") with relative ease. West German taxpayers agreed to make a small additional contribution after receiving a promise that it would be short-lived, but the burden has in fact turned out to be longer than anticipated at first. The resulting increase in subsidization for East Germany has been so massive that Germany has recently turned from being one of the region's fiscally tightest into one of the most generous.

In Poland, where retreat was, as started earlier, mainly an ideological step, another ideological change, although not one concerned with a major rebuilding of the state apparatus, was needed for the state to return. The ultra-liberal ideology adopted in that country had rather shallow roots and did not greatly restrict the movements of the elite. Here, the problem was not that the authors of shock therapy changed their minds, (which, in fact, they did not). Rather, it was their relatively rapid replacement at consecutive elections that made the real difference. The political process brought in forces generally opposed to overtly radical measures, most notably parties whose roots lay in the pre-transition era. Interestingly, since being forced into opposition, the authors of shock-therapy have not been muted their advocacy of radical measures.

The return of the state has involved most complications in those countries where the state was seriously undermined—such as in Russia, where corrupt structures are today even more pervasive than elsewhere and are even overwhelming the remnants of the state agency. Under these circumstances, the return of state has taken the form of powerful criminal elements trying to penetrate state structures. The last presidential election has been seen by some observers as proof that these criminal, or semi-legal, elements decided to try to gain control over the state in order to protect their vast, largely illegal interests. The very unpopular incumbent president Yeltsin entered the elections with meagre support only to be revived by massive help from a group of oligarchs channelling money for his campaign through their banks.

For this very reason—namely, the appearance of illegitimate influence by oligarchs—the state has had serious problems in firmly asserting its legitimacy

among a majority of voters. Among the mistrusting elements are scores who consider themselves losers and who continue to look for leadership that can ensure that the burdens of transition are distributed more evenly. There are numerous parties which strongly oppose the type of market emerging in Russia—i.e. that in which commercial laws are weak and property rights are not enforced. Their programmes call for an overhaul and even a possible reversal of pro-market reforms. If these forces gain the upper hand, one should expect fierce resistance from well-entrenched criminal interests. Only when this political conflict has been resolved can the Russian state be rebuilt, an event which should also usher in a long-delayed recovery.

The Polish example. Poland is often offered as an example of the advantages of a radical programme that, despite an eventual slowdown in reforms, has produced the best results in the region. However, careful analysis of the actual course of reforms reveals that the true cause of recovery has not been the cumulative impact of radical measures. The initial "shock therapy", engineered by Balcerowicz's team, had a sharply negative effect on production, and it was precisely the restrictions on original policies that allowed the economy to turn around. Poland is thus a good illustration of my model, which claims that state over-withdrawal—as well as the radical reforms that led to a sudden decline in state's capabilities—are to be blamed for the initial recession and that a return of the state, in a largely changed form, is to be credited with restoring positive growth.

There can be little doubt that not long after Poland's first post-communist government elaborated its first radical measures, many of them were already being slowed down or reversed by the team of Balcerowicz itself. Some members of the government bitterly complained about this relaxation in radical reform, but in the face of a drastic fall in production clinging to the moral or rhetorical high ground was impractical. Importantly, as a sign of relaxation, considerable deficits were allowed to accumulate early in the first round of reforms after the production of a very high budget surplus; this was seen as one of the highest priorities. Fortunately, non-inflationary methods of financing deficits were found by turning to the country's still-state-owned banks and, accordingly, increasing the state debt.

The same government, with its roots in the anti-communist opposition, also made the decision not to relax Poland's remaining price controls on certain major goods, particularly energy. The state also retained control over certain goods which figured heavily in household budgets, i.e. rents and electricity, in order to protect low-income groups, including pensioners. When the prices for other goods, now liberalized, became stable, the state made periodical adjustments regarding the maximum levels set for the controlled prices. While these state price corrections became one of the major sources of inflation, accounting for one-third to a half of the total increase as late as 1994–95, they also prevented the overall level of prices from spiralling out of control.

In addition, the initially endorsed policy of keeping the economy as wide open as possible was quickly modified. As early as the second year of the transition tariffs were, on average, tripled. This brought them back to a relatively high level. In certain sectors, protectionism reached prohibitive levels—such as in car production, where total payments (tariffs, taxes, import surcharges, etc.) reached half the value of the imported goods. These protectionist measures had a strongly positive impact on the car sector, which quickly showed a recovery, itself a great stimulant for the whole of manufacturing. Quantitative barriers were introduced as well (though on a very limited scale) mainly in the agricultural sector. These were represented by a small though critical peasant party with origins in the communist era. These restrictions greatly limited the inflow of competitive foodstuffs and—combined with price supports—helped in reviving farming production.

It also became clear, quite early on, that the government would be unable to proceed with rapid privatization given that very few state-owned companies were sold in the first two years. The procedures chosen for divestment—i.e. private offers—proved very costly and time-consuming. Meanwhile, other methods which could be implemented more quickly, such as distributing assets free of charge, failed to obtain the necessary parliamentary support. To support public tenders the road was opened for leveraged buyouts by enterprise collectives. The costs of these were to be paid in multi-year instalments, but these applied mostly to smaller entities. This stabilized property rights and, with greater assurances of personal gain, managers—and workers—turned from asset stripping and ordinary waste to efforts aimed at maximizing the capital value of their companies, thus further helping the economy to recover.

Non-recessionary transition: retaining a coherent growth-oriented state

Of all the factual challenges to the conversion theory, the most important, as earlier indicated, seems to be that it fails to explain why China has avoided recession. If it is really impossible to exclude China from the sample then we should ask ourselves how it is that, despite its initial imbalances, China has been able to produce strong—and well-balanced—growth. To answer this question one would have to modify the conversion theory or seek an alternative theoretical model, general enough to encompass this important case as well. The theoretical challenge here is thus to explain what form of deregulation allows precisely a non-recessionary—even expansionary—pathway to be assumed by a transition economy.

In determining which approach to reforms matters, it is best to examine policies adopted in economies showing the greatest contrast in performance; this makes China not the least suitable but the most appropriate case to work with. When this comparative approach is taken, there can be no doubt that what most

differentiates China's transition from East Europe's is not so much its economic structure or political differences but their respective policies. China emerges from such a comparison as almost the opposite to the radical set of reforms executed in Eastern Europe—it is the only case (save, possibly, for Vietnam) where a gradual approach to reforms has been tried. If this is so, there indeed cannot be any other factor but policy differences to account for the contrast in the economic performance of China and Eastern Europe—meaning that conversion, even if unavoidable, does not have to produce recession if gradual steps are taken.

The contrast between China and the rest begins with the general philosophy of conducting reforms. It is important to note that, unlike in Eastern Europe, the government of China has never produced specific programmes for reforms, nor has it outlined a fixed timetable for various elements of reform. Instead, China's government has engaged in a casual process where reform steps have been initiated in response to the pressing needs of the day. In this way, China has not wasted its energy by pushing through programmes that fit an end-model as outlined by the reformers; thus it can focus on solutions that will immediately benefit its economy. Also, by leaving its reform process unscheduled, the Chinese government has made it easier for itself to reverse any steps which prove to be premature or ill-directed. This is because programmes that are not well-defined do not have to be implemented according to a deadline and at all costs by politicians who are involved in a reform process.

The other difference in philosophy refers to the concern by reformers with regard to the social implications of their programme. In contrast to Eastern Europe, the Chinese government has decided to reform the economy while keeping a social compact intact. In particular, it has chosen to ensure that industrial workers will continue to receive their privileges and that the socially excluded will be protected from falling into poverty. For this reason, China has given priority to economic growth rather than to reforms, making sure that reforms are pursued only if they allow the economy to keep expanding. Consequently, reforms have had to be kept in check, while in Eastern Europe governments chose to give preference to reforms, trying to legitimize themselves on the ground that they are the most eager to change the system. Economic growth was given less attention and, if necessary, sacrificed for reforms, and with this the inherited social compact was revoked and higher human costs permitted as well.

These differences in general approach are reflected in the differences between all important aspects of actual reform programmes, including price liberalization and macroeconomic stabilization, of which freeing of prices is a part. Without exception, the economies of the former Soviet bloc, with varying degrees of hesitation, engaged in the immediate removal of state controls on the prices of most goods. This approach exposed hidden levels of inflation and produced higher inflationary expectations which took prices levels beyond simple conversion. China, in contrast, adopted a dual-price system for similar goods, allowing the share of

supplies—subject to demand/supply price setting—to increase at a slow but steady pace. When it found it appropriate, the state would re-impose price controls to prevent the appearance of monopolistic practices and/or wild speculation that might have pushed inflation beyond acceptable levels. This explains why China has been able to liberalize its prices without causing excessive inflation.

Unlike other transition economies, China prepared its economy for price deregulation ahead of time by investing heavily—via the public budget—in bottleneck sectors (Naughton 1995). In Hungary and Poland, where investment was seriously decentralized by bringing banks into the financing process, such bottlenecks were tackled more successfully than in other late-communist Eastern European economies. This practice of China's government has continued alongside the process of freeing prices so that the state has retained an active role in investment. The supply-side of price reform has been further aided by the fact that, unlike elsewhere, the Chinese economy has grown rapidly and continuously throughout the transition, thus generating enough resources for a smooth relaxation of supply constraints.

In Eastern Europe, reformers decided to deal with excess demand—and forced savings—by letting prices increase, but in the process they almost wiped out household deposits. The region entered into transition with depleted private savings and a greatly reduced propensity to save (with inflation itself being one of the reasons behind this). Apart from China, no economy has seen a major absorption of the excess money supply—inflationary overhang—by shifting income from consumption to savings. China has not utilized privatization (nor bond issues) for this purpose, but Eastern Europe has not raised much government income through sales of assets to its citizens either. China, however, has dramatically increased personal savings through a combination of coercion and incentives—which explains why inflation has been low in China despite the considerable deficits maintained by the state.

Former members of the Soviet bloc quickly revealed the existence of repressed unemployment by eliminating their state assistance to industry and at the same time suddenly exposing enterprises to increased competition. Unemployment immediately soared in these economies, as in East Germany, where, if those forced into early retirement are included, the rate of unemployment immediately rose to about 40 percent, with West German subsidies going not into job creation but mostly into welfare payments. In Poland, with a similar lack of concern for jobs, actual unemployment—with early pensions and increased "hidden" unemployment in farming—went up to 30 percent. China has avoided high unemployment in part by protecting its public sector industries and actually allowing them to grow, and as a result scores of jobs have been created during the reform (with no special incentives for companies themselves to cut jobs).

To sum up, the transition in China has assumed a different path from that seen in the other former communist countries, with an active state removing controls at a measured pace. This measured withdrawal strategy in China has been

combined with the application of various complementary state measures—such as regulations—that have helped to mitigate hidden imbalances. Such an approach has allowed China not only to spread its conversion more evenly over time but also to resolve some of the hidden imbalances without ever releasing them into open. This strategy, together with other factors, explains why the Chinese economy, alone among the transition countries, has been able to sustain positive growth. This in itself has been an important factor in helping it to defuse hidden imbalances in a smooth fashion without forcing them fully into the open.

Concluding remarks: recession and recovery explained

The principal lesson from this analysis is that an effective state agency is indispensable for any successful transition away from communism. This is due to the simple fact that, at the outset, what these economies have had in terms of an organizing principle is the state, as the coordinator of decisions and the owner of the means of production—both combined in one powerful agency. That this obvious fact has been ignored by the reformers is a truly remarkable example of miscalculation (or, if one takes a less benign position, of the irresponsibility of the post-communist elite). To avoid wrecking the economic system and thus preventing an early slide into recession, the state must slowly relinquish these two functions. By the same token, the phasing-in of market forces also has to proceed slowly.

The additional reason for assuring an effective state during the transition process is equally obvious, for it is the state that has to execute the measures needed for the transition process to proceed successfully. If the task for the state was to eliminate the state than the just-mentioned need for an effective state would have obviously been immaterial. This is not the case, because no economic system can dispense with the state, and consequently transition cannot mean that the state is reduced to a bare minimum. Instead, a reform of the state is needed. This makes the role of the state as a reformer—the agent of transition—particularly problematic, since while reforming the system the state has to reform itself as well.

While all transition economies that suffered from early recessions did so for the same general reason—a crisis of the state—the particular forms of this crisis differed from country to country. There is a direct correlation between the various forms of state crises in these countries and the intensity of recession that occurred. Specifically, recession has been less drastic in countries where the state initially over-withdrew in an organized fashion, without losing its capability to manage the economy, than in countries in which similarly radical reforms were executed in a disorganized fashion. At the same time, for any pair of economies belonging to an organized or chaotic variant respectively, the country where the general approach

to reforms has been less radical has performed better than the one with a more radical range of measures.

The countries of the ideological model (Hungary and Poland), that is, where the state's capacity was generally damaged less—given that the reforms were relatively muted and conducted in an organized way—are also those where recession was the shallowest of all. At the other end of the spectrum are the economies in which more radical measures were executed in a chaotic fashion (the "collapse" model, exemplified by Russia and Ukraine which, respectively, had the worst economic performances of all, if measured in terms of cumulative losses). My analysis thus does not disagree with the conventional perception with respect to which countries have been less scarred by recession and which have been hurt more. It is different, because it finds Hungary and Poland not to be the most radical reformers but the most cautious ones, while categorizing Russia and Ukraine as the most radical. In addition, it finds the latter also to be the ones that allowed their reforms to run off course, which, for example, caused the Russian and Ukrainian economies to suffer so much more.

At the same time, the most successful recoveries have taken place in those countries where the return of the state has been easiest. Countries whose state capacity was initially less damaged did relatively better. Poland, for example, where the state over-withdrew for conceptual (or ideological) reasons but retained its basic cohesion during the entire process, was in a favourable position to assume recovery. For the state to regain its resolve in Poland, a shift in attitude—and personnel—was necessary, and it took reshuffling at the governmental level (the removal of Balcerowicz's team) to bring this change about. On the other extreme one finds Russia and Ukraine: here, the state immediately fell into disarray and the process of rebuilding the state was more problematic. In fact, this process has not yet been completed, which explains quite clearly why no economic recovery has occurred in either country yet.

Not surprisingly, when we look at the countries in which there was an organized state over-withdrawal, those with more restrained reforms, including Hungary and Poland, have been less economically damaged than those in which steps were of a more radical nature, as in East Germany (and initially in Czechoslovakia, and later after country's disunification, in the Czech Republic). East German reforms have been more radical not only because those in charge wanted to accomplish more change but also because, in this case, the state which was executing reforms had greater capabilities. In the East German case, the over-withdrawal of the state was executed by the coherent West German state apparatus, which was perfectly ready to embark on truly radical measures (leading some analysts to call this model an "instant transition").

It is the presence of a well-tuned West German state that allowed for quick substitution of the damaged East German state, which, in turn, produced the fastest recovery of all the countries in Eastern Europe. While the East German

recession was much deeper than in Hungary and Poland, it was also much shorter than elsewhere. In Poland it took twice as long for the economy to recover, and in Hungary twice as much time as in Poland was needed to accomplish the same; but while slower, their recoveries have proved to be much more successful. While Poland has already exceeded its pre-crisis production level, and Hungary is close to reaching this point, East Germany is far away from undoing its recession. While East Germany has on occasions slowed down, the other two countries have shown relatively uninterrupted production growth. It thus appears, quite paradoxically, that Hungary and Poland have been more successful in restoring their respective state to an appropriate status.

Similarly, Bulgaria and Romania, with less aggressive reforms, have performed better than the exceptionally radical Russia and Ukraine, also in the category of disorganized withdrawal. On the one hand, Bulgaria and Romania engaged in chaotic reforms that wrecked their respective economic systems, but the state in both countries has not completely lost its cohesiveness. While all these four states have been submerged in corruption, in Russia and Ukraine the states—infusing themselves with corruption—have virtually disintegrated. Left without much state control, reforms in Russia and Ukraine have assumed a radical and, quite obviously, chaotic character. Given this difference in state capabilities, and a related degree of disorganization, it is not surprising that production losses in the corrupt model of Bulgaria and Romania have been only half of those experienced by Russia and Ukraine, which represent the collapse model.

Turning to the recovery, it is also clear that with a less-damaged state Bulgaria and Romania have been able to restore economic growth before Russia and Ukraine. In the former, the state, under proper political leadership, could still have been mobilized for launching policies that would benefit the national economy, while fulfilling the private needs of the officials involved. However, due to the extent of official corruption, mastering a robust recovery has proved to be an onerous task. Instead, both Bulgaria and Romania have seen their recoveries suspended. They have recently entered into a second recession, though not as damaging as the first one. Russia and Ukraine, with no effective apparatus to speak of, have failed to end their initial production downturn—and just recently, in the eighth year of transition, they experienced a further decline.

These conclusions are derived from a broad comparative analysis which includes the experiences of economies such as East Germany and China, both of which are usually overlooked by students of transition (with the notable exception of analysts working on China's economy). These two examples are in many ways different from other cases of transition and thus possibly cannot be replicated. It cannot, however, be denied that they belong to the general sample of the once-communist economies engaged in transition. Thus, these two should not be excluded, and the very contrast in question is exactly what makes these two countries particularly

instructive, at least in terms of positive rather than normative (prescriptive) work on post-communist transitions.

The case of China is particularly telling, for its economy, while starting from more or less the same initial conditions, is (possibly next to Vietnam's) the only one that has managed to completely escape recession; in fact, it has experienced unremitting and rapid expansion. Any theory of post-communist recession has to be able to explain this sharp contrast between recession-ridden and growth-oriented pathways of transition from communism. While this proves that there exists a certain path of transition which can steer an economy away from early recession, the question is: what factors account for this road to capitalism? The principal feature of such a path requires that the state remains robust while, at the same time, it uses its authority to carefully execute its own eventual reconfiguration into a market-friendly agency.

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A NEBBISH PRESENCE: UNDERVALUED CONTRIBUTIONS OF SOCIOLOGICAL INSTITUTIONALISM TO IPE

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Sociological institutionalism is unequally present in International Political Economy (IPE) and even when it is used little explicit attention is given to it. It is as if it were not there. This article argues that this nebbish presence is regrettable. Explicit attention to sociological institutionalism could further the theoretical and empirical development of IPE. Theoretically, sociological institutionalism offers concepts for linking up different social spheres and for thinking about the vertical and horizontal levels of governance. Empirically, sociological institutionalism advances the understanding of phenomena at the heart of IPE such as states and firms. It provides frameworks for understanding of the normative and social settings of economic practices. It also offers ways of moving towards an understanding of firms as social and political actors.

In the 50th anniversary issue of *International Organization*, the editors state that International Political Economy (IPE) has been little touched by the constructivist turn in International Relations (*Katzenstein, Keohane et al.* 1998: 675). This study will argue that this assessment is misleading. Even if its presence continues to be timid, and often grossly undervalued, sociological institutionalism occupies a growing space in IPE and raises issues and makes claims which are consonant with those made by "constructivists" in IR. This study argues that much stands to be gained from making this presence more visible and assertive.

Institutionalism is pervasive in contemporary IPE. Economic/rational choice institutionalism has become central to mainstream research in IPE; regime theory (Keohane 1984), European integration (*Moravcsik* 1998), trade policies (*Rogowski* 1989) and foreign investment (*Dunning* 1988) are some of the subjects that have been studied with the help of economic institutionalism. Similarly historical institutionalism is referred to in the discussion of the state (*Halliday* 1987; *Krasner* 1988; *Hobson* 1997). In contrast, with few notable exception,[2] sociological institutionalism is rarely explicitly discussed except as it relates to other forms of institutionalism.

The neglect of sociological institutionalism in IPE is regrettable. However, innovative IPE may be compared to international relations and international eco-

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[2]See the work of John G. *Ruggie* (1982; 1998) which relies heavily on Karl *Polányi*.

nomics, frustration is growing among IPE scholars with the apparent incapacity of the discipline to accumulate and develop (e.g. Hobson 1997; Keohane 1997). Meanwhile IPE is chastised by outsiders for its lack of theoretical rigour and adequate theoretical frameworks. IPE scholars are said to overstate their points (*Wade* 1996), to be simplistic in their interpretation of globalization (*Esping-Anderson* 1996; *Huber and Stephens* 1998), and to focus exclusively on globalization to the detriment of other (possibly more important) factors of change (*Andrews and Willett* 1997). Unfortunately, theoretical rigour is often equated with economic approaches and the importance of preserving IPE as a "space of openness" (*Helleiner* 1994), rather than turning it into a Procrustean discipline (*Strange* 1998), are brushed aside.

In this context I would argue that sociological institutionalism offers IPE an excellent opportunity to develop without compromising either its interdisciplinarity or its theoretical openness. I develop this argument in three steps. The first section introduces sociological institutionalism and shows how it can deal with two central theoretical problems in IPE: the relationship between different spheres of social life and the conceptualization of diverging spatial levels—global, national, local and international. The following two sections illustrate the contribution of sociological institutionalism to two specific issues: respectively, the changing nature of states and of firms.

Sociological institutionalism: assumptions, concepts and frameworks for the study of IPE

Sociological approaches to economics, also called economic sociology (*Swedberg, Himmelstrand* et al. 1987), centre on the social embeddedness of economic activity. The term "embeddedness" derives from Polányi (1957) who, contrary to the economic (objectivist) tradition, argued that market relations are by no means natural or present in all societies, but rather remain contingent on the social context. The vast majority of present work in this tradition draws on neo-institutionalist perspectives—hence the label sociological institutionalism.

The core of neo-institutionalism consists of an interest in how institutions shape, and in turn are shaped by, different social spheres, including the economy (*Immergut* 1998: 25). Beyond this, the different strands of the various neo-institutionalisms provide sharply diverging answers to fundamental questions such as: how institutions are to be studied, what counts as an institution, and what the relationship is between institutions and their environment and institutions and actor behaviour. In answering these questions, it is common to distinguish three traditions of neo-institutionalist thought: economic or rational choice, symbolic or sociological, and historical (*Hirsch, Michaels et al.* 1990; *Powell and DiMaggio* 1991; *Hall and Taylor* 1996). The focus of the first group is on individual choices

according to set preferences and is often the target of explicit criticisms by the second and the third groups who contest its ahistorical, utilitarian materialist, and/or individualist bias.

Sociological institutionalism has more in common with historical institutionalism—often synonymous with historical sociology—than with rational choice institutionalism.[3] The first two work in an essentially neo-Weberian tradition. They are interested in path dependence, organizational bias and rules which structure the context of decisions. Compared with historical institutionalism, however, sociological institutionalism places a greater emphasis on non-materialist aspects of institutions, viewed not only as socially, but also intersubjectively constructed. Its research on these intersubjective meanings focuses specifically, but not exclusively, on the common sense of the day, on shared understandings and practices which inform human action in society. Consequently, "institutions" in sociological institutionalism include world-views, cognitive maps, codes of behaviour, discourses, symbols, or mental frames. This raises question about how institutions develop and change, and how they shape, for instance, identities, interests, behaviour, firms strategies, systems of production, states, or politics.[4] Contrary to the individualism of choice theoretical approaches, in sociological institutionalism social reality is seen as logically and empirically prior to behaviour: it provides reasons for action, as opposed to constraints or causes; it defines identities and hence actors' interests (Ruggie 1998: 22). As opposed to materialist approaches, sociological institutionalism stresses that behaviour, identities and interests emerge through shared understandings of social reality and are not mere epi-phenomena of some underlying material reality. They play a part in shaping this reality.

Theorising political economy in IPE: conceptualising the relation between social spheres

Scholars in IPE, whose basic assumption is that economic relations cannot be analysed independently of the political setting, should be naturally inclined to use approaches which stress social embeddedness. After all, the ideal of the "perfect market" is the product of institutions, and when markets are not perfect, they display power relations. Indeed the market is an institution of political power.

[3] However, there can be very fruitful interchanges between sociological and rational choice institutionalism as illustrated by the collaboration between Pierre *Bourdieu* and James *Coleman* (Coleman and Bourdieu 1991) in connection with the concepts of social and symbolic capital.

[4] This wide definition of institutions is vulnerable to the critique that the concept has been rendered vacuous by the expansion of its meaning to include almost everything (*Pontusson* 1995: 125). Institutionalists reply that since the definition of an institution is part of the issue to be studied there can be no prior definition of the term (Immergut 1998).

Economics is therefore about politics, and politics is more than some struggle in the government apparatus.

In other words, since its inception IPE has been confronted by the issue of how to relate different social spheres to each other. More specifically, it has dealt with how to avoid the Scylla of "over-embedding" the economy by seeing it as only socially/politically determined, and the Charybdis of "under-embedding" it by downplaying the influence of social institutions on economic relations. Moreover, it is precisely here that sociological institutionalism has something to offer. Studying how the economy is tied to other social spheres is at the heart of sociological institutionalism. This, in fact, is the essence of embeddedness (Swedberg, Himmelstrand et al. 1987: 178).

Bourdieu's influential theory of social fields might serve as a good illustration.[5] Bourdieu's starting point is the understanding of social power and stratification. His ambition is to develop "a general theory of the economy of symbolic goods and its relation to the material economy" (*Brubaker* 1985: 87). He argues that social practices form a unity. Even practices, such as lifestyles, music and food tastes—which are usually considered devoid of direct material purpose—are "economic" in that they are part of the strategy of capital accumulation in a broad sense. In a Weberian vein, Bourdieu insists that not only (material) capital is a determinant of power relations but so too is capital based on symbolic (social and cultural) resources. Concretely, this leads him to study rules governing different spheres of social life and the resulting "strategies" for accumulating different forms of capital (economic, social and cultural); these are partly and imperfectly transferable from one "field" of social life to another.

Fields are defined by Bourdieu as a set of (normal, habitual, routine) practices which, in turn, can be understood on the basis of a set of socially and historically informed and shared dispositions—Bourdieu calls these the "habitus". These dispositions translate past experiences into schemes of perception, thought and action; in turn, these suggest the individual behaviour which would conform to the usual practices in the field (Bourdieu 1980: 91). Fields are interlinked, and individuals are part of several fields at any given time.

By looking at the "habitus" and the practices in different fields, Bourdieu explains diverse strategies of capital accumulation which then allow him to paint a rich picture of social stratification and power relations well beyond classical Weberian limits. Similarly, these strategies are not conceived in terms of calculated interdependent decisions, but as behaviour positively sanctioned within the practices of a field and internalised by the individual: it is strategy "without strategic calculation".

[5] For an application of Bourdieu to the study of power in international relations, exemplified by a study of the second gulf war, see (Guzzini 1994: Chap. 11 in particular).

Rather than providing a theory in the sense of a set of casual propositions which specify the conditions under which certain links occur, Bourdieu (again a heir of Weber) offers a conceptual framework for identifying the links between different social spheres and for studying them empirically. He does not believe in the possibility of a more general theory. According to him, there is no *a priori* given hierarchy among different forms of capital. Their relative value differs from field to field and from society to society.

The relationship between different forms of capital is therefore to be determined empirically. Thus, in *Distinctions* (1979), Bourdieu provides a detailed description of the relationship between economic, social, and cultural capital in different fields of French society and shows how they fit together to form a social hierarchy. In *Homo Academicus* (1984, dealing with the university system) and *State Nobility* (1989, dealing with the state elite) he shows how, within single fields, the relative value of different forms of capital have changed and how actors, as a consequence, have adopted their strategies. This open-ended view on embeddedness is very useful for IPE scholars. It allows for a contextual approach to embeddedness which seems particularly important since IPE purports to study political economic realities spanning over a great number of contexts.

Theorising the "international" in IPE: vertical and horizontal levels of governance

Sociological institutionalism also grapples with a second key theoretical issue for IPE: the link between different "levels" of the global political economy and the artificial dichotomy between the state and the global (*Palan and Gills* 1994). The "two level games" solution (*Putnam* 1988; *Evans, Jacobson et al.* 1993) is clearly not satisfactory for IPE. Its focus on the relations between policy-makers and their different constituents leaves no room to structural forces. Moreover, since the theory looks at the international and the local separately (or *vice versa* it can account only for international phenomena; not for "global" ones. Needless to say, the two level games theory does not provide any convincing way of accounting for the (sub- or supra-national) regional level.

Sociological institutionalism can provide useful insights into the debate, mainly through the (French) regulation school and (American) studies of governance. Both have conceptualized governance in a way that makes it possible to understand the complex relationship between the respective transnational (or global), state and regional levels in shaping the regulation of the economy.[6] The shared aim of scholars

[6] Palan (1999) rightly points out that not all regulationists fit the following account. Some scholars have simply adopted a realist conception of the international and hence have failed to properly integrate the global into their accounts, let alone theorize how this integration could be accomplished.

from both traditions is to develop an understanding of the economy in terms of the "rules of the game" as set by the social institutions which govern economic life. It is worth pointing out that both schools of thought are part of sociological institutionalism because of a shared "constructivist" view of social institutions. Both are increasingly focusing on discursive practices, the construction of identities and of interests in the economic spheres (*Boyer* 1990). Similarly, the interest in linking the local and the global does not stem from abstract theoretical concerns, but from the obvious fact that the economic sectors, sub-sectors, regional clusters or production networks operate at different levels concomitantly. This has left scholars with no choice but to integrate "global" and "local" in their study of regulation/governance.

The result is not a general theory, but frameworks of analysis for the study of the global and the local. Indeed, the link between the global and the local is neither uniform nor unidirectional. The different levels are "articulated" with each other: they influence each other but continue to display a certain independence. Moreover, the weight of different levels of governance/regulation varies between sectors, sub-sectors, production-networks and countries (*Mytelka and al* 1985; *Hollingsworth* 1998). One illustration can be found in Lynn Krieger Mytelka's (1988; 1993) studies of the changing regulation of international production and the effects of this on different industries. She has analysed how changes in the textile industry, which are largely global in nature, have impacted upon individual countries and their policies, and where differences in national institutions have played a considerable role.

These frameworks make the integration of different spatial levels an inevitable part of the analysis, avoiding the pitfall of an artificial separation of the national and global realms, and also not making the mistake of pretending that the regional and national levels are of no consequence.

The changing nature of the state and the globalisation of legitimate economic practices

Sociological institutionalism is central to the move in IPE away from sterile questions about "the end of the nation state" and towards more fruitful ones about the ways in which globalization is changing political practices.[7] I will make this

[7] The debate about globalization and the role of the state today is in fact very rich. Notwithstanding the critics, "globalization" research does not purport to show that economic integration is leading towards the disappearance of the state, increased equality among countries and a convergence of prices in national markets (*Hirst and Thompson* 1996; Wade 1996; Huber and Stephens 1998; *Weiss* 1998). Even those IPE scholars most frequently quoted as defending such absurd claims (*Cerny* 1988; Strange 1996) actually argue that the nation-state is not about to disappear,

point with reference to two research tracks of sociological institutionalism which are directly overlapping with IPE.

Sociological institutionalism focuses on the embeddedness of human action. Applied to IPE, it looks at the social embeddedness of the global political economy. The global political economy, in turn, is viewed not simply as a system of more or less well-governed and efficient markets, but as something which consists of a number of overlapping sets of practices that rely on a certain self-understanding and distribute different forms of capital among social actors, hence empowering some over others.[8] Applied to the central relationship between the state and the global political economy, concrete research programmes in this tradition therefore have at least two aspects. First, they focus on shared or taken-for-granted understandings of the nature of the global political economy. Here, sociological institutionalism follows lines similar to those which investigate the so-called "Washington consensus" in IPE. Second, they examine the practices of those groups of actors empowered (i.e. legitimated) by such shared understandings. At this point sociological institutionalism overlaps with the literature on "epistemic communities" in IPE.

Research Track 1. The normative setting of economic practices: exploring the Washington consensus

The "Washington consensus" is a shorthand for the conventional wisdom about the most efficient government action in the present global political economy. IPE scholars are increasingly aware that this kind of shared "common wisdom" is of crucial importance. Constructivist scholars have convincingly argued that the impact of common wisdom cannot be reduced to the constraints posed by the institutions that embody it. Rather facts (e.g. about the global economy) and interests (e.g. defining the strategies of states) are themselves intersubjectively constructed. Consequently, one strand of IPE research centres on the extent to which changes in the ideas about what is feasible and sound have shaped "globalization" and state strategies. A few examples will illustrate the point.

To begin with, there is considerable research on the ideological and organisational origins of such transnational consensuses. This is important for understanding why change in normative settings takes place, as well as to clarify who benefits and loses. In contrast to much of the work in the constructivist tradition, explanations deriving from sociological institutionalism usually venture beyond the realm of discursive constructions into the economic and social structures. This is no doubt the reason why they have been smoothly integrated in IPE.

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but is changing in nature, that there is growing inequality among states, and that there is no reason to believe that prices will somehow converge.

[8] For a very clear general statement of this point see Bourdieu (1997).

The work of Evans (1997) and *Dezalay and Garth* (1998) reflects this strategy. Dezalay and Garth explain the emergence of the "Washington consensus" in terms of the construction of economics as a neutral, technocratic, mathematical science where "it takes a model to kill a model". They explore the interests and the strategies of economists who have managed to carve out for themselves a niche that secures jobs, funding and status. The shift to neo-classical economics grounded in econometrics is understood as one such possible niche in a context which has been predominantly Keynesian and largely "verbal". Dezealay and Garth show how this niche was carved out and developed within US academia through a reliance on media, links to business-life as well as through the control of academic institutions. Similarly, Evans (1997) explains the Washington consensus by the parallel development of neo-liberal economics, neo-utilitarian state theories, and "civil-society"-centred theories of politics. An unsophisticated neo-utilitarian state theory, combined with the focus on the new civil society, has complemented the neo-liberal turn in economics, serving to de-legitimize more generally state intervention in the economy and politics at the state level. As Evans underlines, these theories often move towards self-fulfilling prophecies as they tend to result in an exclusive focus on state failures and to deprive the bureaucracy of its economic and social status.

Both accounts move beyond the focus on academic debates to underscore that the impact of these ideas can be explained only by reference to their place in a wider context. Dezalay and Garth (1998) place these shifts in the broader context of the changing nature of the economy—i.e. the globalization of finance and production—and the related increase in the political strength of the Washington institutions (i.e. the IMF and the World Bank). These changes have made private business, with an interest in models for reducing uncertainty as well as in further deregulation and state withdrawal, more influential both in academic life and in politics.[9] They also point out that the replacement of Keynesianism with liberalism as the dominant view within the Bretton Woods institutions themselves has been greater because the conditionality and reports of these institutions were immediately reflected by private markets. Likewise, Evans sees the immediate, though possibly not long-term, interest of international economic actors (e.g. MNCs and financial market operators) in supporting further deregulation and liberalization as a fundamental reason for the establishment of the Washington consensus.[10] In fact, he suggests that the possible limits to state decline stem from the risk that if this decline goes too far then the stable, predictable, law-abiding environment which is essential

[9] See *Bourdieu and Waquant* (1998) for an elaboration of the importance of US foundations in spreading the ideas. They fund both "scientific" and NGO work on issues which are conceived according to the prevailing understanding of social and economic sciences

[10] On this theme, see also *Fligstein* (1997)

for business will disappear and business consequently will cease to support further liberalization, deregulation and state withdrawal.

Once established, the Washington consensus informs both the identification of problems and their solutions. This shift to a "market civilization" legitimises a set of practices whose ideological effect has been a central theme of Gramscian IPE (*Gill* 1995) and was also a focal point of the late Susan Strange (1990). The Washington consensus constrains policies directly through the pressure of international and national financial markets, central banks, credit rating agencies, or conditionality. There seems to be what Gill refers to as a "new constitutionalism". That is, the explicit or implicit conditionality imposed by international actors regulates and constrains politics in much the same way as national constitutions (Gill 1997: 215).[11] The consensus, however, is not only felt as a constraint, for it alters the way actors conceive of their interests, what is feasible, what is a problem and what is not. *Hirschman* has repeatedly pointed out the significance of underlying understandings for the policies adopted, and the implications in terms of incapacity to solve problems (see Hirschman 1967, on inflation in Chile) or of even thinking about solutions (see Hirschman 1981 on the debilitating effect of dependency theory). It is increasingly common in IPE to explain policy-choices partly in this way—i.e. with reference to the changing world views of actors. Thus, the repatriation of US trained economists with different world views has been used to explain fundamental shifts in policy orientation such as the opening up of the Swedish financial markets (*Korpi* 1992) or the closing of the Korean Central Planning Board (Weiss 1998).

By the same token, changes in the dominant understanding of the relationship between the state and the economy affect who is a legitimate political actor and what legitimate politics are about. This leads us straight onto the second research track where sociological institutionalism has been of consequence for IPE.

Research Track 2. The social setting of economic practices: exploring the diffusion of politics

Shared world views empower actors "in the know" and disempowers others. In examing this process empirically, sociological institutionalism joins IPE scholars concerned with the bearers of ideas, their organisation and institutional setting. In the case of the establishment of the Washington consensus, the two groups which have been most studied are those of policy-makers and private actors respectively, who pushed for the turn to neo-liberalism and who have acquired increasing political influence as a result of it. In studying the first group, sociological institutionalism

[11] Of course, the significance of this pressure may be exaggerated by governments who wish to use it to legitimate and push through otherwise unpopular policies (*Hirst and Thomson* 1995).

clearly overlaps with IPE scholars' interest in "epistemic communities" and the role of norms in policy-making. In working on the second, it overlaps with IPE studies of the "diffusion of power" and the increasing importance of private, often corporate, actors in politics.

First, in the shift to a new dominant understanding of the role of the state in the economy, the focus of much recent research has been on policy-makers, or more precisely the networks of experts and policy-makers usually referred to as "epistemic communities" in IPE (*Haas* 1992). The question here becomes which networks of policy-makers carry a particular set of ideas and how they manage to impose these in a given situation. Such studies invite investigation of policy-making practices and, in particular, of the role that norms play. In returning to these issues IPE scholars (*Trentmann* 1998) have thus joined IR scholars more generally (*Finnemore and Sikkink* 1998) and have moved closer to sociological institutionalism.

Sociological institutionalism has contributed to this literature by demonstrating the way ideas are "imported" and adjusted within national fields of economics and the economy.[12] Consonant with a sociological approach, the analysis does not de-link the analysis of ideas from the social groups who share them. *Lebaron* (1997a), for example, analyses the "field" of professional economists in France in the 1990s, showing the role imported ideas, funds, and positions in the international scientific community play in the field of French economics and in the "strategies" of French economists. In particular, he emphasizes the importance of an international status for those French economists who are not well linked up with national networks—that is, those who do not come from the Parisian faculties and lack prominent positions on editorial boards and other scientific institutions, and who need to establish themselves from the outside. Further, he shows the weight of international ideas and institutions in his study of the reform of the legal status of the French Central Bank (in 1993) aimed at making the bank more independent of government. Here "new constitutionalism" was central. A key impetus for the reform came from the Maastricht treaty. But beyond this, the pressure of international markets and the changing reference points of central actors who "only place themselves on the transnational level" (Lebaron 1997b: 89) played a central role. Similarly, in her study of the ruling elite of Brazil, *Loureiro* (1998) shows how foreign education is fundamental both in constituting identities and networks and as a symbolic resource for imposing politics (for a similar study in the French context, see *Lezuech* 1998). Finally, it merits underlining that the integration of the international consensus can also be negative as in the cases where the policy expert networks are defined in opposition to the dominant consensus, as is often the case with Islamic economic strategies.

[12] These fields are still largely national because of the central role played by the nation-state in the past and the present in funding, organizing and regulating academic production.

As these examples illustrate, sociological institutionalism is closely related to, and in effect overlaps with the concerns in IR and IPE about policy-making networks and tends to study them much in the same manner. In fact, it is difficult, if not impossible, to separate work in IPE and in sociological institutionalism on this topic.

The same goes for the study of the second group of actors which has been empowered by neo-liberalism: the private actors. Indeed, as Strange repeatedly insisted (including in her last piece, see Strange 1998), it would be a serious mistake not to account for the increasing role non-state actors play in politics. In part, this role is adopted simply by virtue of the changes that are taking place in the international economy. As pointed out by numerous IPE authors, including Strange (1996: Part II), private actors such as accountants, credit rating agencies, banks, or for that matter, organized crime or drug dealers, play an increasing role in determining politics. They do not have a popular mandate for such powers, yet the changes in the way that the international economy is operating has made them extremely influential. For example, *Sinclair* (1994) shows how credit rating agencies dominate private and corporate policies simply because of the enormous importance of their evaluations. The aspect of this privatization, or diffusion of power—which sociological institutionalism is best equipped to deal with—is how it is accepted and legitimated.

Indeed, in parallel with the structural shift which has conferred *de facto* new political roles on private actors, the privatization of policy-making (which is increasingly placing politics either in the grey zone between the private and the public sphere or purely in the private sphere) has taken place. What is new about this privatization is the legitimacy and official sanctioning of private policy-making. Sociological institutionalists have been concerned with the way in which this has developed.

Two examples can illustrate this point. First, sociological institutionalists have examined the emergence and increasing importance of private regulatory institutions—that is, institutions in which public policy-making and the setting of rules is mandated to the private actors involved. PIGs (private interest government), or more respectfully SROs (Self Regulating Organizations), play an increasing role in a number of economic sectors (*Streeck and Schmitter* 1985; *Boyer and Hollingsworth* 1997). In a study of the emergence and increasing dominance of SROs of financial markets, Coleman (1994) stresses the importance of the changing perceptions of what is legitimate regulation. In particular he underlines the significant difference between the UK tradition, where state interference continues to be considered as illegitimate, and the US where "a (state) shotgun behind the door" is considered necessary. In looking at the spread of the "Anglo-Saxon" model of finance, he stresses the importance of international market pressures and the changing consensus among policy-makers. He further underlines the significance of national traditions for the concrete ways the model is copied and implemented.

Second, sociological institutionalism draws attention to the emergence (or existence) of governance practices consisting of a mixture of public and private actors. Again, conceptions of legitimacy have evolved and play a crucial role in the success of such forms of governance. Thus, in their study of economic policy-making in Russia, *Sabel and Prokop* (1996) stress the importance of the flexible, decentralized and private sector oriented policy-making, usually associated with post-fordist or flexible production forms. They argue that this is crucial both for creating competitiveness and because this is the policy both national and foreign firms consider legitimate. Similarly, in exploring the role of "deliberative associations"[13] in Central Eastern Europe, *Stark and Bruszt* (1998) underline the importance that these institutions be recognized as existing forms of economic activity and as legitimate sites of policy-making.

To sum up, this section has shown how sociological institutionalism has contributed to one specific aspect of the debate about the evolving role of the state in IPE: the role shifts in world views (e.g. the establishment of the Washington consensus) have played in bringing about changing roles for the state. The overall contention is that sociological institutionalism can provide important insights for understanding exactly how, and if politics is "uncaging" from the nation-state in different contexts (*Mann* 1993) and what, if any, of the traditional "functions" of the state are disappearing and becoming illegitimate in the process (*Ferge* 1999).

A less economic understanding of firms

Although themes consonant with sociological institutionalism have already been addressed in the discussion of political (state) phenomena in IPE, economic actors (such as the firm) are still understood primarily through the lenses of economic institutionalist in IPE. Yet, as the remainder of this article will argue, this neglect leads to an unduly restrictive understanding of the power relationships involving firms at the heart of IPE.

In a world where production is increasingly organized in global "webs" over which states at best have imperfect control, firm motivations and behaviour are of fundamental importance (*Reich* 1992). Firms play a central role in determining crucial political questions concerning jobs, income redistribution, taxes, welfare provisions, research and development, and environmental policies. Therefore, understanding the firm is a central part of any analysis that purports to ask political questions about the economy (*Stopford and Strange* 1991, Strange 1970; 1991; 1995).

[13] These institutions are deliberative because they involve negotiations; and they are associations because they refer to networks between the array of public and private actors concerned with any one issue.

That said, IPE scholars have chosen, on the whole, to examine firms through the lenses of economic approaches and particularly institutional economic approaches. The approaches to the firm and the behaviour of multinationals most commonly referred to in IPE, centre on oligopolistic market conditions, market imperfections and strategic behaviour (*Gilpin* 1975; *Kindleberger* 1979), on neo-institutionalism (Dunning 1988) and on product cycle arguments (*Casson* 1987). As argued by *Sally*, approaches which regard firm behaviour as originating from its embeddedness in a social and political context have largely been ignored (1994).

The adoption of an economic approach leads to a concentration on questions of efficiency. These questions are no doubt important but they tend to downplay the distributional, political and social aspects both of firm strategies and of their consequences. Also, they tend to misread the actual behaviour of firms, seeing it in strictly economic terms; this is a shortcoming particularly relevant for a discipline like IPE which started with the purpose of overcoming exactly such a bias.

Sociological institutionalists reject both the traditional economic view where firm behaviour is analyzed solely as a response to external market conditions, *and* institutional economic analysis where transaction costs are determinant. Instead, sociological institutionalism stresses the social construction of firm identity and behaviour. Firms are viewed primarily as social institutions. Firm strategies and structures are shaped by the internal social context of the firm: the behaviour of a firm is a consequence of its history, traditions, culture and internal power relations (e.g. personal rivalry, competition among divisions). Moreover, sociological institutionalists link their analysis of the firm as an institution with the environment in which the firm is embedded. This environment must be considered in terms of social, political, and cultural relations—and not only in terms of markets and economic factors, as neo-classical economics and rational choice institutionalism would have it. As a result sociological institutionalism is better than conventional economic analysis in dealing with questions such as: why do firms behave differently in similar contexts? Why do some firms adapt well to changing circumstances while others do not? Why do different firms have different structures and strategies in different contexts, and what are the distributional consequences of firm behaviour?

In his critique of transactions costs economics, *Granovetter* (1992) provides a succinct statement of the difference between sociological and economic institutionalist approaches. *Williamson* (1975; 1985) contends that the transaction costs (i.e. the costs due to the combination of bounded rationality, uncertainty, opportunism, and small numbers) involved in any transaction explain whether the transaction will take place through markets, hierarchies or networks. In his critique, Granovetter points out that Williamson overstates the uncertainty of most market transactions by ignoring the role of social relations and networks in which they are embedded *and*, conversely, overstates the smoothness of transactions within firms (hierarchies) by understating the problems of transparency and uncertainty in a bureaucratic institution. In some cases the importance of social ties for regulating exchange is

obvious—as, for example, in sectors dominated by family firms, minority groups or migrant workers (*Ben-Porath* 1980). However, Granovetter contends that social ties are important in a more general way. This is because they also shape economic activity in sectors where market relations guide firm behaviour and structure, precisely for the reason that they are at the origin of the shape that these firms and their market relations take (Granovetter 1990).

This kind of sociological analysis has been applied extensively to subjects of direct relevance to IPE. First, sociological institutionalists have employed their analysis of firms to explain broader political changes. Neil Fligstein (1991), for instance, explains the diversification strategies of large American firms by investigating power-holders (i.e. management and shareholders) and their capacity to impose their views. *Mintz and Schwartz* (1990) explain the increasing influence of finance and insurance companies over firm strategies in terms of the changing corporate cultures. Finally, Charles Sabel (1995) argues that the evolving discursive practices determine whether middle-level management will resist or adopt flexible production strategies. This is in turn essential for understanding the extent to which there will be an overall shift to new flexible, post-fordist forms of production.

Second, sociological institutionalism has been used to analyse how (changes in) the relationship between context and firms influence power relations in society. Thus, *Boltanski* (1981) shows the importance of the Cold War, a coalition of conservative politicians and the business elite for shifting management practices in France. He focuses on alterations in the world view of the French business elite and its impact on their business strategies. He argues that they have brought about a reorganization of the economy (and of the elite). Likewise, comparative work has underlined the importance of differences in socio-political contexts in shaping firm structures and strategy; these in turn, are directly linked to distributional issues in society. An excellent example is the work by *Hamilton and Biggart* on organizational forms in the Asian economies (*Orrù, Biggart Woolsey et al.* 1991; Hamilton and Woolsey Biggart 1992). They show the importance of cultural factors—including a shared Confucian culture—in shaping similarities, *and* the significance of different histories, state interventions and political events in explaining differences in the overall structure of the private business sector and the strategies of firms. The relations between different social groups are correspondingly different. There is a wealth of excellent studies, focusing on the same issue in various countries (see, for example, *Bugra* 1991; *Sadowski* 1991; *Bahout* 1994; *Szelényi, Eyal et al.* 1996).

IPE scholars have occasionally made use of sociological institutionalism. Work on foreign direct investment and the strategies of MNCs sometimes turns to it. Sally (1992) used a sociological institutional approach to study the behaviour of French and German multinationals in the chemical industry. He departs from sectoral policies and state/business relations as a basis for understanding the business culture in the two countries and, consequently, firm behaviour (see also *Tavis* 1988).

Similarly, the approach has been used for studying the role of state institutions and policies in shaping firm structures and behaviour (*Katzenstein and Tsujinaka* 1992; *Whitley* 1998).

On the whole, however, the sociological institutionalist literature on firms has been ignored. This is regrettable since sociological institutionalism could be used to break the trend which is making firm studies in IPE a branch of business studies; in other words, it could help those who try to use the study of firms to understand the international *political* economy.

Conclusion

To sum up, sociological institutionalism could play the same role in IPE as constructivism does in IR. Both raise similar issues concerning the importance of intersubjective meaning in the construction of identities, politics, and the economy. However, unlike constructivism in IR, sociological institutionalism has not yet received the recognition it deserves. In IR constructivism has been noisy and visible; a self-proclaimed "constructivist school" has triggered a new seminal discipline debate (between "constructivists and rationalists") and this in turn has led to theoretical renewal and to the development of a whole range of new empirical research agendas. In contrast, as has been shown, sociological institutionalism is moving into IPE in a slow and selective way. In many areas, here exemplified by the study of firms, sociological institutionalism has developed outside of the IPE debate. In other areas, where sociological institutionalism has influenced IPE very strongly (as in the debate around the state), sociological institutionalists have not proclaimed their specific contributions and the value of their presence. They have been absorbed, but remain invisible and undervalued. The argument being put here is that, by providing a higher profile to sociological institutionalism, it would be possible for IPE scholars to move forwards both theoretically and empirically.

An obvious question following from this centres upon what explains the difference between IR and IPE: why is constructivism so assertive in IR while its kin in IPE so nebbish? The easy answer would be that IPE is more focused on economic phenomena and actors, and that the theoretical tool kit of economic approaches is best suited for the study of these. However, as underlined above, this is simply not true. A more interesting way to answer the question would be to apply sociological institutionalism reflexively to the field of IPE and to clarify why the strategies of IPE scholars have so far been constructed in a way which has largely excluded this kind of approach. Indeed, a further virtue of making sociological institutionalism an explicit part of IPE would be that it paves the way for a treatment of reflexive issues, such as this one, and for attempts to make serious (and critical) sense of the future directions taken by our discipline.

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THE END OF POST-SOCIALISM: THE STRUCTURE AND EFFICIENCY OF THE OWNERSHIP OF HUNGARIAN LARGE COMPANIES IN 1997

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On the basis of the analysis of the structure of large company ownership, through ownership, efficiency and the transformation models, the authors consider that the economic transformation has been completed in this segment and the period of post-socialism has ended. There are no arguments or reasons regarding that post-socialism can be further used as an indicator of the period, either with the surviving presence of the socialist economic model or with the identification of the explosion and transition of socialist economy into market economy. None of the elements of the socialist economic model are characteristic of the economic environment of the large companies in the nineties, however significant the companies' "state" past (that they were transformed from state companies) or ownership structure (state/local self-government, foreign and home entrepreneurs, etc.) is in influencing the operations of the given companies.

According to the latest works on Hungarian privatisation and large company reorganisation, (*Szalai* 1997; *Voszka* 1997a; *Csite and Kovách* 1998; *Tóth* 1998; *Vedres* 1997) the theories and models originating from the restructuring of the post-socialist market economy—i.e. at the beginning of privatisation—are either unverifiable in the light of actual details, or are only in part valid. Not one empirical research into the model of political capitalism or nomenclature bourgeoisie (*Hankiss* 1989; *Sztaniszkis* 1991) can be proven. It is true that most managers of the largest companies held management positions in the eighties; hence Erzsébet Szalai's prognosis was largely true in that researchers only partly accept respective theories on technocrats' ability to survive and their potential power, managerial theoreticians (*Szelényi, Eyal and Townsley* 1996; *Szelényi, Szelényi and Kovách* 1995; *Böröcz* 1995; *Böröcz and Róna-Tas* 1995; *Róna-Tas* 1994), managers becoming owners, diffuse ownership and managers disposal of power—and then only those theories concerned with the period after privatisation and the intensive period of company transformation (1993–97). Éva Voszka's extraordinarily thorough monograph unequivocally proves that it was not characteristic that managers of the largest socialist companies did not receive property. (Voszka 1997b). According to data prepared on the economic elite, only 1.9 percent more managers were in possession of their own firms in 1997 than in 1993; and thus arguments relating to managers becoming owners are less relevant. It is also true that a mere 12.8 percent of the people interviewed in 1993 and 21.8 percent in 1997, disposed of a greater than 50 percent share in some kind of venture; however, this can be explained by

the appearance of a Hungarian owner-manager layer who became proprietors in the nineties (Csite and Kovách 1998). According to *Lengyel and Bartha* (1997) there was no dominant group among the most important economic players (banks, corporations, political elite) which particularly controlled the others (Csite and Kovách 1998). Contrary to theories on diffuse ownership conditions, Kolosi and Sági successfully presented the large company group who had the real ownership. (*Kolosi and Sági* 1997). According to István János Tóth "the largest achievement of the Hungarian privatisation was that it helped put the rights of company ownership into the hands of 'real owners' ". (Tóth 1998, p. 611) In Tóth's study, from which this quote is taken, the author analysed data from large companies between 1995 and 1996; this study brings into question the universal application of the David Stark model of recombined large company ownership to the transformed Hungarian economy. On the basis of Éva Voszka's book and the results of our research, recombined large company ownership is not verifiable (Voszka 1997a, Csite and Kovách 1998). According to the analysis of the structure of large company ownership, by 1996 individual ownership had become common. At the same time, according to the type of ownership and its structure (multinational, self-founded or arising from privatisation, and majority state—local self-government owned) the Hungarian economy is multisectoral (Csite and Kovách 1998).

The relevant general binding models and theories concerning the ownership structure and owners of Hungarian companies were constructed before the period of intensive privatisation; and thus now, after privatisation, it is worthwhile re-examining the real composition of ownership. In this study, carried out in 1997 after the privatisation of the larger enterprises, to supplement data that was collected on the economic elite and using the data collected about the large companies, there is an analysis of the ownership structure of one segment of the Hungarian economy. The sampling and the sample size have provided the opportunity to present representative data on the large company ownership structure, and perhaps serve to give decisive arguments to the debates on this. The data methods have enabled us to find answers to the exciting question of how efficiency effects the ownership type and the process of privatisation; furthermore, perhaps the judgement of the transformations of the nineties can contribute to a joint analysis of ownership and efficiency. We think that, on the basis of our data, a large part can be described as typical organisational features of the large segment of companies in the Hungarian economy. Given this, an opinion of the characteristic post-socialist economy, or rather the restructured market economy, can be formed.

Literature on the economics of transition describes the nineties in terms of post-socialist transformations, and asks whether characteristics remain which were features of the socialist economy; or, have the processes of privatisation, economic liberalisation and market economy transformation totally removed such features from the Hungarian economy, in our case from the management of large companies? In our view, the usage of "post-socialism" as an indicator of the period

is no longer valid. For verification of this a difficult task lies ahead as, in reality, post-socialism never really found its theoretician. Transition or backwardness are synonyms of post-socialism and we did not have knowledge of a theoretical analysis which could analyse post-socialism, as a system. In our interpretation, post-socialism is a transitional period in which the socialist economic elements of organisation and operation appear, and if it is not possible to demonstrate this then we cannot talk about post-socialist economy or post-socialist transition. When János Kornai analysed the growth of the Hungarian macro-political economy, he found a relationship between post-socialism and the surviving elements (goulash post-socialism, prosperous state, grandialism, premature prosperous state) of the socialist political model (*Kornai* 1995/6). To describe the social economy as a system we use Kornai's model, given that it is the most widely accepted (Kornai 1993). Kornai described the social economy as being over-centralised, as having accelerated growth and an imbalance of prices, as a system of state ownership and the Party state. We believe, and try to prove in this study, that none of the elements of the socialist economic model are characteristic of the economic environment of large companies in the nineties. However, what is significant is the extent to which the companies' "state" past (i.e. they were transformed from state companies) and character of the ownership structure (State/local self-government, foreign and home entrepreneurs etc.) have in influencing the operations of those companies.

Ownership structure and character

Two-thirds of the corporations were unequivocally privatised by 1997; the formerly dominant state/local self-government ownership retained 16.6 percent of the firms; a further 16.9 percent were mostly owned by cross holding and subsidiaries. Foreign and worker-director ownerships obtained a majority share in nearly half of the large companies; at that time the owner-manager group had a majority share in 11.1 percent of the firms (*Table 1*).

The majority of the largest firms remained the property of the state/local self-governments, which included 60.2 percent of large company assets and 66.4 percent of the total number of employees. With regard to the companies' total income the largest amount accrued to the private sector (55.3 percent). Between 1993 and 1997 the private sector became dominant in the large company sector of the Hungarian economy; however, the conditions of management theories for diffuse ownership are not verifiable; that is, this dominance is only conditionally true[1] for those large companies which can be described as cross holdings—these account for

[1] At the same time, we had to note that the questionnaire did not contain questions referring to firms in possession of the companies—however, we are aware of the leading managers properties outside of the companies.

16.6 percent of the total number of large companies. Our data strengthens I. J. Tóth' findings on the fast growth of private ownership after 1993 (Tóth 1998); in the case of large companies, the state (like the local self-governments) had a larger interest than in the total Hungarian company ownership structure.

Table 1

Types of companies on the basis of dominant ownership[2] *(N=549)*

	Percent	Number of cases
Foreign ownership	23.3	128
State/local self-government ownership	16.6	91
Cross holding/subsidiary	16.9	93
Small shareholder/cooperative type ownership	8.2	45
Worker-director ownership	23.9	131
Owner-manager ownership	11.1	61

The role of the change of regime and privatisation in the large company segment shows that one-fifth of the firms were established before 1990, whereas all

[2]The variables of ownership type with regard to the data on the company ownership structure were defined according to the following:

Foreign owner: a company where more than fifty percent is owned by a foreign company or a private individual or, where there is no owner with a greater than fifty percent share and the largest share of the company is in the hands of a foreign company or private individual;

State/local self-government: a company where more than fifty percent is owned by the state or a local self-government or, where there is no owner with a greater than fifty percent share and the largest share of the company is in the hands of the state or a local self-government.

Cross holding/subsidiary ownership: a company where more than fifty percent is owned by another company or, where there is no owner with a greater than fifty percent share and the largest share of the company is in the hands of another company.

Small shareholder/cooperative ownership: a company where more than fifty percent is owned by a Hungarian private individual (who is neither a worker nor director at the company) or, where there is no owner with a greater than fifty percent share, where the largest share of the company is in the hands of a Hungarian private individual.

Worker-director ownership: a company where more than fifty percent is owned by the workers, managers and/or directors of the company or, where there is no owner with a greater than fifty percent share, where the largest share of the company is in the hands of the workers, managers and/or the directors of the company.

Owner-manager ownership: a company where more than fifty percent is owned by the leading manager of the company or, where there is no owner with a greater than fifty percent share, where the largest share of the company is in the hands of the leading manager of the company.

There were only a few companies which were dominantly owned by a bank and these firms have thus been placed in the cross holding/subsidiary ownership group. 85.4 percent of the companies were in ownership groups where the owners disposed of a more than fifty percent share; the remaining 14.6 percent of the companies were placed into groups according to the largest ownership share.

the others came into existence by total transformation, privatisation or they were newly formed. (*Tables 2 and 3*)

Table 2

The year of the company's foundation (N=582)

Year of foundation	*percent*
before 1988	8.6
1988	2.4
1989	11.7
1990	14.1
1991	17.0
1992	17.5
1993	12.7
1994	7.6
1995	3.8
1996	3.1
unknown	1.7

Table 3

The present firms preceding venture (N=582)

Preceding venture	*percent*
Newly-founded firm	37.1
Firm which previously operated as a different business organisation	50.2
Firm which previously operated as part of a different business organisation	10.5
Unknown	2.2

More than sixty percent of the larger firms were established between 1990 and 1994. According to this, the intensive privatisation of the Horn government reorganised the ownership structure of already existing firms: only 14.5 percent of the large companies were founded after 1994. In the privatisation of those firms which were in existence in 1988, the directors and workers obtained the largest share of the companies (*Table 4*); in a quarter of the firms the majority owner was the state or local self-government.

Foreign ownership took over fewer of the formerly socialist firms than in the whole segment of large companies. The arrival of multinationals in Hungary took two forms: firstly, greenfield developments and secondly, entities participating in the privatisation of those firms previously under state ownership; in this second

case it was rather that they incorporated property originating from the state into newly-founded firms. (*Table 5*)

Table 4

The distribution in 1997 of the type of company ownership of firms existing in 1988 (percent)

Foreign ownership	12.7
State/local self-government	26.7
Cross holding/subsidiary ownership	15.2
Small shareholder/cooperative type ownership	7.3
Worker-director ownership	33.9
Owner-manager ownership	4.2

Table 5

Ownership types and the company's preceding venture (percentage) (N=540)

	New firm	Formerly operated as a different business organisation	Formerly operated as part of a different business organisation
Foreign ownership	54.8	32.3	12.9
State/local self-government ownership	13.2	75.8	11.0
Cross holding/subsidiary ownership	31.5	51.7	16.9
Small shareholder/cooperative type ownership	45.5	47.7	6.8
Worker-director ownership	28.2	63.4	8.4
Owner-manager ownership	68.9	24.6	6.6
N	207	274	59

The privatisation and transformation of large companies was not the deciding factor in the process of management gaining ownership—i.e. the other "managerism theorem". Éva Voszka did not find, within the 49 highlighted socialist large companies, the process of managers becoming owners within their own company to be typical; data collected about the 1997 economic elite indicate the same pattern as that found by her. The leading managers and the lower managers did not become dominant in the large companies. Manager ownership of more than a 50 percent share was only found in those firms where the owner and the leading manager was the same person. However, the proportion of these companies was less than 8 percent of the total number of large companies (*Table 6*); in nearly half of the large companies there was no management ownership. (*Table 7*)

Table 6

The proportion of leading management ownership in each ownership type (percent)

	0 percent	0.1–20 percent	20–50 percent	50–99 percent	100 percent
Foreign ownership	78.9	18.8	2.3	–	–
State/local self-government ownership	93.4	6.6	–	–	–
Share-holding/subsidiary ownership	67.7	24.7	7.5	–	–
Small shareholder/cooperative type ownership	53.3	26.7	20.0	–	–
Worker-director ownership	25.2	47.3	27.5	–	–
Owner-manager ownership	–	–	–	45.9	54.1
N	306	127	55	28	33

Table 7

The proportion of management ownership (company managers and other managers) in each ownership type (percent)

	0 percent	0.1–20 percent	20–50 percent	50–99 percent	100 percent
Foreign ownership	75.8	19.5	4.7	–	–
State/local self-government ownership	91.2	7.7	1.1	–	–
Share-holding/subsidiary ownership	64.5	22.6	12.9	–	–
Small shareholder/cooperative type ownership	48.9	20.0	13.3	17.8	–
Worker-director ownership	13.0	15.3	22.9	48.9	–
Owner-manager ownership	–	–	–	37.7	62.3
N	279	82	55	95	38

The proportion of management ownership—except for firms under owner-manager ownership—was only high where, under privatisation, other employees, apart from the managers, became owners; and, according to our taped interviews, private ownership means corporative ownership (i.e. collective workers and leaders ownership domination), and small shareholder/cooperative type companies. (Here too, and most importantly, a few firms operating in the cooperative form were T.S. or Á.F.É.SZ.). The company management only obtained 6 percent of the large company ownership. The significant joint ownership by leading and lower managers accounted for ten percent of the firms. (Éva Voszka and I. J. Tóth pay attention to the managers who did not receive personal property but instead gained state property through the medium of their firms. In out questionnaire we also asked about this; hence the above data were not only collected on personal property of

managers in this category but on the property of their own firms.) According to the data in *Tables 8–10*, the managers became the majority owners of large companies by founding new firms in which there was little or no state ownership.

Table 8

The proportion of leading manager ownership based on the company's previous type of venture (percent of the total sampling)

	0 percent	0.1–20 percent	20–50 percent	50–99 percent	100 percent
New firm	19.9	6.7	3.8	4.4	4.2
State firm	27.3	11.5	3.5	0.9	0.5
Ltd./stock company	5.3	1.8	0.7	0.2	0.5
Cooperative	0.9	1.8	0.4	0.7	–
Other	2.4	1.3	0.5	–	0.7
N (percent)	306	127	49	34	33
	(55.7)	(23.1)	(8.9)	(6.2)	(6.0)

Table 9

The proportion of manager (leading company and other managers) ownership based on the company's previous type of venture (percent of the total sampling)

	0 percent	0.1–20 percent	20–50 percent	50–99 percent	100 percent
New firm	18.2	4.9	2.6	6.4	6.9
State firm	24.8	6.9	5.5	5.1	1.5
Ltd./stock company	4.7	0.9	0.9	1.1	0.9
Cooperative	0.9	1.3	0.4	1.3	–
Other	2.2	0.9	0.7	0.2	0.9
N (percent)	279	82	55	77	56
	(50.8)	(14.9)	(10.0)	(14.0)	(10.2)

With regard to large companies—and stressing the defining character or private ownership—the question is: how well the origin of private ownership is linked to the David Stark "recombined ownership" theorem? (*Stark* 1992; *Bruszt and Stark* 1996) I. J. Tóth—who has been quoted several times—believes that cross holding ownership was, at that time, not only characteristic of state owned firms, but also of privately owned firms. He stressed that the probability of ownership being cross holding was linearly proportional to the size of the company. We hold

Table 10

The proportion of non-leading and other manager ownership based on the company's previous type of venture (percent of the total sampling)

	0 percent	0.1–20 percent	20–50 percent	50–99 percent	100 percent
New firm	27.7	4.9	2.6	3.5	0.4
State firm	29.7	6.0	4.6	3.1	0.4
Ltd./stock company	5.8	0.7	1.5	0.4	0.2
Cooperative	2.6	0.7	0.5	–	–
Other	3.6	0.7	0.4	–	0.2
N (percent)	381 (69.4)	72 (13.1)	52 (9.5)	38 (6.9)	6 (1.1)

the view that 16.9 percent of the large companies are dominant among cross holdings. Considering this, it is possible to restrengthen the fact that the recombined ownership was not exclusively an indicator of the nature of the Hungarian economy. Each joint ownership type was more common than the cross holding company (*Tables 11 and 12*), from which it can be concluded that 7.8 percent of the large companies were owned by one owner.

Table 11

The different types of joint company-ownership (The percentage of the total firms questioned)

	Foreign	State	Subsidiary	Small shareh.	Employee	Owner-manager
Foreign	–					
State	4.6	–				
Subsidiary	8.2	7.8	–			
Small shareholders	4.4	2.7	5.8	–		
Worker	10.2	11.7	14.9	7.8	–	
Owner-manager	9.3	8.6	13.2	9.3	30.2	–
The percentage of the ownership share of the firm	33.0	29.9	31.9	14.9	42.1	44.3

It is mainly the foreign and state owners who exclude other owners from having a share of their companies and, contrary to the recombined ownership theorem, the foreign, the worker-director and owner-manager types are more active in joint ownership than the state majority owned companies. With regard to the variable analysis of the joining of the different ownership groups (*Table 13*), the state

Table 12

The proportion of companies according to the ownership share of the given owner

	0 percent	0.1–20 percent	20–50 percent	50–99 percent	100 percent
Foreign ownership	67.0	3.1	7.5	8.9	13.5
State/local self-government ownership	70.1	8.2	5.1	4.4	12.2
Cross holding/subsidiary ownership	68.1	9.1	8.8	8.2	5.8
Small shareholder/cooperative type ownership	85.1	6.0	4.5	3.9	0.5
Worker-director ownership	58.1	13.3	11.8	13.5	3.3
Owner-manager ownership	55.7	23.2	10.2	4.9	6.0

and foreign ownership are the least open, if compared with the other ownership types; the owner-manager and the small shareholder/cooperative type ownerships generally join together with other ownership types.

Table 13

The relationship between different ownership groups (correlation coefficient) (N=549; in brackets, the significance level)

	foreign ownership	state/local self-government ownership	cross holding/ subsidiaries	small shareholders/ cooperative type ownership	worker-director ownership	owner-manager ownership
Foreign ownership	–	–	–	–	–	–
State/local self-government ownership	−0.272 (0.000)	–	–	–	–	–
Share holding/subsidiary type ownership	−0.248 (0.000)	−0.218 (0.000)	–	–	–	–
Small	−0.147	−0.146	−0.100	–	–	–
Shareholder/cooperative ownership	(0.001)	(0.001)	(0.019)			
Worker-director ownership	−0.326 (0.000)	−0.237 (0.000)	−0.191 (0.000)	−0.099 (0.021)	–	–
Owner-manager ownership	−0.266 (0.000)	−0.258 (0.000)	−0.187 (0.000)	−0.012 (0.621)	−0.039 (0.356)	–

With regard to the situation in 1997, 38.7 percent of large companies were newly-founded and two-thirds of the firms were brought into existence by the privatisation of previously existing firms. It was possible that the newly-founded company received state or cooperative property but there is no exact information on this. 43 percent of large companies had previously been state companies (*Table 14*).

Table 14

The type of the company's previous venture (percent) N=566

New firm	38.7
State company	43.8
Ltd., stock company	8.7
Cooperative	3.7
Other	5.1

In the literature on privatisation (Szelényi, Eyal and Townsley 1996; Böröcz 1995; Böröcz and Róna-Tas 1995; Stark 1994; Bruszt and Stark 1996; *Grabher and Stark* 1996; 1997; Tóth 1998; Voszka 1996; 1997a) the most controversial issues are those of the breakdown of state assets in recombined ownership form and the continued operation of state majority-owned companies. According to the data of 1997 on the firms which had a predecessor company, most came into being through transformation and only 27.7 percent were established through separation from a predecessor company. (*Table 15*)

Table 15

How the preceding firm came into being

	Transformation	Separation
State company	81.0	19.0
Ltd./stock company	83.0	17.0
Cooperative	81.0	19.0
Other	93.0	7.0

According to the theorem on recombined ownership (Stark 1994), in the model of Hungarian privatisation, the privatisation of the parent company happened through smaller firms which were linked to the parent company in various ways. In earlier parts of this study, we showed the frequency of the unification of cross holdings and other ownership types, stressing that the validity is limited and conditional. In the distribution of former state owned companies, according

to the present ownership type and the mode of transformation (*Table 16*), similar conclusions can be drawn.

Table 16

The distribution of the 239 former state companies according to their present ownership type

	Total	Transformed	Separated
Foreign ownership	16.7	70.0	30.0
State/local self-government ownership	28.0	85.0	15.0
Share-holding/subsidiary ownership	15.5	70.0	30.0
Small shareholder/cooperative type ownership	5.9	85.0	15.0
Worker-director ownership	31.0	89.0	11.0
Owner-manager ownership	2.9	57.0	43.0

The foundation of firms through separation from other business organisations—which in our interpretation is a precondition for recombined ownership—it was precisely those companies which remained under the control of the state and those which became worker-director ownership types from the previous organisation (and which were also in the smallest proportion) to which the recombined ownership theorem can be most easily applied in the Stark model. In the case of large companies, those which came into being through transformation can be excluded from the recombined ownership model. Principally, most of the firms which came into existence through separation were dominant under the owner-manager ownership; these had ownership shares in other companies belonging to the sample; at the same time, the owner-manager ownership firms had the smallest income (*Table 17*) and had obtained very little state property.

Large companies which come into being through transformation generally have a larger number of employees and a greater income than those formed due to separation from another company. Stark (1994) and later Bruszt and Stark (1996) held that the recombined ownership form was valid for the company property nexus and for privatisation of the 200 largest companies; however, the 1993 data sample, with regard to the method of formation of new firms, the number of employees and income, showed similarities to that of 1997 (*Tables 18 and 19*). Moreover, according to the latter, the larger companies generally came into being through transformation and not through separation. Thus the model of recombined ownership does not explain the differences in the sample.

Cross holding, as the dominant ownership type (discounting those firms which were the smallest) in the large company segment of the economy, is where the role of the recombined ownership is most conceivable. More intensive privatisation definitely does not result in the intensive growth of the firms of the larger ownership

Table 17

Ownership type and income (percent)

	0–200 mill. HUF	200–500 mill. HUF	500 mill.– 1 bill. HUF	1–10 bill. HUF	above 10 bill. HUF
Foreign ownership	21.4	16.2	19.5	27.4	53.3
State/local self-government ownership	12.5	17.5	13.3	19.1	26.7
Share-holding/subsidiary ownership	14.3	15.6	14.2	21.0	16.7
Small shareholder/cooperative type ownership	12.5	11.7	8.8	5.7	3.3
Employee ownership	21.4	24.7	28.3	22.3	–
Owner-manager ownership	17.9	14.3	15.9	4.5	–
N (100 percent)	56	154	113	157	30

Table 18

1996 income and the firms's former venture (column percent) (N=515)

	0–200 mill. HUF	200–500 mill. HUF	500 mill.– 1 bill. HUF	1–10 bill. HUF	above 10 bill. HUF
New firm	53.4	39.7	40.0	31.5	34.5
Firm formed through transformation	39.7	46.8	46.4	58.0	65.5
Firm formed through separation	6.9	13.5	13.6	10.5	–
N (100 percent)	58	156	110	162	29

Table 19

Number of employees on 1 January 1997 and the firm's former venture (percent)

	less than 20	21–50 people	51–100 people	101–500 people	501–1000 people	more than 1000
New firm	74.1	64.2	35.8	17.9	14.6	21.6
Firm formed through transformation	22.2	30.5	47.4	66.3	78.0	73.0
Firm formed through separation	3.7	5.3	16.8	15.8	7.3	5.4
N (100 percent)	81	95	95	35.3	41	37

network: 80 percent of those firms which had an annual income of more than 10 billion HUF, in the state/local self government and foreign ownership company sector, were the least open to cross holding. At the same time, it is true that the cross holding/subsidiary ownership form was found among the largest firms. Cross holding as a dominant ownership form was characteristic of the small, most importantly, commercial food processing industry and construction industry firms, respectively. For these firms the income and the number of employees were growing at a faster rate than those firms which came into being through transformation.

In connection with recombined ownership, the ownership role of the banks is another issue. This was minimal in 1997. Less than 5 percent of the large companies were owned by banks. This could be a consequence of the privatisation of banks (and thus the retained investments), and of foreign capital which was not very interested in investing in the sphere of manufacturing companies. (*Wachtel* 1997; *Fogarassy* 1996)

The structure of the large companies' owners and ownership managerialism (e.g. diffuse ownership, managers individual ownership) and the presence of recombined ownership has not been dominant or characteristic of Hungarian privatisation.

Ownership and efficiency

The economic growth of companies under examination between 1993 and 1997, calculated on the basis of 1996 prices and with regard to the number of employees, shows a fairly changed picture. The unequivocal decrease in the number of employees between 1993 and 1998 (*Table 20*) slowed down between 1993 and 1997, and the number of employees grew in 30 percent of the firms (*Table 21*); income shows the same tendency.

Table 20

The number of employees of companies on the 1 January of the given year

Number of employees	1988	1993	1997
0 – 20 people	9.4	16.1	15.1
21 – 50 people	4.1	16.5	17.7
51 – 100 people	4.9	12.5	17.7
101 – 500 people	33.2	36.6	35.2
501 – 1000 people	18.9	9.1	7.7
more than 1000 people	29.5	9.3	6.7
N	244	497	549

Table 21

The change in the number of employees

	percent 1988–1993	percent 1993–1997
Significant decrease (−50 percent)	28.6	13.0
Moderate decrease (−10 percent < x < −50 percent)	43.2	36.0
Stagnant (−10 percent < x <0 percent)	13.3	21.2
Moderate increase (0 percent < x < +50 percent)	6.2	13.8
Singnificant increase (+50 percent < x)	8.7	16.0
N	241	486

The growth of the number of employees and the income in the foreign dominated firms was unequivocal; the firms which remained under state ownership increased their income but the number of their employees radically decreased. The ownership group which was the most stagnant includes the small shareholder and cooperative type firms. Those firms whose data shows mostly decreases were those which were owned by the workers and directors. The owner-manager ownership did not show growth in income, but the number of employees grew quickly. (*Tables 22 and 23*)

Table 22

The change in the number of employees 1993–1997 and the ownership type (column percent) (N=468)

	foreign	state	share holding	small shareh.	worker	owner-manag.
Significant decrease (−50 percent)	8.9	13.4	21.9	25.0	9.7	7.7
Moderate decrease (−10 percent < x < −50 percent)	29.5	50.0	42.5	25.0	42.5	17.3
Stagnant (−10 percent < x <0 percent)	17.9	26.8	13.7	13.9	27.4	15.4
Moderate increase (0 percent < x < +50 percent)	17.0	7.3	11.0	16.7	13.3	1.2
Singnificant increase (+50 percent < x)	26.8	2.4	11.0	19.4	7.1	38.5
N	112	82	73	36	113	52

From the analysis of the above it is obvious that between 1993 and 1997 the economic growth of the companies which belonged to each ownership type was characteristically different.

Table 23

The quintiles of income and the ownership type (percent) (N=510)

	Foreign	State	Share holding	Small shareh.	Worker	Owner-manag.
Lowest quintile	18.6	20.7	15.1	22.2	24.8	31.6
2nd	12.7	18.4	22.1	33.3	17.9	24.6
3rd	16.1	13.8	16.3	17.8	23.9	29.8
4th	23.7	23.0	22.1	15.6	15.4	14.0
Highest quintile	28.8	24.1	24.4	11.1	17.9	–
N	118	87	86	45	117	57

In the sample which represents the large company's population in 1997, there were significant changes in the operations system. We evaluated changes with the following linear regressional elements (*Table 25*): (a) The changes in income between 1 January 1993 and 1997; (b) The changes in the number of employees between 1 January 1993 and 1997; (c) The changes in the company's assets between 1 January 1993 and 1997.

We used the following five groups of variables:

— The age of the firm in 1997

— Was it a state company?

— The previous state of the firm (reference being to newly-founded companies): Did it come into being through transformation or separation?

— Type of ownership

— Which branch of industry does the company belong to?

We thought it probable, as a hypothesis, that in each ownership type the transformations between companies were significantly different, after the separation of the branches of influence between 1993 and 1997. We designated as a reference group the newly-founded, dominantly foreign owned service companies.

a) Income

The model that we made to explain the changes in income between 1993 and 1996, in the light of the results, does not work. As well as the very low value of R squared (0.02), none of the illustrative variables had any significant influence on the income trend.

b) Employment

The variables in the model in part explain the changes in the number of employees of a company between 1993 and 1997 (R squared=0.15). The number of employees in companies that came into being through transformation, in state or worker-manager ownership and trading companies, differs from the reference group. The difference represents a decrease in employment after 1993, a decrease of the weight of the former state companies in the large company population (in

particular due to the redundancies in the durable state companies), and a decrease in worker-manager ownership companies.

c) Company assets

The coefficients that show changes in company assets reinforce the considerable evidence that there was a loss of assets in the former state companies. The illustrative power of the model is the same as for the model which was constructed for the purpose of evaluating the changes in employment (R squared=15). The increase in the volume of assets of companies formed through separation and the private owner-manager owned firms surpassed that of the reference group. We concluded from our data that the increase or decrease of a company's assets was closely connected to the company's director ownership—that is to say, the larger the part of the company under the ownership of the directors, the greater the probability that the assets of the firm grew during the mid-nineties.

In the mid-nineties the already visible trend in the large companies continued: the (former) state companies suffered considerable losses of their assets and, in connection with this, the number of employees also fell considerably. In the large company population the weight of privately established and manager-director owned firms grew. For these respective types, the number of their employees kept pace with, and their assets surpassed those of firms which were established by foreign investors. However, the history and ownership structure of the firms were not affected by the income-formation.

Company efficiency

We measured the operation efficiency of companies in 1996–97 using a five-model linear regression: (a) the profit made in 1996 compared to one unit of the assets; (b) the income made in 1996 compared to one unit of the assets; (c) the income made in 1996 per employee; (d) the profit in 1996 per employee; (e) the profit per one unit of income in 1996. The question we put forward was designed to find out if there was any difference in efficiency according to the different methods of formation at the beginning of the nineties; furthermore, if so, then was there any connection with the character of Hungarian post-socialist economy?

a) profit per assets

Besides the 16 percent R squared, the durable companies under state ownership and the companies formed through transformation differ considerably from the reference group, and they show lower efficiency. These firms have comparatively large assets and low profits and, most importantly, it may be supposed this includes companies which have not been privatised due to the low adaptability to the market; it also includes durable state firms in which the state owner does not judge profitability according to the performance of the management. According to

our suppositions, these firms must be those where the siphoning of the profits has not been stemmed and that is why the value of the workable assets is still falling.

b) income made per unit of the assets

Besides the weak illustrative power of the model (R squared=0.13) this shows that the way in which the firm came into being divides the population of the Hungarian companies. From this point of view, in 1996 the owner-manager and the employee owned firms were efficient in their respective fields: they could produce significant income with relatively low company assets.

c) income per employee

The relatively high illustrative power of the model (R squared=0.20) shows that state owners were still dividing the large companies: the serious employment cutbacks in the state owned and employee-manager owned firms were to no purpose as the income per employee was still less than average.

d) profit per employee

Of our models, this has the greatest illustrative power, R squared=0.23; on the basis of the beta coefficient compared to the efficiency of the newly founded foreign owned firms, that of the other types of firms is low. Mostly it is the small shareholders and the owner-manager owned firms which come close to the efficiency of the newly founded foreign owned companies, and it is the state owned firms that are left behind.

e) profit per income

The illustrative power of the model is small, R=0.07, and it is worth paying attention to the fact that, apart from the worker-manager owned firms, the efficiency of all the other company groups is considerably lower than that of the newly founded foreign owned companies; and this is not affected by the fact that the company was formerly state owned or not.

In the evaluation of efficiency, in terms of the different viewpoints, the ownership structure and the company's past would appear to have a significant role in the present population of Hungarian large companies. The company's "state" past is a disadvantage from the point of view of capital and work efficiency: the efficiency of the former state firms is lower than that of the newly founded ones. Ownership structure is also influenced by the operation efficiency of firms: the capital and work efficiency of the state and local self-government companies are less than for the others; the capital efficiency of the worker-manager and the Hungarian owner-manager owned firms is better than that of the foreign owned ones, but the work efficiency is not; those companies which own other companies, characteristically cross holdings, are the same as the state companies while the dominantly small shareholder owned companies (characteristically either firms on the stock exchange of cooperative firms) are the same as the foreign owned ones in terms of efficiency.

Management

In our earlier study (Csite and Kovách 1998), we came to the conclusion that the directors of the large companies can be divided distinctly into four groups: owner-managers, clientele, technocrats, and posted foreign employees. From experience, there is a close relationship between the different types of economic directors and this can be characterized by social statistics, and the company's efficiency and ownership structure. The latter can be seen as the decisive function of managerial culture (of which many elements are not particularly well-known in the case of the multinationals) in the formation of the competitive viability of the market economy and management participation. This, according to our research, was one of the important defining factors of the growth model of Hungarian large companies (as is highlighted in the professional literature by *Kerekes, Rondinelli and Vastag* 1995; *Hoványi* 1995).

The 1997 economic elite group which obtained owner-manager property was the youngest elite group. The average age of the members of this group was under fifty, the highest proportion of which being under forty. The qualifications held by members of this group are lower than that of the other three groups, given that nearly forty percent did not have university degrees. We can characterise the culture capital structure of these groups by those who have a university degree (mostly technical degrees) and by the high proportion of English language speakers. Two-thirds of the group work at privately founded companies as owner-directors. Most of these companies were founded between 1988 and 1993, but slightly more than two-fifths of them were not privately founded—instead they were established through privatisation. More than half of the owner-managers made their earnings from the private economy, even in the eighties. This proportional number is the highest in this group, which indicates that the members of the 1997 elite can be clearly differentiated from those in the other four groups; ten percent of them, even in the eighties, followed the "socialist's course" of developing a middle class status: that is, they tried to increase their own wealth and develop and follow the until then, "bourgeois" lifestyle by abusing the opportunities offered by the regime. Besides the owner-manager companies this group is found in a larger proportion in the cooperative and cross holding firms.

The other group of the 1997 economic elite is the "powerful clientele" who, in their companies, because of the dominant state and local self-government property, were able to connect many branches with the elite fraction. The latter, according to Iván Szelényi, represent the new politocration. The main characteristic of the members of the clientele group is that most of them do not have any share in a firm. More than half of the companies between 1991 and 1993, a quarter of them after 1994 and more than a quarter of them after 1993, gained an elite position. A quarter of the members, who are over fifty years old, joined the economic elite

between 1988 and 1993, and they retained this position in 1997. The members of this group have the highest level of qualifications.

The main characteristic of the group of technocrats is that they obtained shares during privatisation, and the largest proportion of them in cross holding and worker-manager owned firms. It was not usual that the managers were not able to privatise their companies alone; instead, they did this by drawing in employees and other managers or foreign investors. By choosing the privatisation technique, they succeeded in keeping their position of authority or they became directors. Due to the impossibility of individual privatisation, the directors of the companies divided the respective owner and company directors' duties. In our interpretation these remained characteristic of corporatives, because in ownership and management decisions many elements (e.g. ownership partners, validity company employees interests, state bureaucracy) had to be taken into consideration which did not result in an increase in competitiveness. It can be emphasised that the group of technocrats played a leading role in the company's economic strategy, whose structure most closely resembles those companies which remained under state control. Most of the technocrats gained their present leading positions between 1988 and 1993: that is to say, not in the wave of privatisations following 1993; rather, at the time of the change of regime in the "privatisation" at the beginning of the nineties.

The directors of the dominantly foreign owed firms account for less than a quarter of the economic elite, and they are clearly separable from characteristic social statistics. This is the next elite fraction, after the owner-manager group: they are mainly in their forties and their qualifications and foreign language skills are of the same high standard as that of the clientele group. Nearly fifty percent of their number were born in Budapest and they are from highly qualified families. However, their ownership shares are lower than those of the other groups. In their companies they hardly have any shares and according to the taped interviews they want to obtain ownership in the coming years.

The transformation model of large companies

In the large company segment of the Hungarian economy, in the nineties there were four typical methods for the formation of market economy competitiveness according to ownership, efficiency and management composition (i.e. redistributive, corporative, owner-manager and multinational). The transformation models of the companies differ from each other according to their level of participation in privatisation. Considering large company ownership, apart from the state and local self-government firms, in 1997 the private ownership was unequivocal and decisive; this was a result of the breakdown of state property. Private ownership exists at different levels: from that of multinational and owner-manager private ownership

to corporative private ownership, of which the proportion of the latter is much more significant than can be found in literature on privatisation. It can be seen that, after the reduction of the socialist type of redistribution and the liberalisation of economic policy, the role of the state in the large company sector, according to the ownership type, can be differentiated, (occasionally significantly). However, the direction of the state policy directly controls only the majority state/local self government owned companies and the effect of state policy is not greater in the large company economy than in the developed market economy. The liberalisation of economic policy brought about market competition in 1997. At that time the state maintained the market competitiveness of strategic large companies (or those who did not wish to lose their assets) by state subvention and other allowances. According to Éva Voszka the highlighted large companies received greater state support in the mid-nineties. (Voszka 1997a)

The market competitiveness of each type of transformation goes together with the characteristic managerial nature. The interest, capital and socialisation of a company's management are decisive—at the time of the company's necessary reorganisation—for market competitiveness. According to our interviews, management in all types of companies are preparing for special "internal" privatisation. After the privatisation of state property it was only possible to obtain private property from other private property (apart from the 15–16 percent state/local self-government large company sector). From the point of view of the development models, the endeavours of the management to become owners are decisive.

The redistributive model

The state and local self-government agreed to play the dominant ownership role in the transformation/development. This state and local government agreement could have been for many reasons: the significance of a firm's strategy, preparations for privatisation by defining asset amortisation, other political views (e.g. preservation of workplaces) and lobbying interests. The view of the redistributive development model is not efficiency, but rather the preservation of company competitiveness at the cost of state/local self-government intervention. Efficiency, of course, is not contrary to the model of state development, but those companies which belong here were not left to go bankrupt even if their ventures were not particularly successful. The state/local self-government as an owner, after the liberalisation of economic policy, had limited development funds which it used alongside direct subvention (e.g. in the case of the Postbank); there were also indirect allowances to maintain the company's competitiveness. The most general form of indirect subvention were state orders, the maintaining of positions of monopoly using political instruments, the lax control and extortion of budget payments (per-

haps by the remittal of these), and customs and export allowances. The state development model really maintained each element in the former redistribution, by which it wished to bring each company or company group into a competitive position in the circumstances of the market economy. Due to falls in company assets and the worst efficiency index between the large companies, the state's direct interventions are likely to continue. Management itself had little opportunity to obtain property within its own company; however, it is possible that the wish of the directors to obtain a share of the company was behind the continuous fall in the value of company assets and the negative efficiency indexes. Managers mostly depended on political connections rather than real economic achievements. It is not accidental that the proportion of people who were already managers in the eighties is largest among the directors of those companies which belong to the redistributive development model. The lobbying techniques of those company directors who belong to the political clientele were the same as those applied during the eighties. During the earlier socialisation, the large company managers accumulated skills, knowledge and connections which are still effective in the nineties.

The corporative model

During privatisation, companies were formed from state firms which—due mainly to the ownership structure and the consequences of the company market transformation influence—can best be described as corporativisation. The common characteristics of the worker-director, cross holding, and small shareholder/cooperative ownership types, which came under analysis earlier in this study, are that the company is, for the most part, under private ownership, but the ownership and disposal rights are divided between more owners of the ownership groups. Thus we have to pay attention to the conflicting interests of directors, in whose hands lie the disposal power when decisions are made on efficiency and market competitiveness. The management of the company, because of earlier practices and ownership corporativisation, has two different challenges when making decisions on those affairs affecting market competitiveness. One is the completion of changes in market orientation, structure, work organisation and management; the other is that, because of worker ownership and political preferences (workplace), balanced decisions have to be made. Probably the results of the decision-making is that while there is high capital efficiency, the work efficiency does not grow accordingly in the companies of the corporative model. Also, in the corporative model, and according to the research, the number of employees was continuously falling, but because the workers were also the owners it was not possible to carry out radical work organisational changes. The worker-director share was high in those companies which preserved the former state work organisation and strategies. The

cross holdings, where the ownership rights were unclear and the leading managers did not have ownership interest, had a similar efficiency to the state sector. The small shareholder/cooperative ownership companies, in which the ownership right had been divided the most effectively, resulted in the management influence being relatively high and they belonged to the most efficient companies. The state had only indirect political instruments with which to influence the corporative model. In the case of the majority ownership of worker-directors, the managers had experience, connections and lobbying capacity. This explains why they were able to obtain those state allowances and subventions which the companies belonging to the state model continuously receive.

The owner-manager model

The owner-manager model is, as a matter of fact, not a model of transformation because usually it is characteristic of those firms which have been newly founded. However, it is possible that one source of assets was from those which were under state ownership, but the state assets were introduced into the company as private property. Although these firms started with a "clean page", they became large marketable companies in such a way that direct and indirect state aid was at its lowest, and they did not have the benefit of the multinational firms' capital power, market or work organisation experience. The model characterises dominant private ownership. This implies unambiguous ownership conditions, the consequence of which is clean structures of power. The consequences of strategic decisions, made on the basis of the gains of the market economy, is that this model has not only the best efficiency indicators but also the fastest growth, mainly in those branches (services) where the invested capital return and the accumulation of profit is fast. The state economic policy uses only indirect instruments in the lax enforcement of the black market economy control, in connection with the owner-manager model. Probably it was the lack of resources and a liberalised economic policy which used different instruments (in the formation of market competition for the companies) which were developed according to each different model. In the redistributive development model state subvention is regular, gives favourable loans and handle late budget payments in a lax manner, in the case of the corporative model it is dependent on the lobbying capacity and also the loose control of the presence (black job-market, tax, N.I. contributions) of the black market economy. These could have been part of a hidden state economic policy at that time.

The multinational model

Nearly one quarter of large companies are under the ownership of the multinational firms. The development model is unambiguous: the multinationals brought companies into being which cater to a relatively safe market; they follow such models that have been rested and formed in the market economy area; they started with an optimal number of employees and plant size; and the state of the Hungarian employment market and the state economic policy insures, by way of five year tax and other allowances, international competitiveness. The management has hardly any share in the company which, for one reason, is because the ownership and disposal rights are clearly and effectively separated. The other reason is, due to the fact that the management has no ownership share, that it is not interested in profit and efficiency through ownership. According to the taped interviews, the managers of the multinationals have the highest social capital of all the managers of other large companies; and in the next few years they will try to obtain a larger share in their companies.

Table 24

The transformation models of large companies

	Redistributive	Corporative	Company	Multinational
State control	Direct control	Indirect market	Market indirect	Indirect market
Redistribution characteristic	State subvention, the lax control of budget payments	Individual state subvention, lax control of budget payments and black market	The lax control of the black market	Tax, settlement and excise allowances
Ownership characteristic	State/local self-government	Corporative	Private owner	Private owner
Capital efficiency	Weak	Strong	Strong	Moderate
Assets	Decrease	Decrease	Fast growth	Stable
Work efficiency	Weak	Medium	Medium	Strong
Number of workers	Decreasing	Decreasing	Growing	Stable
Management	Profit orientated	Profit and ownership orientated	Profit orientated	Ownership and profit orientated

Table 25

The linear regression coefficients

	Changes in income 1993/96 (n.b.l.[a])	Changes in employ-ment 1993–97	Changes in assets 1993/97 (n.b.l.[a])	The 1996 profit per unit asset (n.b.l.[a])	The 1996 income per unit asset (n.b.l.[a])	The income in 1996 per worker (n.b.l.[a])	The profit in 1996 per worker (n.b.l.[a])	The profit per unit in-come in 1996 (n.b.l.[a])
Age of firm	−0.001	−0.013*	−0.008	−0.017*	−0.016*	−0.021*	−0.030***	−0.007
Former state company	−0.191	−0.163	−0.550***	−0.195	−0.074	−0.433*	−0.544*	−0.199
Firms precedents								
new firm (ref.)								
formation by transformation	−0.056	−0.486***	−0.037	−0.893***	−0.747***	−0.438*	−0.661*	−0.242
formation by separation	0.246	−0.166	0.423*	−0.522	−0.204	−0.534*	−0.932**	−0.384
Ownership type								
foreign (ref.)								
state	−0.211	−0.408*	−0.313*	−1.079***	−0.150	−0.717**	−1.474***	−0.559*
cross holding	−0.287	−0.244	−0.324*	−0.472*	0.395*	−0.013	−1.013***	−0.791**
small shareholder	−0.326	0.098	−0.060	−0.215	0.601*	−0.092	−0.682**	−0.582*
worker-manager	−0.022	−0.242*	0.051	0.024	0.574**	−0.430*	−0.820**	−0.354
owner-manager	0.101	0.251	0.484*	0.017	0.707**	0.028	−0.595**	−0.666*

*$p < 0.1$; **$p < 0.01$; ***$p < 0.001$

[a]n.b.l. = natural base logarithm

Table 25 *(continued)*

The linear regression coefficients

	Changes in income 1993/96 (n.b.l.[a])	Changes in employment 1993–97	Changes in assets 1993/97 (n.b.l.[a])	The 1996 profit per unit asset (n.b.l.[a])	The 1996 income per unit asset (n.b.l.[a])	The income in 1996 per worker (n.b.l.[a])	The profit in 1996 per worker (n.b.l.[a])	The profit per unit income in 1996 (n.b.l.[a])
Branch								
Service (ref.)								
manufacturing industry	−0.021	−0.266*	−0.410**	−0.120	0.042	0.030	−0.360	−0.027
construction industry	−0.064	−0.311*	−0.304*	−0.013	0.525**	0.763***	0.055	−0.334
trade	0.161	−0.493**	−0.307	−0.354	0.352	−0.014	−0.991**	−0.631*
Constant	0.742***	1.926***	1.040***	1.283***	1.385***	2.686***	2.798***	2.261**
R squared	0.02	0.15	0.15	0.16	0.13	0.20	0.23	0.07
F	0.91	6.98***	5.71***	5.55***	5.74***	10.04***	9.18***	−0.249
N	427	476	400	365	476	509	376	375

*$p < 0.1$; **$p < 0.01$; ***$p < 0.001$

[a]n.b.l. = natural base logarithm

The end of post-socialism

On the basis of the analysis of the structure of large company ownership, through ownership, efficiency and the transformation models, we see that the economic transformation has been completed in this segment and that the period of post-socialism has ended. There are no arguments or reasons which justify post-socialism being used as an indicator of the period. In other words, the surviving presence of the socialist economic model or the identification of the explosion and transition of the socialist economy into the market economy are not valid factors for identifying post-socialism.

From the elements (i.e. over centralisation, accelerated growth, imbalance of prices, state ownership and the party state) of Kornai's model of social economy, the party state, the state ownership, the imbalance of prices and the accelerated growth have disappeared, while the degree of economic centralisation is greater in many national economies where the market economy is entirely taken for granted. The differences between the efficiency of large companies can be brought into connection with the transformation of the company—i.e. from state companies or originating from elsewhere—but the conditions for diffuse ownership have unequivocally been terminated and private ownership has become dominant. Decisions about economic policy and the regulations with regard to transformation change according to the model. Hence, it is not possible to talk about the self-regulating mechanism of the market but, in this case, state intervention intended as development policy and not in the sense of restricting the operations of the market. According to our analysis, the different regulations with respect to the transformation model for large state companies, and the state's agreement to take a supporting role during a period of a lack of resources and liberalisation of economic policy, can be viewed as different forms of hidden development support.

From the four models of transformation, three (redistributive, multinational, owner-manager) are market transformations. In the case of the models of multinationals and owner-managers the structure of ownership and the nature of the structure (which are in connection with efficiency) show the market economy organisation. The state and local self-government ownership as a redistributive model and the owners' redistributive role is not contrary to the market economy aspirations of these companies. The role of the state/local self-government helps those companies which the decision-makers deem to be worthy of survival. From the point of view of the transformation of the market economy, the transformation of the corporative model is the most problematic, because in this case the market strategic decisions are interconnected with other views (e.g. ownership group, workers interest). According to the taped interviews, those companies which belong to this model instigated changes, through which the disposal power and the market managerial system quickly showed similarities with the three other transformation models. In the worker-director owned companies, the proportion of the manager's

share grows quickly; this was originally higher than that of the workers anyway, and here in the example of those firms where the managerial share was more than fifty percent, the possibilities of the workers interests, or other ownership groups' interest, and of the division of disposing power interest were quickly terminated. Those managements which became majority owners mercilessly completed the necessary steps for market competitiveness—for example, through a larger proportion of redundancies. This, in cases where workers had large shares, was either carefully carried out or in some cases not at all. The quiet, second part of privatisation which is happening at the present will, in a few years, terminate the characteristics of the corporative model; with this the transformation of the market economy of the large company segment will finish. There seems to be nothing that can obstruct the second wave of privatisation; the post-socialist period is over, at least in the large company segment of the Hungarian economy.

Appendix—the data basis used in the analysis

The analysed data in the study originated from a data survey completed between 1 February and 15 March 1997. The 1993 data survey resulted from the "Social Stratification in Eastern Europe" research programme, led by Iván Szelényi and supported by the OTKA. The 1997 data surveys were led by Iván Szelényi and Imre Kovách; the latter compiled the questionnaire by adapting the 1993 questionnaire. The aim of the survey was to obtain representative data on the leading management of Hungarian companies with the highest incomes (director general, managing director, directors etc.) For this we chose companies with a larger than 200 million HUF income from the 1996 Hoppenstedt-Bonnier company register and later gained a randomly picked survey sample of a thousand elements. (Only companies from Budapest or county towns appear in the survey sample.) Of the planned 1000 interviews 582 took place; the others either refused to answer the questionnaire or we were not able to make an appointment to answer it.

Approximately 80 percent of the questions on the questionnaire referred to the activities, life-styles, family backgrounds and political leanings of the company directors. The other parts of the questionnaire endeavoured to obtain information connected to the ownership structure, the history, the product structure and the marketing of the companies. In sixteen cases, answers were refused for this second section of questions. Thus in total we were able to obtain information about 566 companies.

The distribution of some basic variables of the participating companies in the data basis:

Branches (percent)

manufacturing industry	29.7
construction industry	10.2
commerce	23.0
service	25.4
other	11.7

Number of employees 1 January 1997 (percent)

up to 20 people	15.1
21 – 50 people	17.7
51 – 100 people	17.7
101 – 500 people	35.2
501 – 1000 people	7.7
more than 1000 people	6.7

The 1996 income (percent)

less than 20 mill. HUF	11.0
200 – 500 mill. HUF	30.1
500 mill. – 1 bill. HUF	21.7
1 bill. – 10 bill. HUF	31.4
Over 10 bill. HUF	5.7

Former state company (percent)	43.8
New firm (percent)	37.1
Firm formed through transformation	50.2
Firm formed through separation	10.5

Company assets on 1 January 1997 (percent)

less than 50 mill. HUF	20.2
50 – 200 mill. HUF	28.7
200 – 500 mill. HUF	22.0
500 mill. – 1 bill. HUF	13.1
more than 1 bill. HUF	16.0

1996 profitability (percent)

loss-making	10.8
broke even	3.5
profitable	69.3
unknown	16.4

WWFI97_2-economic branch of more than 10 people

	Observed N	Expected N	Residual
1.00	167	184.3	−17.3
2.00	54	69.3	−15.3
3.00	107	120.3	−13.3
4.00	137	78.9	58.1
5.00	50	62.2	−12.2
Total	515		

Test statistics

	WWFI97_2
Chi Square	51.691
df	4.000
Asymp. Sig.	0.000

a 0 cells (0.0 percent) have expected frequencies less than 5. The minimum expected cell frequency is 62.2.

Chi-Square$_{0.95}(4) = 9.48$—this value of the table is less than the given value of chi-square, so we discount the zero hypothesis which says the two divisions are equal.

Branch industry of the respective firms from I. J. Tóth's works.

	Observed N	Expected N	Residual
Chemical and pharmaceutical industry	18	15.1	2.9
Textile industry	20	33.1	−13.1
Engineering industry	51	41.9	9.1
Paper and printing	17	20.6	−3.6
Food-processing	28	32.0	−4.0
Construction	59	56.2	2.8
Wholesale and retail trade	133	127.2	−5.8
Total	326		

Test statistics

	respective firms branch of industry
Chi Square	9.239
df	6.000
Asymp. Sig.	0.161

as 0 cells have expected frequencies less than 5. The minimum expected cell frequency is 15.1.

Chi-Square$_{0.95}(6) = 12.59$. This value of the table is larger than the given value of chi-square, so we accept the zero hypothesis that the two divisions are equal.

From the WW_EM97: I. J. Tóth, the chosen number of categories of populations. Our sample upwardly distorts only the manufacturing industry, the food processing industry and the trading firms.

	Observed N	Expected N	Residual
1.00	58	59.5	−1.5
2.00	58	135.4	−77.4
3.00	117	94.5	22.5
4.00	82	25.5	56.5
Total	315		

Test statistics

	WW_EM97
Chi Square	174.729
df	3.000
Asymp. Sig	0.000

as 0 cells have expected frequencies less than 5. The minimum expected cell frequency is 25.5.

Chi-Square$_{0.95}(3) = 7.81$. This value of the table is less than the given value of chi-square, so we discount the zero hypothesis that the two divisions are equal.

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WHAT IS LEFT OF "REFORM ECONOMICS"?

L. ANTAL

In the seventies and eighties the so-called "reform economics" became surprisingly popular in certain countries of Eastern Europe, in Russia and later in China. The key issue, raised by reform economists coping with the increasing troubles of socialist economy was: "How could a more effective, more liberal economic system be created with substantially larger role of the market and private ownership without breaking up the framework of the monolithic political and centrally planned economic systems?" This limited way of thinking was inevitable: in this period even the most radical economists did not believe that socialist system would come to an end in the foreseeable future.

Reform economics has frequently been criticised. No doubt, it has never been a theoretical school, has not been in possession of peculiar paradigms. Its main representatives did not belong to a common scientific workshop. Some critics deemed reform economics an irrational vision or wishful thinking because existing socialism was an incurable system. Reform efforts could result at most in the prolongation of the old system's agony.

Notwithstanding these critical remarks reform programs have had considerable effect on economic practice, especially in Hungary. The introduced Hungarian reform was really ambiguous because of its ideological limits yet this limited reform at once ceased the shortage on the market and led to moderate welfare.

Ten years after the Soviet Union falling to pieces reform economics, similarly to kremlinology, lost its relevance. It was replaced by transition economics. Nevertheless, as to the author, former reform attempts nowadays contribute to successful Hungarian transition.

Instead of a precise definition

The only comprehensive work attempting to describe the abstract politico-economical model and the dynamics of the socialist economic-social-political system distinguishes between the transition to the socialist system, the classic socialist system, its reformed version, and finally, the stage of market economy transformation. (*Kornai* 1992) (The author does not deal with this latter.) It considers reforms to be a change—distinguishing them from the frequent technical adjustment (in the terminology of the day, "perfection") of the system on the one hand, and from the profound change of the system, the "revolution", on the other. "Revolution" goes beyond the framework of the given socio-economic system and the changes are deep and at least medium-radical.

As far as the depth of change is concerned, Kornai refers to a set of notions which are also manageable for practical purposes. Accordingly, the most basic factor is the political sphere or, simplified, the monolithic political structure (and its dissolution). Therefore the deepest changes are those that take place in, or start from this sphere. The second level of depth is the dominance of state property.

The third one, which is also partly a consequence of the first, is the predominance of bureaucratic co-ordination. Moving towards the phenomenon level, the fourth group includes such deeper and general system-specific features as paternalism, soft budgetary constraint and weak price sensitivity. Finally, the fifth level comprises a group of superficial phenomena which are relatively easy to change (e.g. by modifying plan indicators or restructuring) but do not warrant in-depth and irreversible transformation. (Forced growth is considered to be one of these; this could be "dropped" within the framework of traditional planning economy, although the propensity remains.)

Given these, Kornai (1992) considers "all changes which modify at least one fundamental feature in at least one of blocks 1, 2 or 3. (these are the deeper system-specific features) without shifting the system outside of the socialist family of systems" as reforms. I believe this is an acceptable approach and it confirms the opinion I have maintained to the present day: namely, that there was a reform in Hungary at the end of the 60's[1] (similarly to Czechoslovakia, though unfortunately for only a year); this cannot be said of the changes in Bulgaria, the Soviet Union, Romania or East Germany although they are often referred to as reforms.

On this basis, reform economics could be considered to be the broad intellectual trend which actually surfaced in the mid-50's (after Stalin's death) in a number of Eastern European countries. In fact, the movement for economic reform even became fashionable and perhaps predominant from time to time, the aim being to reform the traditional planned economy. I emphasize: the aim was to reform and not to exceed, nor replace the planned economy with a capitalist market economy.[2]

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[1] The elimination of the mandatory planning system (as a comprehensive system) proved to be a really relevant and later irreversible change, even if its effects were far from those assumed by many. (This is true in both directions: assumptions of those in favour of reform have also failed to come true; they—including me—had hoped that the narrowed economic reform would be the battering ram which would generate much more penetrating changes involving also the political sphere, thus initiating an organic development process. Neither had those views in opposition to reforms proved true that this change would lead to economic anarchy. Béla Csikós Nagy once remarked sarcastically: "It is not impossible that shoe factories would still produce shoes if they received no specific instruction to do so.")

[2] In the second half of the 80's, many experts in Hungary also considered a transition to a market economy when they openly talked about restricted reforms. Several elements of later Hungarian reforms may be regarded as anticipating a later transformation (e.g. the establishment of a two-tiered banking system, tax reform). Such a change in thinking occurred as a consequence of the limitation of the soft dictatorship and the widespread recognition that the operating economic system had simply become unfeasible. The pragmatism which became traditional to the country gave enough leeway for those engaged in economics (experts, administration managers, and even some politicians) to realise that the system of central planning was not functioning in practice and the only thing that remained important was to maintain appearances.

It was a strange experience that, in 1984, we were assigned by Ferenc Havasi, Secretary of the Central Committee (of the Hungarian Socialist Workers' Party) to elaborate a reform proposal under the leadership of Rezső Nyers and Tamás Nagy. The draft document was prepared and reviewed by the secretary of the Party in charge of economic policy. In the small meeting preceding

This intellectual trend was diverse and extended to several countries, even to those where reform eventually could not gain a foothold. The tides and ebbs of reform waves by and large coincided in the whole of the region. The players in them, however, were far from thinking along the same lines. The only thing they had in common was the realisation that the existing economic system (both in the 50's and in the 60's and at the end of the 70's, to refer only to the typical periods of Hungarian reform waves) had serious weaknesses; these simply could not be solved within the framework, and based on the logic of the traditional (and later, the half-reformed) system of a planned economy. (The solution within the logic of the system was simply a transformation of planning priorities and requirements, and decision-making competence. Based on these, the plan tasks or participating organisations which reacted to the troubles recognised all this, but within the boundaries of an all-permeating consciousness—i.e. central decision-making competence.) A common trait to writings conceived on this level was that they started from a deep (at least deeper than allowed by the "etiquette" of the time) critical analysis of the operating system and proposals were largely aimed at the increased broadening of the influence of market mechanisms (in Hungary, in the 80's, this even concerned the capital market) but without questioning the basic logic of the political set-up and the dominance of the community—i.e. state and co-operative property. (Proposed changes, therefore, in terms of the definition above, were aimed at blocks 3 and 4.)

This study makes no attempt to present all the many intellectual trends related to reform. The first wave of this thinking process include people like the Pole W. Brus, the Slovak Ota Sik, the Soviet Lisichkin, Petrakov, Libermann, and among Hungarians, György Péter, János Kornai and István Varga (who headed the committee which elaborated a reform concept in 1957).[3]

Later on, the number of participants in the reform debate expanded to include such personalities as: Tibor Liska, Tamás Bauer, Károly Attila Soós, Márton

the official debate, Ferenc Havasi said: "In the first twenty pages—I have underlined on purpose—the expressions and synonyms market and capital market appear at least 30 times. Do not forget that I will have to sell this in the Political Committee to Comrade Gáspár and others. Put in there at least something Marxist, let us say the harmony of production forces and production relations. Or is even that not true any more?" he asked meekly.

In my experience, however, this was not the situation during earlier reform waves. Whether because during the 60's and 70' they still believed in the harmonisation of plans and the market as a superior system, or because they thought that the restrictions on reforms could not be surmounted in a predictable period of time (and so it is useless to contemplate it) the majority indeed meant reforms when they talked about them. Some of the early great reformers still pamper this illusion. [See e.g. the "third way" of *Sik* (1985) and *Nove* (1983).]

[3]In terms of Hungary, this concept is included in a collection of texts edited by László *Szamuely* (1986); the collection includes an analytic study by the author.

An evaluation of reform concepts—and reformer types—is provided in an article by Kornai (1986). An overview of international reform literature is found in Kornai (1992).

Tardos, Rezső Nyers, János Mátyás Kovács, Sándor Kopátsy and András Hegedűs. These economists looked at the issue of self-management and later the role of large enterprise management. Much later, in relation to financial reform issues, Lajos Bokros, György Surányi and László Asztalos appeared as significant figures. The organisation system was analysed by Tamás Sárközy and István Csillag, and in addition to them László Lengyel and myself. All the above-mentioned individuals were recurring participants in the reform debates and analyses conceived under the heading of reform. (This list is of course far from complete. It is simply impossible and perhaps pointless to list all writings on the topic of reform—they would fill a library.)

The majority of those listed have to my knowledge worked for shorter or longer periods in various working committees organised either by the MSZMP (Hungarian Socialist Workers' Party) or the government. These committees had the task of drafting proposals for the political decision-making administration and thus excluded the public from the process. This attachment to the administration is of course understandable, and perhaps it was necessary, given that reform initiatives usually started from, or at least had the approval of the enlightened part of the political elite. Thus, being excluded from this group practically also meant exclusion from the opportunity to make proposals and an almost forced resignation from the shaping of events. This situation survived until the mid-80's in Hungary; then, the silent liberalisation of the political system and the increased role of publicity became perceptible (in Poland, although a strong and efficient secondary publicity had been functioning for a long time, the same process was not entirely identical).

In any event, it is a fact that reform literature became extremely widespread and in certain periods it became almost "fashionable". It seized a number of people and it cannot be denied now in retrospect, that the impact they had on public awareness of issues related to economy was unprecedented. Writings on reform and analyses, proposals on the reasons and possible solutions for economic troubles in various fora of debate soon became the focus of attention[4] and over a period of time achieved a breakthrough. What happened during this period gave me a sensation similar to that when I first read about the age of enlightenment. I still consider this to be a great achievement of reform economists and reform economics.

The tentative list of players involved in reform publications clearly proves that one cannot talk about representatives of a certain school of economics, nor about experts with the same values, the same understanding or the same style. Neither the convinced pragmatic and prophetic Liska, nor the strictly professional Tamás Sárközy with his professed cynicism (and who, by the way, does not consider himself to be a reformer, but this does not contradict the fact that some of his writings can be deemed as organic parts of the populous reform literature) (*Sárközy* 1990)

[4] Iván T. *Berend*'s book (1990) provides a thorough, factual and lively evaluation of these debates during the 70's.

can in any respect be placed on a common platform; perhaps their only shared view is that they both regard the state as the cause of all trouble. (However, in my opinion, other, similar comparisons would also lead to approximately similar results.)

Change and reform[5] is probably a piece of reform literature which had one of the largest impacts. Yet, the economic views, the economic and socio-political understanding, and the general thinking of its authors are far from identical. This fact was known at the time the study was born, but later the differences of opinion on sometimes decisive issues—and which over time became deeper—were evident for readers.

Such fundamental differences in views were and remained present in the evaluation of liberalisation and strict monetary policy, despite the fact that the paper took a clear position on these issues as well. Later on, disputes of such nature also appeared in the press. Beyond the obviously opposing opinions, there was a difference in emphasis and in the judgment on the relative importance of certain issues. There were also debates on how far it was possible to go in terms of compromises, and also in terms of expanding the range of issues raised towards topics which point beyond economic topics. Nevertheless, the respective values of participants were not even common in some very general respect.

Yet, in retrospect this was not too serious a problem for the purposes of the product—i.e. it hindered common thinking only as an exception. This naturally demonstrated all the advantages and drawbacks of reform thinking at once, especially if compared with the „Társadalmi szerződés" (Social contract) which was born at almost the same time. Reform thinking in general—although it must be stressed, not all reformers—was lopsided and it sought to narrow the path where it was just possible to match the tolerance of power at any time with the objectivity and strictness which was absolutely necessary for an "outsider". With reference to András Kovács's film, the unyielding reformer wanted to find and of course push out the Walls; the reformer wanted to be inside and informed of not only facts but also the forces and interests which motivated decisions; at the same time, the reformer wanted to stand outside or, at least, keep his distance so that the inherent rules of the system which would result in the reproduction of the system itself and the filtering out of innovation would not apply to him.[6] Thus the reformer's role was contradictory and although theoretically not a failure, in practice there were often failures and this brought disgrace, and in the worse cases, discord.

[5] See: *Közgazdasági Szemle*, June 1987 (short version) and a full version in the magazine *Medvetánc* (1987/4). The position of the Theoretical Working Group of the Central Committee of the Hungarian Socialist Workers' Party and comments by some contributors were also published in *Közgazdasági Szemle*.

[6] This description is appropriate in my case, but it certainly does not apply, for example, to Tamás Bauer who was much less ready to compromise than myself.

One of Aladár *Madarász*'s writings contains the statement that reform economics does not have its own paradigm. He is right and it is perhaps clear by now that I do not consider reform economics to be a school of economics, much less a scientific genre. However, I consider professionalism to be a real requirement (unfortunately, even this is not true of all representatives of the trend) and the possibility of significant work being produced in this area—that is, scientific work—was high on the agenda. It is a fact, however, that this cannot be an adequate measure of reform economics—rather, it should be measured by how much, in its time, it was able to exert influence on public awareness and *through that*, on decision-makers.[7] There is no guarantee that this special role was fulfilled by the deepest, professionally most thorough and, mainly, the most original and innovative intellectual products: there is certainly an overlap, but it is equally certain that the two sets of criteria were not completely congruent, not even in exceptional cases.

If we accept this approach, then

— on the one hand, the competence of reform economics cannot be defined clearly; it is difficult to give an answer to the question: of the analytical and descriptive works in the fields of economics, history, macroeconomics and sociology studies (a number of which surfaced in this period and more than one of which was discussed directly in the reform process or evaluated/re-evaluated during the period earmarked by reform) which can be deemed a part of reform economics and which cannot?

— on the other hand, the measure for judging these works is not necessarily the values of universal science (or the trends and institutions which nowadays approximate to this rank). (All the more so because mature and "chiselled" work is sometimes in the form of a self-motivated scientific performance, legitimised by participants of international conference "tourism". Such work is necessarily durable and its foundations are questionable and actually—and fortunately—come in for questioning from time to time.)

[7] There was a time when I believed *vice versa*—i.e. that others had to be influenced through decision-makers. Today—not a little due to the effect my close colleagues and sometimes friends had on me—I admit that the order, if not in reverse, certainly has one more step in between: communication with the intellectual group which is traditionally able to shape the opinion of others, simply because that is its mission (and of course would not approve of anyone disputing this privilege). I confess, however, that the reverse order—i.e. that power may be influenced primarily through public opinion—was not evident to me, and it has not been evident even in the period which has elapsed since the introduction of the multi-party system. (Sometimes I feel the direct opposite to be true. After the undisciplined loosening of the 80's, the final word is again pronounced by well-versed party bureaucrats, if we search for an authentic evaluation of the economy in various mass communication fora.)

How can the efforts towards reform economics be evaluated?

Three points can be made with respect to the above question.

The first focuses upon the way in which the changes (initiated and partly achieved by the reforms) shifted the system of a traditional planned economy to another (reformed) system and how this affected the functioning of the economy. (It is clearly pointless, as well as impossible, to measure the efficiency of individual reform proposals separately.)

If we try to compare the performance of the Hungarian economy with that of some non-reformed planned economies, the answer is more or less clear. Hungary's growth performance in the long run turned out to be no better after the reforms than that of neighbouring Eastern European countries. Yet there can be no doubt that the equilibrium of the consumer market improved suddenly and in a relatively short time: the domestic population felt this as much as tourists visiting from neighbouring Eastern European states.[8] This improving market equilibrium was directly related to the substantial expansion of the role of market-type coordination, the sometimes supported, sometimes only tolerated expansion of the so-called second economy, and the less rigid regulation of imports from the West. All these changes were in some way related to the gradual, uneven, but after a while, irreversible series of reform steps.[9]

It is also a fact that the reform process managed to produce a peculiar symbiosis between private activities and community property; this changed the motivations and living strategies of employees over a surprisingly broad range of activities. (This sphere includes the household farms established prior to the reform, auxiliary businesses of co-operatives, later the company business units (*vállalati gazdasági munkaközösség*) and various forms of small entreprises, e.g. auction-type rental schemes.)

Based on all this, the negative evaluation of growth performance mentioned above becomes doubtful. On the one hand, the highly unbalanced economy (especially being a shortage economy) was able to present faster growth—at least temporarily—in statistical terms. (This does not even require proof.) On the other hand, the gradual unfolding of a secondary economy, which could not or could only

[8] In one of his speeches as speaker at the Party congress, János Kádár summarised the success of the reforms in a single sentence: "If there is meat, the butcher says hello, if there is no meat, the buyer says hello." There could hardly have been a more tangible critique of the shortage economy for the public than this statement. The otherwise well-founded analyses of theoretical economists on the distorting effects of shortages were of little interest to the public.

[9] Thus, people (e.g. Róbert Hoch) who attribute the improving consumer market situation simply to a change in economic policy priorities and an economic policy focused on living standards (i.e. independent from reforms) are not right. Once the significance of the new type of (meat-eating) socialist people was recognised, way had to be given to the development of household farms and, to some extent, of entreprises.

partially be controlled, demonstrates that growth performance was better (and remained better after the political system change) than that measured statistically.

At the same time, it is also certain that particular aspects of the reform programmes (which were often experiments—for example, the introduction of the so-called competition price system in 1981) did not attain their perhaps most important goals—i.e. the fundamental transformation of the attitudes and motives of companies which continued to belong to the dominant public sector. Profit-orientation remained an empty abstraction or, at best, a distant goal.[10]

Although the economic reforms proved to be effective, the actual results undoubtedly fell short of the expectations of those who initiated them. It is also a fact that economic policy practice came to rely much more than before on reform proposals but in most cases their implementation was half-hearted.

A possible *second* approach is to see whether the concepts and proposals had a direct effect and thus influenced public thinking on a broad basis. Did the process induce debates, intellectual activity or, at least, represent a turning point? If this is the starting point, then it is relevant and necessary to record a few works which were quite successful and effective in the later waves of reform.

These may be the following:

— Tibor Liska: *Kritika és koncepció* (Critique and concept) (1963)

— Márton Tardos: *A gazdasági verseny problémái hazánkban* (Problems of economic competition in Hungary) (1972)

— Tamás Bauer: *A második gazdasági reform és a tulajdonviszonyok* (The second economic reform and ownership) (1982)

— the HVG debate on the necessity of the "reform of the reform" (October–December 1982) in which practically all reform economists involved in the issue participated

— András Hegedűs: *A nagyvállalatok és a szocializmus* (Large entreprises and socialism) (1984)

— László Antal, Lajos Bokros, István Csillag, László Lengyel and György Matolcsy: *Fordulat és reform* (Change and reform) (1987)

Although this list is subjective, it would seem that in the quarter of a decade which preceded the systemic change these were the most important works although from a professional point of view they may not necessarily prove to be the most durable in the long term. (Of course, there are a number of other writings which could, at least, supplement this list and which were important a few years ago. However, these studies, which represented a turning point-type at the time, do not seem so special today.)

[10]This is proved by sociological analyses, corporate case studies, research dealing with the background of corporate and co-operative mergers, analyses on the situation of priority companies and analyses showing the significant development of decisions (also on a sociological basis). Fortunately, all such studies became more numerous in the 70's.

From what is being said here reform economics can be regarded as a loose stream composed of elements which are strictly scientific but there are also reform writings of a less scientific nature. Yet the factor uniting the participants was that they all wanted to surpass the traditional planned economy and this was an important goal for them (regardless of the fact that their respective views of the world were different). Their agreement was that this aim (i.e. reform) was sensible and worthwhile—and could only be achieved by making some concessions to the structures of a market economy.

For the purposes of the development of economic thinking, however, it is more important to point out that this period saw the evolution of an "intellectual renewal task" or some sort of belated economic enlightenment. The products of this can by no means be considered parts of a strictly reform literature but they certainly contributed to the advancement of the reform spirit which started in the mid-60's. A thorough economic history and re-evaluation of the period has elapsed since the planned economy was established [in the book of Iván *Pető* and Sándor *Szakács* (1985)]. Comprehensive macroeconomic—politico-economic works aiming to describe and compare Eastern European economic systems have been published [e.g. the major works by János Kornai (1980), Tamás Bauer (1981) and Károly Attila Soós (1986)]. The econo-sociology trend has gained strength, and it also describes the system from a microeconomic point of view. I consider these works to be outstanding even on an international scale and, at the same time, they represent something which is wider than reform economics.

Over the years, interested intellectuals and an even broader group of the public has learnt to speak "economese". Reform economics developed a language—furthermore, a communication form which does not always operate with a precise set of notions and uses analogies. It strives to make not only the issue raised understandable but also emphasizes its connection with the citizen what infringements of interests it resolves and vice versa, and what it generates. This language and terminology, of course, does not always comply with the strictest scientific requirements, nor is it exclusive and elitist: therefore, it is suitable for public consumption and this is its goal. A number of neighbouring disciplines—e.g. sociology—involuntarily adopted this language later on, for the same reasons.

Thirdly, when considering whether reform economics has itself made an enduring contribution to economic science it is not so easy to give a direct answer. In his book on the socialist system Kornai states that the model of a traditional planned economy forms a closed and coherent system. This is true. It is most probably due to this fact that important comprehensive analyses, be it Kornai's work (1980) or Tamás Bauer's analyse basically the relations of a traditional planned economy. Statements on the reformed system may only be considered as distractions, and are not really organic parts of the aforementioned studies. [The only exception in this respect is Károly Attila Soós' book (1986).]

As the system of a traditional planned economy can be regarded as a closed logical model, the common feature of systems which have evolved in the wake of reforms is exactly that an economy based on the predominance of bureaucratic coordination is made more viable and efficient precisely by changes which contradict the basic logic of the system (and often acknowledged as a necessity). There are also differences between the formalised system set down in rules and the informal system, because the informal system gives way to adjustments which would be very hard to implement under a strictly implemented bureaucracy. Logically, there seems to be only one credible explanation for this, i.e. if the traditional planned economy cannot be reformed and the only course is its elimination. Reform economics, however, adopts arguments which start something like this: "It would still be better if..."

The results are thus contradictory and, after strict descriptive and thorough analysis, an economic system which was definitely confusing many respects appeared to be quite viable as it gave way to the ingenuity of the players. This hybrid system, however, is difficult to explain by the logic of economics, to say the least: this is why the chapters of studies and documents which elaborate the proposals that analyse and criticise past events tend to be more convincing than the subsequent proposals. (The only exception to this rule in Hungary might be the last few years of the 80's, and only because this period could be considered as the beginnings to the collapse of the planned economy and the transition to a market economy.)

At the same time, some objections to this occur in the following form: "Reforms only extend the agony of an unviable system, therefore they might even be harmful". In retrospect, such arguments are also irrelevant because the centrally planned economy, whether traditional or reformed, definitely collapsed at the end of the 80's. The difference is only that, during the reform period, it was possible to buy meat here. That did make a difference.

Rethinking in retrospect

The issues raised by reform economics (which used to be sensitive) have become irrelevant and unimportant today. There is a fraction of reform literature which will probably stand the test of time, will certainly be interesting for economic history just as Polányi's discussions on the agora or native barter trade are interesting. They will, however, certainly not be interesting for the future development of economic thinking.[11]

[11] More precisely, they remain interesting and relevant for those who still think that history will sooner or later arrive at the values searched for but never found by the ideals of socialism (and called "socialist", although one might say they have never been looked for, simply because

This is obviously not a tragedy for the profession. A similar fate must have befallen Kremlinologists. By now, the research topic which used to be interesting in the old days—i.e. that one of the high-ranking Soviet leaders was moved from his room adjacent to Brezhnev's to one floor below—has lost its significance. Similarly, it has become irrelevant to conduct shrewd analyses of what messages certain communist functionaries sent through leading papers—not to the people, to whom they were addressed, but—to each other. This science has lost its significance just as the vegetarian reform research topic "How to make the artificial market more delicious" has become superfluous.

As far as Kremlinologists are concerned, this really means only the elimination of a few research positions or a temporary unemployment problem among the researchers involved. As far as my own position is concerned, unfortunately I have to say that socialism (which has been reformed a number of times) ceased to exist just when I was beginning to understand it. Thus, a part of my intellectual efforts no doubt went to waste and I had to start studying new things—but now with the certain knowledge that the market economy will not cease to exist before I understand it.

János Mátyás *Kovács*'s most recent study (1997) discusses the issue of what enduring values the science of economics, developing on the basis of socialism, has created. That is, has socialism made any relevant contributions to universal economics and if it has, why this has not been noticed in the West.

His conclusion is rather harsh. He thinks that there is a scientific contribution. The realisations "will be indispensable, but primarily as counter-examples which show (off the mainstream) what happens if the majority of the usual assumptions of dominant schools of economics does not apply. In order to become really indispensable, however, first they have to be understandable for the 'big white man'. Less verbal, more formal analyses, more strict definitions, more precise proof rules, separation of descriptive-explanatory and normative, deductive and inductive, and abstract theoretical and empirical procedures, pronouncing the premises, standard language use and the exhaustive reasons for any deviation from that standard, etc., etc.—the most excellent notions introduced by Eastern European scientists have to (should have) overcome these methodological obstacles in order to be comprehensible and consumable for the economics science of the world." (Kovács 1997)

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of the monolithic power establishment); given this assertion the original questions should not be abandoned.

It is a strange twist of fate that there are now a number of platforms on the right wing of the political spectrum which also declare support for capitalism, but are in fact looking for their own solutions from the perspective of a long obsolete romantic anti-capitalism—i.e. some sort of rightist third way. The latter would be described—as far as it seems—by a large mass of sweating small entrepreneurs. These would not only be entrepreneurs but would also work in their own workshops or plants; it would be a capitalism without cheats. From a cynical point of view it would be a capitalism which is not capitalism.

After this, one should not be surprised at the question: "and the ideology historian who looks at the work of this Eastern European economist, what should he do about a discipline the representatives of which may boast that in their best moments they conduct scientific investigations of some marginal cases, or realise which programmes they may not propose for improving the world? They started from 'what to do', but today they also know what not to do."

Yet this picture seems to be rather despondent. The central, fashionable topic of the day (which could fill a library of professional literature) is centered around two topic words: "transition" and "privatisation"; in other words, around the question of how to undo, in a historically minimum time, what has unfortunately been done; again not a typical (nor modern) question for economics. This task—i.e. the almost imperceptible dismantling of what is now sean as a dilapidated structure, will probably not become a part of the main stream, either. There will probably be at least as many mistakes—though different ones this time—as there were in the previous period. (This is not sure of course, but experience so far would seem to confirm this supposition.)

This is not necessarily an indication of failure, for the science of economics (if not each economist) has to deal with what there is. It would have been strange for Eastern European economists of the 60's to focus on the same issues that have excited the theoretical experts of the developed and sophisticated Western market economies over a period of several centuries.

It is true that the majority of Eastern European researchers are not really familiar with the language and habits of the "big white man"—i.e. standard Western economics (though there are exceptions). However, it is far from certain that scientific performance, considered to be mainstream over there, will indeed become a part of universal science; yet this is, of course, uncertain in the case of all kinds of scientific performance. On the other hand, I hope that issues which attempt to provide answers (or at least explanations) not to the questions arising in the most developed part of the world but to the problems of societies and economies which are considered relatively backward will sooner or later become an organic part of universal economics.

Although not easy to confirm, there seem to have been intellectual achievements in recent decades which will be of lasting importance not only provincially but also on a universal scale (and not only in the research of extremities, curiosities, economic Siamese twins but with a much more general scope). (The book by Pető and Szakács surpasses Alec Nove's analysis on Soviet economy in all respects as far as general professional criteria are concerned. Sooner or later this will perhaps be recognised, perhaps even where the profile-competence and appointment lists of universal science valid today are compiled.) In terms of methodology they may

not (or only rarely) contribute, but in approaching the issues, they may provide a substantial contribution to the accomplishments of mature science.[12]

For the time being, what is apparent is that, after the intellectual effervescence of the 70's and 80's, no really significant works have been authored in Hungary. Naturally, it is to hoped that this is just a brief interlude. My impression is, however, that economy is becoming political again and if Lenin once said: "politics is concentrated economy", today we may say that economy is deconcentrated politics, and this is definitely not in favour of scientific development.

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[12]Thomas S. Kuhn's work (1970) on the history of science formulates a strong hypothesis that areas of science which have mature and sophisticated systems of notions and analysis, which are generally accepted and therefore have seemingly unquestionable paradigms, may at a certain point become too conservative; thus they become obstacles to the reconsideration of issues or become self-motivated in themselves. Impotence is but a step from here.

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POST-SOCIALIST TRANSFORMATION AND THE LABOUR MARKET IN HUNGARY— THE QUEST FOR INSTITUTIONAL REALIGNMENT*

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The severe transition-related recession of the 1990s in Hungary was strongly felt in the labour market: employment declined at a rate greater than the fall of production, and real wages declined substantially as well. However, with these socially painful adjustments over, it seems that Hungary's labour market is now reluctant to accommodate the much-hoped-for economic upswing: even under the circumstances of two consecutive years of impressive rates of economic growth and rising investment employment has not started to recover to any perceptible degree.

Preliminary results of our research into the causes of, and possible cures for this apparent closedness of today's Hungarian labour market suggest that, parallel to the dismantling of a large part of earlier internal labour markets, a new institutional infrastructure fitting the logic of operation of occupational type labour markets has as yet failed to evolve. We will argue that it is primarily this uneven process of institutional development (combined, perhaps, with factors widely held responsible for the persistence of unemployment in some long-established market economies) that accounts for Hungary's dismal employment record at the current stage of economic recovery.

The main lesson we will draw from this assessment is that in the years to come a prerequisite of employment-enhancing and lasting economic growth in Hungary is the alignment of the institutional infrastructure of the labour market with the advance of occupational labour markets.

The Hungarian economy in the early 1990s was hit by a severe recession related to the economic transformation.[1] In the course of this process employment declined by over 25 percent—greater than the fall in production—while real wages were being eroded and registered unemployment rose to a rate of over 10 percent.[2] Clearly, a fall in employment greater than the decline of production (with a corresponding improvement in productivity) would hardly have been possible if a good part of the formerly established internal labour markets of large state-owned firms disintegrated and dissolved into occupational labour markets. As a matter of fact,

*This study is a substantially shortened and somewhat revised version of Gábor (1997a). It was presented at the Bamberg–Budapest Inter-University Workshop on "Work in the European Context" (BUES, Budapest, April 7–8, 1999).

[1] The arguments that follow take as a reference the views and ideas advanced by *Kornai* (1993), (1995) and (1996) on the causes of the transformationary recession and conditions of recovery, but they are confined to aspects strictly related to the labour market.

[2] János *Timár* was among the first who noticed that, compared to the dramatic decline of employment that was brought about by the transformationary recession (as a result of which Hungary's employment rate fell from a level higher by far to a level even lower than is typical among market economies), the magnitude of the increase of unemployment was disproportionately small in absolute terms. (Timár 1994).

internal labour markets in recessionary periods act as employment buffers in that they reduce the output elasticity of employment and, by so doing, tend to lower (or slow down the growth of) productivity. [3]

The fact that internal labour markets did recede and give ground to occupational labour markets in Hungary in the 1990s can be explained primarily by privatisation; this brought in its train the predominance of firms too small and unstable to maintain internal labour markets.[4] This is shown very obviously in the sudden proliferation of self-employment. Obviously, given the natural desire of the overwhelming majority of workers for income and job security, such an abrupt proliferation of self-employment could hardly have occurred had employment opportunities in internal labour markets not diminished drastically. Moreover, self-employment in Hungary today is in a large part only a mask that hides extremely precarious employment relations (representing the polar opposite of the kind of employment relationship characteristic of internal labour markets) through which separation costs as well as taxes and social security contributions can be saved. The excessive multiplication of this kind of compelled (pseudo-)self-employment should be seen not as a manifestation of a working population highly entrepreneurial in spirit but rather an indication of a temporary detour, or perhaps even worse: a low-equilibrium trap, of small-business development.[5]

[3] These observations are typically traced to transition-costs economic interpretations of the *raison d'être* of internal labour market-type employment relations along the lines proposed in the seminal paper by *Williamson et al.* (1975); other economic interpretations view the employment relationship as a particular kind of principal-agent relationship and stress problems of asymmetric information and moral hazard; yet there are also others, following the footsteps of *Hirschman* (1970); who point out the importance of "voice" as a political-institutional mechanism of the adjustment characteristic of internal labour markets, as against "exit" as a competitive mechanism characteristic of occupational labour markets—see, for example, *Freeman* (1980).

[4] *Smith* (1988) found that only firms large enough (i.e. with a staff of about 500 at least or, according to *Oi* (1983), 1000) establish internal labour markets. It is appropriate to note here, however, that this piece of indirect evidence and the ones that follow are only poor substitutes for the as yet lacking comprehensive body of relevant statistical evidence. For a systematic approach—whose adoption it is hoped might provide more substantive first-hand evidence before long—see *Groshen and Levine* (1998). See also *Eyraud et al.* (1990) and *Gibbons and Waldman* (1998), respectively, for alternative routes to the estimation of the scope and impacts of internal labour markets.

[5] This is suggested by the apparent inconsistency of the relatively low rate of failure and that of retreat of Hungary's overpopulated and overfragmented small-business sector: as many as two-thirds of those small and mostly young undertakings which were surveyed in 1993 were still in business in 1996. (*Lengyel* 1996) Moreover, the "death rate" of those from among them which had been started under the pressure of necessity was below that of the total sample. Furthermore, although the size of the units (measured according to the number of their staff) that had survived increased somewhat during that three-year period, this did not hold for the small-business sector as a whole—see figures in *Footnote 9*. For my view of the state of health of the Hungarian small-business sector and its developmental prospects see Gábor (1997b).

Another piece of indirect evidence of the disintegration of formerly established internal labour markets and their dissolution into occupational labour markets is the withdrawal of firms from regular training: the role they used to play in regular training by establishing and operating apprentice workshops in their factories (i.e. as a device to gain access to a larger and selected pool of skilled young workers) is now increasingly assumed partly by workshops run by the training schools themselves, and partly by micro-businesses which can thus benefit from tax relief (and also from informal fees that families of apprentice candidates without a place of practical training might be forced to pay).[6] A similar conclusion can be drawn—tentatively at least—from the marked devaluation in the 1990s of labour market experience *vis-à-vis*, for example, formal education;[7] it can also be seen from the observation that, other things being equal, those from among the unemployed who, prior to unemployment, were relatively low paid in their jobs—and can thus be assumed to constitute a sub-sample in which workers with shorter or no tenure in an internal labour market are overrepresented—, if they are re-employed, typically register a wage gain, on the other hand, the formerly better-paid reemployed will typically suffer a loss.[8] As for waged employment in micro-businesses, registered employment is rare among these.[9] However, where it exists, it does so mostly in the form of casual/seasonal and part-time employment with practically no guarantee of job and/or income security of any kind. Furthermore, small-business owners prefer to rely on references obtainable from fellow-entrepreneurs when searching for new employees (Laki 1997)—again a practice that would clearly be foreign in an internal labour market context, where employers usually do better by relying on recommendations from their workers.

Of course, it would be a mistake to assume that internal labour markets in Hungary have been deprived entirely of their conditions of existence. (Yet it

[6] While the number of apprentices participating in regular vocational training dropped by 17 percent between 1990–1991 and 1993–1994, those from among them who attended training shops run by schools even increased by 58 percent, while the number of apprentices trained in groups at firms decreased by 49 percent. At the same time, participation in other (non-group) forms of regular training grew by 12 percent. Source of figures: *Benedek* (1994).

[7] See *Kertesi and Köllő* (1999), who regard this finding of their estimations of Mincerian-type wage equations as an indication of a general devaluation of practical skills accumulated in the pre-transformation era.

[8] This observation is reported (and given a hypothetical interpretation that—unlike the one I am proposing—relies on the theory of statistical discrimination) in *Köllő and Nagy* (1995).

[9] According to figures reported in *Laky* (1996), the average number of employees in unincorporated small-undertakings of single owners—typically own-account workers—did not change from 1993 to 1995: it remained as low as 0.3. As for corporations, the ratio of those with a staff of less than 20 even increased—from 72.5 to 87 percent—between 1991 and 1995. A particularly striking increase could be observed in the ratio of the smallest corporations: the proportion of those with a staff of 10 or less grew from 47.6 to 74.8 percent in the two-year period from 1993 to 1995; it then continued to grow—and at the time of writing had reached well over 90 percent (December 1998).

must be pointed out that it would be a mistake to ignore, when talking about the predominance of internal labour markets, the role occupational labour markets played in the 1970s through the 1980s as places of employment for those large segments of workers who were only loosely attached to the labour force and/or eager to accept less-remunerative and less-demanding jobs—or who were simply unskilled and untrainable.) Managers of newly-established Hungarian subsidiaries of multinational companies, particularly in the engineering industry, for instance, do their best to adopt Western-type internal labour markets. This is demonstrated by their efforts to build up their own systems of training as a private source of supply of skilled labour for themselves. In other cases involving the privatisation of existing firms, to the extent the privatisation was not followed by the introduction of new technologies—the old-type, informal internal labour markets were left almost unaltered, in spite of management efforts.[10] What is being stressed here is that in Hungary today a much smaller proportion of workers has chance to be employed in internal labour markets than was the case in the 1970s and 1980s; moreover, a much larger proportion has to be satisfied with the employment opportunities which occupational labour markets offer (for the most part including self-employment).

Meanwhile, however, the labour market in Hungary has become conspicuously closed and inflexible. Notwithstanding the remarkable gaining of ground by occupational labour markets, it has responded to economic recovery in ways which not even the predominance of internal labour markets would imply. As a matter of fact, even under the conditions of positive economic growth and rising investment, employment continued to decline up until 1997 and showed only an insignificant (i.e. a few decimal percentage) increase last year; in spite of the fact that the majority of those squeezed out of employment in recent years have withdrawn from the labour force—particularly those with little hope of being rehired later—and are now economically inactive (therefore not counted as unemployed), long-term unemployment is not diminishing; what is more, wage inflationary pressure has not lessened.[11]

This paradoxical behaviour of the Hungarian labour market—namely, excessive job-rationing[12] and wage-inflationary pressure in the context of occupational

[10] This has been demonstrated by the case studies—e.g. *Bódis* (1996), (1997) and *Janky* (1996)—of an ongoing research project (entitled "Economic sociological investigation of hierarchical economic organisations") inspired by the ideas of *Csontos* (1994) and coordinated by him until his unfortunate early death in 1997.

[11] For a solid and carefully documented general account of the labour market impacts of the first half-decade of the Hungarian economic transformation see *Galasi and Kertesi* (1996).

[12] The phenomenon of job rationing as a regime in which otherwise apt outside applicants are widely denied jobs (despite their lower wage claims) is traced back, by efficiency wage theories, in part to workers' unobserved heterogeneity. This being the case, and considering the fact that the existence of internal labour markets is also traced back in part to this heterogeneity, it follows that efficiency wages and internal labour markets are in this respect conditional upon each other. (Cf. *Weiss* 1990.) Further, it should be noted that the role internal labour markets may play in

labour markets—can be said to be intellectually embarrassing. More importantly, it involves the danger that the ongoing economic recovery will fuel wage inflation to a degree that calls for restrictive economic policies, with the consequence that the recovery may get stuck before growing demand for labour could bring forth any sizeable increase in employment.[13] Furthermore, overtly excluding character of the Hungarian labour market, as a result of which huge masses of people devoid of entrepreneurial spirit are notoriously deprived of the possibility of waged employment and are compelled to make their living as self-employed, may contribute to the perpetuance of the current unfortunate state of affairs; in the latter, overpopulated and overfragmented small-businesses are a medium for the acute danger of long-term economic dualisation—consequently they represent a threat to, rather than a catalyst for economic transformation. In order to escape these dangers it is essential to explore what it is that causes labour market inflexibility.

Obviously, differences in historical precedents and peculiarities of the transformationary recession preclude the possibility of extracting immediately adaptable lessons and direct guidance from treatments of the labour market rigidities which market economies experienced following the oil-price explosions. At the same time, a special account of their findings, and considering them in the light of the peculiarities of the Hungarian case, may serve as a useful starting point of exploration.

It is important to note first that, similar to the situation which the majority of the developed market economies faced following the oil price explosions, Hungary in the 1990s got acquainted with high unemployment rates coupled with high rates of inflation. This syndrome, commonly known as stagflation, was originally assumed to arise partly due to the anomalies of adjustment ("friction") accompanying accelerated structural changes. It is assumed that the larger the structural (e.g. regional, occupational, etc.) disequilibria of the labour market at a given point of time, the higher the rate of unemployment necessary to discipline inflationary pressure.[14]

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maintaining a regime of excessive job rationing is also tacitly acknowledged in the so-called insider-outsider approach by *Lindbeck and Snower* (1988). In this approach insider workers, understood as "full-fledged employees", are claimed to be able and willing to make underbidding by the outsiders expensive for the employers to accept and/or disagreeable for the outsiders themselves to engage in.

[13] In this discussion of the role which the development of wages and consumption have played in the transformationary recession, and of the kind of income policy to be pursued in the recovery, Kornai repeatedly calls attention to this danger—see Kornai (1993; 1995; 1996).

[14] Namely, the higher the natural rate of unemployment in a competitive economy and the higher the equilibrium rate of unemployment (NIRU or NAIRU) in imperfect competition—the latter is understood as the rate at which workers' real wage claims and firms' real profit claims are consistent with each other. As a result, price-inflation expectations are fulfilled. Note that the theory of imperfect competition is itself a product of the 1980s—see *Blanchard* (1986) and *Blanchard and Summers* (1986). Since the arguments below refer to the conditions of imperfect competition, the concept of equilibrium unemployment is adopted hereafter.

An important implication of this approach is that, with accelerated structural changes having been accomplished, stagflation is bound to disappear—an implication that was not entirely supported by later experience. It is true that equilibrium unemployment declined in the 1980s but not as far as its pre-stagflation level and with considerable variation among individual countries. This directed analysts' attention to the effects institutional factors such as: 1. labour market corporativity, 2. path-dependency of equilibrium unemployment (usually labelled as hysteresis) or 3. internal versus occupational labour markets may exert upon a country's unemployment performance. It is the responsibility of these factors for the inflexibility of the Hungarian labour market that are now considered below.[15]

1. Initial attempts to find out why the unfavourable effects of the oil-price explosions lasted longer than had been anticipated, and why they varied in degree from country to country, yielded the assertion that there exists a theoretically well-arguable U-shape relationship between labour market corporativity (i.e. centralisation of wage negotiations) and unemployment performance.[16]

Centralised (macro-level) collective bargaining is claimed to have the most favourable properties on the ground that unions negotiating in such setting are in a position which both allows and enables them to take full account of the unfortunate effect excessive wage claims (ones that are inconsistent with the anticipated growth of productivity) may exert on the rate of price inflation. Thus, on the one hand, they will not easily fall victim to wage illusion. On the other hand, they are aware of the danger an unanticipated acceleration of price inflation entails—namely, that it normally invokes restrictive economic policies as counter-actions; in turn, these result in declining employment, which imposes involuntary unemployment upon a part of their membership and increasing burdens of unemployment benefit contributions upon the rest.

Micro-level collective negotiations are claimed to have favourable properties as well; this explains the relatively good unemployment record of those countries in which unions are engaged typically in firm-level bargaining. Here, trade unions will feel obliged to show self-restraint for they know that, with a firm facing highly price-elastic demand for its products, workers face highly wage-elastic employment opportunities. Consequently, unions will fear that higher wages (whether or not increasing production costs are passed on to buyers in the form of higher prices) may lower the firm's profits (either because of falling revenues or as a consequence of lower profit margins) and induce decreases in staff numbers.

[15] References to the literature on which the relevance of these factors for Hungary is considered are placed in footnotes at the respective sections.

[16] See *Calmfors and Driffil* (1988). This view, which came to replace previous views of a more linear, negative relationship between the level of collective negotiations and macroeconomic performance (see, for example, *Bruno and Sachs* 1985), itself came under attack in the 1990s (see, for example, in Lindbeck and Snower 1997) and is widely regarded as outdated by now.

Industry-level bargaining, in contrast, is clearly the worst alternative setting as far as equilibrium unemployment implications are concerned; this is because industry unions negotiating separately will act like non-cooperating players in a prisoners' dilemma game. That is, they will know that none of them has to carry full responsibility for the impact excessive union wage claims in the aggregate make on the rate of unemployment and inflation. Given that each of them will know that everybody else will think this way and act accordingly, they all are likely to end up showing minimum restraint. Also, with demand for an industry's output being less price elastic than for a firm's (as a consequence of the lower substitutability of an industry's output), industry unions have less reason to bother about the industry-level employment impact of their wage claims.

Now, in Hungary today, taking the as yet rudimentary state of industrial relations into consideration,[17] one should be sceptical about the merits of an explanation of labour market inflexibility that draws too heavily on the above arguments. If the differential equilibrium unemployment impacts of different degrees of corporativity are as claimed, the most one can extract as lessons relevant to the Hungarian case are "ifs". One can only say that, had macro-level tripartite negotiations turned out to be more productive, and/or had the implementation of some kind of Western-type income policy (that would have filled the gap the hasty elimination of central wage regulation in 1990 had left behind) been tried and found effective as a device for moderating wage inflation, etc., then Hungary might have tided over the economic transformation at lower costs—i.e. with less restrictive economic policies and thus lower job losses.[18] Similarly, equilibrium unemployment in the years ahead could in principle be favourably affected by a macro-level collective agreement in which the parties would commit themselves to moderate wage inflation. Realistically, however, it is exactly the present rudimentary state of industrial relations that makes it hard to believe in the feasibility of such an agreement. Hungary's strongly divided trade unions, keenly competing for a shrinking constituency base, can hardly be expected to enter into such an agreement. Should they eventually become resigned to doing it, it would be naïve to assume that they would really be able to meet the negotiated terms in a consistent way.

2. Similar doubts can be cast on the merits of the oldest (but still quite recent) versions of path dependency arguments (Blanchard and Summers 1986, 1991) as far as their relevance to Hungary is concerned. True, they start out from the assumption that trade unions act as partial representatives of insider workers' interests—a kind of partiality which is clearly manifest in union behaviour in Hungary as well. This partiality, however, could produce hysteresis only in so

[17] For facts which substantiate this unfavourable general assessment see *Ladó and Tóth* (1996).

[18] In his assessment of the results of the much discussed corrective measures of the Bokros-package, Kornai (1996) himself sees it as a fortunate accident, presumably the consequence of a surprise inflation, that real wages declined considerably in 1995.

far as our unions were massively involved in wage setting.

As against these early explanations, later interpretations of this same phenomenon are based on assumptions that do seem directly applicable to the Hungarian case. Namely, they assume that either employers are (for good reason or not) reluctant to hire from among the long-term unemployed or (if only for this reason) the long-term unemployed lack the confidence necessary to effectively compete for jobs, or both. They argue that since increasing unemployment tends to increase the incidence of long-term unemployment—i.e. the proportion of long-term unemployment—it causes an upward shift in equilibrium unemployment which means an increase in wage inflation at any given level of total unemployment.[19]

True, these latter interpretations also examine wage setting in a collective bargaining context. Nevertheless, they may serve as a suitable reference in finding out the causes of labour market rigidity in Hungary. This is because, in the first place, they allow, implicitly at least, for the possibility that, thanks to the high proportion of long-term unemployed in total unemployment, large segments of insider workers remain defended against the unfavourable impacts of massive unemployment—even with the lack of strong union support. Moreover, their reasoning would even account for the kind of low-employment-equilibrium trap situation where the disciplinary (i.e. wage-inflation moderating) effect of an initial increase in total unemployment has been more than offset by the sufficiently large increase in long-term unemployment it called forth. Yet, what would be essential in the adoption of these interpretations to the Hungarian case is to address the issue of what (presumably institutional) factors determine whether a given (increase in the) rate of unemployment is likely to be associated with larger or smaller (growth of the) incidence of long-term unemployment.

Finally, according to a third characteristic explanation, the observed dependency of current rates of equilibrium unemployment on past rates of unemployment is primarily connected with the fluctuation of capacity utilisation in the course of a business cycle. (Soskice and Carlin 1989) Namely, with capacity utilisation having declined in the initial phase of a recession, a fall of investments and an increase in capital scrapping are bound to follow—with the result that capital stock will shrink. Granting this, when recovery comes it soon leads to an overutilisation of the undersized capital stock, with the consequence that price and wage inflation will start to accelerate at a relatively low rate of employment (and a correspondingly high unemployment rate).

[19] See *Layard and Nickell* (1996). Although this line of reasoning appears to differ fundamentally from the previous one in its departure, as *Lever* (1995) pinpoints: depending on how broadly or restrictively the notion of "outsiders" are defined—whether it is meant to refer to the long-term (how long?) unemployed only or, more broadly, to the unemployed, or it should embrace non-union member employees and/or workers in non-internal labour market jobs as well—can one regard the two lines of reasoning at theoretically more or less distinct from each other and attempt to decide (possibly with the help of econometric analysis) which of the two fits reality better?

Given the enormous magnitude of the reduction of capital stock that accompanied the transformationary recession in Hungary, this argument deserves serious consideration. At the same time, it should be kept in mind that hysteresis of such origin, unless the rise of inflation thus induced is diagnosed incorrectly and suppressed by hastily adopted restrictive economic policy measures, is transitory by nature. Moreover, the timely anticipation of an imminent and fast recovery may give impetus to business investments early enough to simultaneously accelerate the upswing and prevent an undue transitory rise in inflation.

3. While traces of the ideas reviewed and reflected upon in the foregoing appear incidentally in the study of the ongoing transformation of the Hungarian labour market, the marked and sudden contraction of the domain of internal labour markets and its bearing on the prospects of economic transformation have somehow remained beyond our range, leaving obvious parallels with market economy experience unrecognised and unexploited.

In order to amend this deficit, reference here is made to the marked correspondence that cross-country comparative labour market studies usually reveal between the historically established patterns of coexistence of internal versus occupational labour markets and certain aspects of the institutional infrastructure that surrounds the labour market (e.g. vocational training, statutes of labour, industrial relations, employer and employee attitudes and norms of behaviour, etc.).[20]

The instrumentality of this correspondence becomes obvious in the light of the costs parties to an employment contract—i.e. workers and firms—incur if they terminate their contract: the lower these transaction (separation/replacement) costs, the more viable occupational labour markets are.[21] These separation/replacement costs are in turn lower, the closer substitute job offers of different employers are for a worker with a given qualification, and the closer substitute workers with a given

[20] See especially Eyraud et al. (1990). Also see *Hashimoto and Raisian* (1988). *Schmid* (1995) and Freeman (1998) are particularly persuasive in their pointing out the importance of the recognition of the way labour institutions fit together for an understanding of their outcomes.

[21] These costs include the so-called "quasi-fixed" costs of employment born by employers (i.e. costs of recruitment and selection, direct and indirect costs of training of newly hired workers, severance payments, etc.) as well as those direct and indirect costs that workers incur if they change their place of employment (e.g. search costs, reduction in one's expected life-time earnings, etc.), which might be substantial in internal labour markets and negligible in occupational markets. (Oi 1983.)

Note that equilibrium unemployment is also seen as a function of institutional factors—namely, of the existence of severance payment, a characteristic of internal labour markets—in the multiple-equilibrium model set up by *Saint-Paul* (1995) in the spirit of Blanchard and Summers (1988). In that model severance payment has an unfavourable impact on equilibrium unemployment partly by discouraging separations and partly by strengthening the bargaining position of (insider) workers. This gives rise to the conjecture that the first two of those explanations of high equilibrium unemployment that were discussed above (under the heading of hysteresis unemployment) overlap with the ones that concentrate on the effects of institutional factors related to the type of labour market.

qualification are for a firm—i.e. the more standardised the skill-requirements of a given occupation and the actually acquired skills of workers with a given qualification are. The more standardised occupational skills and skill-requirements are, the more reasonable it is that occupational skills be acquired in specialised training institutions which are obliged to respect the established occupational standards in their subject-matters of instruction, rather than in the form of on-the-job training. Furthermore, under the conditions of low separation/replacement costs involved with highly standardised occupational skills acquired in specialised training institutions, workers can best promote their interests collectively by forming or joining unions that are organised along the lines of crafts and occupations; they can then press for collective agreements that include well-defined job demarcation lines and formal qualification criteria of admittance that are uniform throughout the economy.

In contrast, with an internal labour market, a two-pillar system of vocational training is compatible: basic occupational skills acquired at school are complemented by a large number of special skills, varying in contents from firm to firm, which can only be acquired while working. Given the long duration of employment contracts and the strong bearing of the length of tenure and on-the-job training on earnings and promotion, workers can best advance their interests collectively by forming or joining unions that are organised at the level of the firm (or group of firms within the same branch of the economy), and by pressing for collective agreements that include well-defined and enforceable rules of hiring, firing, and promotion (possibly together with other kinds of job property rights provisions).

Whether the configuration of the labour market and its institutional infrastructure in a given country at a given time is more internal or occupational in its nature is the result of a historic process of institutional evolution. In the course of that process, tensions arising from the perception of unexploited opportunities and/or unfulfilled expectations by workers and firms (e.g. dissatisfaction with each other's attitudes and behaviour, with the performance of training institutions, with the prevailing system of collective bargaining, and so on) would call forth institutional adjustments that gradually eliminate inappropriate institutional elements. Presumably, it is mainly these gradual adjustments that eventually produce a constellation which is largely self-perpetuating (with compatible and mutually reinforcing opportunities and expectations) even amidst extreme swings in the economic environment.

The particular equilibrium that such a stable, self-perpetuating institutional configuration represents should be respected by labour market policies as well (themselves coming within the institutional infrastructure of the labour market); this is especially important given that it constrains the choice of the effectively adaptable set of policy instruments. Faced with a predominantly internal labour market configuration, for instance, active labour market policies should take into

account the fact that participation in retraining programs cannot procure tenured jobs for the prime-aged unemployed, and to the extent this is known to them, they may be reluctant to undergo retraining. On the other hand, a configuration in which the typically occupational labour markets of small firms dominate, granting wage subsidies to employers hiring from the unemployment pool will not be cost efficient either: non-renewable, short-term employment relations and high turnover rates will result.

As for the present situation of the Hungarian labour market, it is far from any kind of a self-reproducing institutional equilibrium. As a matter of fact, the remarkable advance of occupational labour markets has not been accommodated by the institutional environment. Namely, parallel with the liquidation of an increasing part of firms' apprentice workshops, the kinds of skills and qualifications which can be acquired in vocational training have become ever less transparent and standardised—lack of coordination and supervision has led to an enormous inflation of certificates of dubious credence and market value.[22] Moreover, the fall in investments, caused by the recession, by hindering the process of large-scale replacement of obsolete capacities, has retarded the devaluation of job-specific skills and thus the diminution of separation costs. Trade union organisation along the lines of crafts and occupations has not gathered momentum either. Finally, while the expectations of the main army of the unemployed bear the imprints of their earlier internal labour market experience, too many of the newly trained face, as job applicants, the disheartening experience of distrust towards their qualification certificates on the part of employers.[23]

Taking established market economies as a reference, the advance of occupational labour markets in Hungary in the course of transformation should thus be assessed as an irregular, uneven process. In the period of transformationary recession the role of internal labour markets as employment buffers has been reduced (perhaps, even beyond what one would regard as normal in a market economy); yet the conditions of operation of occupational labour markets have not been created (i.e. low separation/replacement costs, that could have effectively moderated wage-inflationary pressure by intensifying competition between insider and outsider workers, etc.). Such being the case, active labour market policies (like massive re-

[22] To refer back to regular vocational training, what lies behind the category of "training not in groups" as a form of training currently being practised is in large part training in technologically obsolete and/or narrowly specialised shops in the small-business sector. For this reason alone, such training is not appropriate for introducing apprentices to the complexity of an occupation.

[23] That those who enter the labour market after completing their studies in regular vocational training have, nevertheless, relatively good chances to get a job can partly be explained by their willingness to accept jobs that were and/or could be filled with unskilled workers. (This explanation is suggested in Chapter 5.3 of *ILO* 1997.) It is indeed reasonable to assume that, to the extent school and/or qualification certificates are unsound signals of one's acquired general knowledge and/or occupational skills, employers are induced to hire formally overeducated and/or overskilled workers.

training programs or generous wage subsidies) have, as a matter of course, not been particularly effective either.[24]

The main lesson to be drawn from our assessment of the Hungarian situation is that, assuming occupational labour markets retain their prominence in the future, a prerequisite of the degree of labour market flexibility and policy efficiency necessary for sustainable economic growth is the formation of an appropriate institutional infrastructure—namely, one that fits and confirms the logic of operation of occupational labour markets. This could, perhaps, best be promoted immediately in Hungary by redesigning the system of vocational training in a way that could yield transparency. The work could start with the specification of the skill-requirements of occupations and then continue with the elaboration of their standard cores of instruction—these are huge tasks, which can only be carried out successfully with government assistance or the involvement of organisations representing workers' and employers' collective interests. One of the most important points is that the credibility of qualification certificates issued by training institutions has to be reestablished so that the expectations of workers and employers can gradually adjust to the principles of operation of occupational labour markets and in this way the principles will be reinforced by fulfilment.

It is true that one could hold the assumption that, facing an institutional infrastructure seemingly inconsistent with the logic of operation of occupational labour markets, employers will increasingly resort to building up their own internal labour markets. The result of this would be that the present anomalies of the disrupted institutional balance of the Hungarian labour market would gradually be eliminated. Nevertheless, the confrontation between the indications in the equilibrium unemployment literature after the oil price shocks and the diagnosis of the overtly excluding character and inflexibility of the Hungarian labour market, suggests the following: considering the urgency of a marked reduction of wage inflation as a condition for any sizeable expansion of waged employment (this latter being in turn, as was pointed out, a necessary condition of small-businesses embarking on the road to modernisation), it is the predominance of occupational labour markets that promises a smoother way to economic development.

Yet even accepting the argument that infrastructural institutions (e.g. vocational training, collective bargaining, statues of labour, expectations of employers and workers, active labour market policies, etc.) should be brought into conformity with the operation of occupational labour markets, one must still pose the question

[24] Based on a wide range of unemployment literature, *Falusné Szikra* (1991) drew attention to the important role active labour market policies would have to play in the initial stage of economic transformation, and attempted to specify the main "strike directions" that she believed could be appropriate under the constraints of transformation. Yet, her expectations, although moderate compared to the views prevailing at that time, turned out to be too ambitious in the light of later experience.

of whether this would not result in a degree of institutional homogeneity that, while promoting short-term flexibility, endangers long term efficiency.[25]

True, mutually reinforcing interactions taking place between a dominant type of labour market and an institutional infrastructure that conforms to it are such that they have, as a matter of course, unfavourable impacts on the costs of operation of the non-dominant type (i.e. they impose excess costs of training, search, collective bargaining, etc. on those who would rely on it), thus inhibiting the latter from ever becoming predominant. Nevertheless, it can subsist in its non-dominant position and thus contribute to the perpetuation of institutional heterogeneity in so far as its comparative advantages are large enough to compensate for these excess costs. After all, a firm can benefit from an internal labour market even in an occupational type institutional environment inasmuch as certain individual characteristics of workers are of vital importance but can only be learned and/or acquired after several years of service, or as long as a low turnover rate is worth these excess costs for some other reasons.

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[25] Based on a wide selection of the relevant literature, *Grabher and Stark* (1997) convincingly demonstrate the importance of organisational diversity in the evolutionary potential of economic institutions in general, and under the conditions of post-socialist transformation in particular.

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THE TRANSFORMATION OF AGRICULTURE IN HUNGARY IN THE NINETIES

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This study attempts to identify and describe the reasons and tendencies for contemporary developments in Hungarian agriculture and to demonstrate that the transformation of agricultural relations is not complete yet. Therefore, proposals to codify and institutionalise the *status quo* are *ab ovo* senseless and will do more harm than good. Agricultural programmes (or national programmes covering agriculture as well) and policies specifying their goals, instruments and schedules must reckon with the fact that they will take effect in an environment of transformation.

The study includes the following sections: short historical overview with special regard to issues relating to economic structure and population; summary of the major symptoms of the current crisis in agriculture based on relevant domestic literature; short survey of the beginnings of privatisation in the agricultural sector, a picture of the present state of the land issue, a record of the recent performance of agriculture and of social and economic policy measures taken so far and a few- short and medium-term conclusions.

Conceptual framework

In general, most international experts consider agricultural transformation to be complete once the bulk (e.g. 90 percent) of arable land (and occasionally of other farm property) has been transferred to private ownership. (*Lukas* 1997) Many Hungarian analysts already speak of what they call "consolidation" after the initial crisis brought about by the transformation.[1]

Hungarian policy-makers have drawn up medium- and longer term modernisation programmes (*Magyarország...* 1995); the previous government published the main principles of the National Agricultural Programme (*NAP* 1997) in 1997 and, at the end of the same year, Parliament passed an act of the development of agriculture.[2] EU accession negotiations are beginning in the near future, and technical and organisational requirements concerning legal harmonisation and many other issues, need to be resolved if progress is to be made at the negotiations. Moreover, the rules of international trade in agricultural produce approved by the

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[1] The relevant programme referred to in the next is *Földművelésügyi...* (1997)

[2] 1997. évi CXIV. törvény az agrárgazdaság fejlesztéséről (Act CXIV of 1997 on the development of agrarian economy). *Magyar Közlöny*, No. 102., 1997, pp. 7273–7275.

World Trade Organisation of the United Nations—WTO—(on customs, and acceptable instruments of market protection and subsidies) are also known; this is also true of the ways and means used by OECD Member States to abide to them; finally, we also know that the world and the international financial institutions expect the transition economies to show growth (by around 5 percent of the GDP annually) in the next few years. Numerically, these would allow the current Hungarian agricultural output to be doubled. Since no external constraints implying serious hindrances are in sight, we could, in principle, draw up a forecast on the basis of the above.

The main reason why this has not been done is that, as has happened several times in the 20th century, (and in the 19th, too) domestic relations in agriculture have turned into a battleground for acute and intensifying social tensions. The present problems have been going on now for almost 15 years. This tension is rather extensive in the sense that it affects a substantial part—i.e. almost half—of the population of the country; since these tensions do not have their origins in agriculture alone, no reassuring solution can be found within a solely agricultural framework. So strong are the tensions that they deprive any specific agricultural programme of meaning and they can even be regarded as obstacles to Hungary's accession to the European Union. This issue will be returned to later on, but it should be noted in advance that the crucial problem is that social groups who are opposed to each other cannot or will not participate in these programmes (or, at best, would only like to use individual elements included in them, and only in mutually exclusive ways). Therefore the present agricultural structure, while reflecting actual power relations despite the ongoing process of transition, would be difficult to reconcile with that of the European Union. (Fertő 1997)

Historical overview

In Hungary, the same set of development symptoms affecting economy and society in quasi-identical ways has recurred time and again over the last hundred-and-fifty years. The main structural elements of this complex situation are land shortage and rural over-population; underlying this problem, at the level of economic structure, there is insufficient demand for industrial activities and services on the input side, and on the output side a low demand for the processing and sales of agricultural products. Typical concomitants of the above are shortage of capital in agriculture and contraction and swelling of poverty in villages. All these are on such a scale that they prevent the rapid progress of overall economic development. Moreover, surplus labour originating in agriculture cannot be absorbed (which is also a problem for villages in general).

In the first half of the 19th century Hungary could still be qualified as a purely agricultural country (with 75 to 80 percent of the total population working in agriculture); furthermore, its economy was characterised mainly by bounded labour (corvée) and other compulsory services for peasants with respect to the estates of the nobility. The abolition of feudal charges (proclaimed in 1848) was finally codified in the imperial edicts of 1853, on the basis of the more-than-a-hundred-year-old socage settlement of 1760. The latter had been designed for a completely different population and different economic relations (and even at that time it had certain intentional distortions). The surveying of land only began in 1856, the end of the process left approximately half of the former estates' labourers without land of their own. The last legal hope related to the status of former manor cotters was blocked by an act of 1896. However, legal disputes concerning land distribution were still going on as late as 1912; the last procedural order was completed in the summer of 1914 (although its announcement was prevented by the break-out of World War I).

After a lost war, revolutions and the Trianon Peace Treaty, approximately one quarter of the Hungarian population consisted of farm servants (resident estate workers), landless villagers and their family members, and another 10 to 12 percent of owners (tenants) with plots of under 5 "hold" (i.e. 2.9 hectares). Such plots were not sufficient for subsistence. The land reform of 1920 allocated land to some 300 thousand landless workers and dwarf holders (with another 110 thousand cases affecting other categories). With this reform, the 35 percent of the population living from agricultural subsistence remained almost unchanged until World War II. (The Upper House approved a seriously trimmed version of Pál *Teleki*'s extremely moderate 1939 Bill concerning the redemption or leasehold of a total of 1.4 million cadastral "hold" (about 0.8 million hectares) over a period of ten years, but this was not implemented.)

Land reform in 1945 brought about three major changes: it gave land to approximately half of the farm servants (i.e. approximately 110 thousand individuals) and more than half of the landless agricultural labourers (approximately 261 thousand), and also to another 247 thousand dwarf and smallholders (whose average family plots were already 2.9 ha). The reform created around about 400 thousand new farms. (Farm servants received the biggest plots.) Even so, the reform failed to satisfy at least some 90 thousand claimants and their families.

In spite of the above state of affairs, the stubborn hunger for land, and rural over-population, major social conflicts were rare. There was always some external circumstance—related to economic or other trends—to conceal the signs of underlying tensions.

From the 1850s to the 1880s unskilled village labour was absorbed by the exceptional boom brought about by infrastructural development (e.g. railway and road construction, and regulation of riverways; here they worked as navvies). Once this process was over (and under the impact of other circumstances such as the en-

try of cheap American grain and the decline in wages in agriculture), agricultural movements immediately gathered strength and occasionally their actions resulted in serious clashes; yet even these were cushioned by the possibility of emigration to America. It was only after the war, when that escape route had also closed down, that the 1920 land reform—much more modest in scale than corresponding ones in neighbouring countries—was implemented. Visible poverty began to disappear. (One million landless people—labourers and their families—were left in villages and on their outskirts. The 600 thousand servant population living in semi-feudal manorial settlements and in estate-administered communities disappeared completely.)

After the second land reform, a "class struggle" was artificially generated in the villages; there were allocations and re-allocations of farm plots, as well as repeated entries to and exits from co-operatives. These shorter or longer periods of flight from the villages nevertheless gave the landless and the very poor some means of existence until the consolidation of large-scale farming (which took place after 1958–60). The large-scale farming system covered (as a "historical maximum") 6 million hectares at the peak of its existence. Some 860 thousand people (and partly their family members) found permanent or almost permanent working possibilities (although, in most cases, the plots were insufficient for subsistence).

Another method also evolved to alleviate the damaging impacts of land-hunger and rural overpopulation. Paradoxically, this consisted of the allotment and, later on, under the socialist regime, the leaving behind, of land of a minimum size; under the 1920 land reform and the 1936 Settlement Act approximately 300 thousand families received a building plot (i.e. sufficient exclusively for building). However, the plot usually included a piece of land sufficient in size to use as farmyard or kitchen garden. Hence by the time the war broke out, some *2 million families* had landed property of some sort, although the number of registered farms hardly exceeded 1.5 million.

The same scenario recurred at the time of the land reform of 1945–46: 347 thousand people were allotted a building-plot (150 thousand exclusively for building). The plots were around 1,700 m^2 on average.

Finally, at the time of the last phase of collectivisation (1958–60) there were again plots of land that did not have to be brought into the cooperative. Firstly, there were the remaining private farms. Although these had contracted to less than one quarter of their original size over a period of years, new owners of lost private land were already operating under the title: "complementary farm plots of workers and employees", or as "area taken out of cultivation". This category included some 0.5 million hectares. The major segment of land owned by so-called "specialised co-operatives" (these were stable, each with around 70 to 80 thousand ha since the end of the seventies) also remained in private ownership. Thus they were in the same category as minor plots of land (e.g. vineyards, orchards, small isolated plots) not claimed by the co-operatives (and registered statistically as "household

plots"); of course, land going with the building plot came into this category. The number of building plots must have increased (by hundreds of thousands by the end of the eighties) owing to the intensive parcellisation efforts of state enterprises (farms) and co-operatives in the seventies and eighties.

As a paradoxical result of nationalisation/collectivisation, about two-third of households (some 2.3 to 2.5 million consisting of persons representing all categories by place of residence, occupation and social status) acquired/retained what was mostly land of a minimum size. This fact made it impossible to predict by standard economic and sociologic reasoning which group(s) in which region would suddenly feel an urge to add a bigger or indeed very big piece of land to their small plots.[3] Reality has demonstrated exactly that: loud predictions have been disproved, without exception, during the actual course of the privatisation of landed property.

Crisis of the Hungarian agricultural system

The opinions of experts concerning the crisis of the agricultural system in Hungary are polarised by two factors. The first is a chronological one: did the crisis precede the change of the political and economic system, or was it triggered by the latter. In other words, did the former system arrive at a crisis on its own, or was its disintegration due to transition politics? In the latter case, was it the policies of the first government which led to crisis, or did the second exacerbate the situation? The second factor is methodological in nature and relates to whether the causes and consequences of the crisis can be described in purely economic (market economic) terms, or whether social movements are equally important (perhaps essential) for understanding them.

Those experts who claim that the symptoms of—economic—crisis were evident in agriculture in the eighties draw attention to certain phenomena. Given the escalation of their cost and sales problems on both the internal and external markets, large-scale producers (i.e. state farms cultivating thousands of hectares and production co-operatives working the fields of several villages) could only survive by expanding production. Relying mainly on wage labour, and constituting the base of the agricultural system these units had to reduce their product mix and produce an ever smaller range of mass products (thus they had produce only one type of corn, or fodder, or livestock). The other land became the basis for private farms (mainly dwarf holdings). As a result, however, they became ever more prone to fluctuations in economic trends. In the eighties, business relations

[3] According to Pál Juhász's observation: "With the general spread of the dual system of large-scale farming and household or complementary farms, the scope for family enterprise narrowed, but this narrower scope became accessible to practically all". (*Juhász* 1987, p. 15)

between big and small farms—which could have reduced the exposure of the big ones—also started to disintegrate. Big farms intensified their industrial activities and services—i.e. non-agricultural complementary activities. However, this has not provided a lasting solution.

The agricultural product structure and the technology of big farms was extremely capital-intensive and their revenues did not ensure appropriate returns on capital invested. Machinery and equipment purchased originally with state subsidies could no longer be renewed/upgraded in the eighties. Price revenues lagged more and more behind expenditures and the maintenance of technologies selected earlier (e.g. sowing seed, fertilisers, plant protection, pedigree stock, irrigation) were increasingly difficult to maintain. Monetary restriction from the eighties onwards also hit agriculture: subsidies declined while requirements increased. With the introduction of the two-tier banking system in 1987 and the brutal credit policy implemented by banks with respect to food industrial companies, the chronic current asset shortage of big plants was made obvious. Also obvious was their total exposition—given the absence of state intervention (i.e. co-ordination, as in every plan economy)—to the (at that time, still state-owned) procurement, processing and exporter monopolies. Their fixed and current assets both started to decline in the last years of the decade. After a few years' stagnation (only prevented from turning into decline due to the performance of complementary branches) during 1989 and 1990, both their gross output and sales decreased.

Quasi-unanimous agreement, however, ignored the presence of the above phenomena, and gave way to debates as to whether they were rooted in the system itself (implying, potentially, the aggravation of crisis phenomena and open crisis); or, could the gradual reforms implemented on established bases (meaning, first of all, units of large-scale farming) be expected to lead to a market-type, adaptable system of agriculture. Advocates of the latter standpoint demanded an actual raise in the level of central—cash—subsidies.

Those who considered the unfolding crisis to be systemic referred to the following decisive traits of the agricultural system: extremely polarised farm structure[4] with capital-wasting big farms monopolising land use at one extreme, and labour-wasting small farms unsuited for modern vertical co-ordination at the other; yet both cases were characterised by a lack of direct access to mechanisms for coordinating the activity of farms with that of the monopolies supplying the inputs of the latter and procuring, processing and selling their output while, at the same time,

[4]Named "dual" by, among others, the author of a World Bank study, although this was not the case in reality. Despite the mediation of a multitude of different artificial transmissions, procurements by both farm types originated from the same sources and their products travelled through identical or similar sales channels to markets of identical or quasi-identical types. In a dual economy, the two farm types are disjunct with respect to their procurements and sales markets as well, or one is characterised by pure subsistence or natural farming and product exchange without cash. These variants are now starting to emerge in Hungary.

operating separately; they had defective and often distorted market contacts, with little or no information at all). There were no procedures for tracking and monitoring the progress of their products through market channels. Activity-financing and price-setting issues were beyond their decision-making competence or indeed their bargaining power. Interest representation was not properly established and at best only powerful groups among them could lobby.

The above-listed components of the agricultural system were organised and interlinked in such a way that the system was simple, transparent and easy to manage for those on top of the decision-making pyramid. In other words, Hungarian agriculture like that of the other former socialist countries, operated with an East European, instead of an American or West European, version of vertical coordination (or, to use a more common phrase, vertical integration). In the socialist version, the prime integrator was the state.

It follows directly from the above that products manufactured in the framework of integration had to be made, preferably, at farms identical in type and size, using the same technology and producing in similar quantities the smallest number of product types possible. The other main consequence was that products had to go through a process which was inevitably disintegrated in an economic sense thus could only be coordinated by the state. In such circumstances, the most appropriate, and often only buyer's market was the market of the socialist countries, with the Soviet Union in the first place. This organisational and institutional system has been chronically unable to respond to signals emitted by the western markets (or by domestic market, for that matter), and to communicate them effectively and efficiently to the primary producer.

Inevitably, even small fluctuations in the buying capacity of socialist markets shook the very foundations of the domestic agricultural system. In the end (well before the disintegration of COMECON), after the 1984 COMECON Summit, Hungary was obliged to deliver much larger quantities of foodstuffs, especially grains and meat, to the Soviet Union than before (and at extremely low rouble prices). Export subsidies for grains and meat exports bought with the rouble reached between 150–375 percent. Moreover, the Soviet Union simultaneously reduced its earlier free-currency purchases; yet, satisfying escalating Soviet demand also meant that Hungary's exports to the West were reduced. As a result, the respective deficits of the trade balance and the budget increased, and the revenues of large-scale farms decreased. The latter could no longer expand their output, but neither did they have the funds required change over to a new production structure.

Another interesting, but hardly foreseeable, feature of the given agricultural structure was that, at the enterprise level, it could simply not adapt at all to the gradual reforms taking place in its economic environment (especially if the latter implied a weakening of state coordination). The gradual liberalisation of trade and prices in the second half of the eighties, and the elimination and dismembering of monopolies (trusts) was concurrent in every case either with the disruption of

familiar partnership relations, or the unilateral (and unremediable) exposition of big farms to new or unknown market actors. All this occurred well before the big wave of transformations, liquidations and bankruptcies had cleared the way for finding new partners.

When the crisis became open, big farms (co-operatives) either liquidated their complementary branches or the latter simply broke away from them. Other circumstances, perceptible from the mid-eighties on, included a decline in employment and a reduction in the cooperation with small farms (or at least the disappearance of previous forms of co-operation). Land tenancy instead of household plots (or wage supplementing plots) became the order of the day; many cooperatives liquidated their trading branches based on micro-producers; instead they subcontracted part of their producing activities to their members (*KSH* 1990; *Molnár and Szabóné Medgyesi* 1991) The presence of subcontractors obviously modified social relations within big farms: between those remaining with the farm and those leaving it either voluntarily or under some constraint, and also the interrelationship between the afore-mentioned groups and the rest of the village population. The study prepared for the Presidium of the Hungarian Academy of Sciences (*Sipos and Halmai* 1993) mentions as potential sources of social conflict the embryonic state of interest representation for different groups and other parties; regardless of the state of the former, there were no interest reconciliation institutions anyway; the legitimacy of big-farm leaders was weak and this created a lack of confidence among the managing groups. At other places there was evidence of the increasingly rigid managerial hierarchy of co-operatives, the shameful living and working conditions of those living at settlements in certain state farms, and the miserable situation of those forced to be free labour but unable to find employment in co-operatives and state farms alike.

The above developments mainly occurred prior to the maturing of the open crisis of the agrarian system, of agricultural production and employment. Open crisis actually brought a single new element to the surface and this is referred to as the *land issue* below. This soon became the *crucial issue* of transformation in provincial Hungary. The overall economic environment also began its descent into depression and this accelerated the process of agricultural decline: the nadir (as it stands today) shows that agricultural output has declined by 45 percent—compared to the first half of the eighties—and more than half a million jobs have been lost in agriculture.

Beginnings of privatisation in agriculture

Initial privatisation measures relied on the conceptual/theoretical model of the "two-level co-operative"; this was realised in practice somewhat imperfectly in

the form of co-operatives or state farms operating as holdings (or something called a holding) for some time after the systemic change.[5]

Judging from various sources, however, mainstream privatisation ought to have meant the transformation of big farms, with all their landed and other property, into joint stock or limited liability companies. This would have left the way open for members of the (old or new) management to become independent.[6]

By 1988–89, bigger co-operatives had already shed their former territory and/or their branch-based, two-level labour management system, and also their policy of incentives originating in basically undifferentiated wages (by branches). As a result, 8 to 15 organisational units emerged from each co-operative (employing an average staff of 20 to 30); these were organised mainly according to branches.[7] Many of the smaller units became semi-independent (i.e. self-accounting), and by 1990 the majority (albeit few among those pursuing agriculture as a core activity) had a bank account of their own. New organisational units hence quickly turned into independent small enterprises contributing some 30 percent of the price revenues of co-operatives, and accounting for a similar share of employment there.

In the eighties so-called in-company partnerships, specialized groups, "lump-sum" accounting sections and other, lease- or contract-based organisations mushroomed in agricultural co-operatives, the same as in industry. From 1988 on, in accordance with the Companies Act, these could be considered autonomous companies, and it also occurred in numerous cases that the co-operative itself formed a company on part of its property. Moreover, co-operatives were entitled, already prior to 1988, to take part in so-called associations with other co-operatives or state farms (e.g. "gestor" farms—that is, farms responsible for the introduction and running of specific production systems), other state enterprises, banks or private companies. From 1989 on, the associations in question were allowed to transform into companies with co-operatives as potential members. These entities became popu-

[5] The two-level co-operative model was designed by the economists of the Research Institute for Co-operatives in the eighties. (*Gaál* 1990) It was one or another variant of the same that was quoted, most frequently by economists, at the 1988 Kiskunmajsa Conference as well. According to Pál Juhász's initial debate lecture, "co-operative and state farm centres are gradually transforming into *financial institutions for enterprise management*—instead of the dismembering of co-operatives." (Italics in the original K. L.) (*Halász* 1989, p. 5)

[6] The conceptions in question were based on Act XIII of 1989 (the so-called Transformation Act), at least as far as co-operatives were concerned. A subsequent amendment imposed a moratorium on the sales of real property and suspended the transformation of co-operatives into companies. Act II (the so-called Transition Act) attached to Act I of 1992 (the Association Act) obliged co-operatives to begin transformation anew (to prevent them becoming companies in the meantime). An amendment dating from spring 1994 prohibited cultivated land, apported by land owners, from being turned into a company form as an asset.

[7] Source of facts and data hereafter: Molnár and Szabóné Medgyesi (1991). The authors investigated 128 co-operatives, 66 of which had switched (up to 1989) to the so-called advanced incentive system.

lar capital investment targets for co-operatives, which invested 9 percent of their assets in this way (while no capital replacement took place at co-operative farms). Half of the capital so placed went to join stock and limited liability companies, the other half to limited ("deposit") partnerships. It seems likely that part (perhaps a major part) of the capital invested in this way was lost in the early nineties.

Land statistics also provide evidence showing the extent of gradual and accelerating privatisation. In the first half of the eighties, land acquisition by private individuals essentially took the form of re-qualification and parcellisation of the landed property of co-operatives.

Land purchase (up to the 3 ha limit) and sales (by co-operatives) was liberalised in 1988 only, and sales and subcontracting by lease affected, annually, only 3 to 4 percent of the total co-operative land area. In 1989, however, some co-operatives were already selling lots of 50 to 100 hectares, at an astonishingly low price of HUF 1,300 to 1,800 per hectare, while the lease was HUF 1,500 for grass and around 10,000 for plantation, and the price of smaller pieces of land amounted 10 to 30 times the lease. Prices of subcontracted areas approximated farm rents. According to several sources land taken out by co-operative members withdrawing in early 1990 did not exceed 105 thousand hectares, and the total area of individual farms grew very slightly, by a total of 34 thousand hectares only. Thus it can be presumed that part of the 170 thousand hectares growth registered under the heading of "complementary farm plots" in 1989 to 1990 also originated from sales or subcontracting. Moreover, land leased out by co-operatives to individuals totalled 26 thousand hectares in 1981, 134 thousand in 1986, 232 thousand in 1989 and 349 thousand in 1990. (KSH 1990)

Parallel with the above, the membership of agricultural production co-operatives, especially the number of active members, underwent a drastic decline. At the beginning, the main reason for this was not the high number of exits, but the exodus to the (semi-)private economy motivated by the higher incomes to be gained there or due to the lack of work at the original work place.

State farms also made attempts to lease or subcontract land in the eighties, and the signs are that their total land area also diminished. The method of their privatisation was more akin to that of state enterprises: the original plan was to leave the most important parts of 28 farms (the original number of 20 was first raised to 25 and then to 28) in state ownership to allow them to fulfil their current role in education, research, improvement and the propagation of new technologies, or their prospective role in vertical integration. It was mandatory for all of them to transform into companies and laggards could only do so without landed property. Half, or somewhat more of their former landed property remained in state ownership and it is only now that it is being leased. In the first round, units—e.g. industrial plants, service providers—detachable from the farm, and machinery, equipment and real estate superfluous for future operation had to be offered for sale at estimated asset value according to the relevant regulations of the State

Property Agency. Proceeds went toward paying off debts accumulated over the previous years. The items in question were sold at a loss and with partial success only. Then came agricultural production plants and units thereof unclaimed by the state. (To that effect, companies had to be taken to pieces: this is what was called "decentralised privatisation".) The least is known about the new owners of these units (apart from occasional cases of ESOP and management buy-out). However, the press has frequently dealt with cases of livestock farms cut off from fodder cultivation areas by landed area marked off for compensation or by persons eligible for compensation but prevented from acquiring land by privatisation (or long-term lease contracts). Large-scale privatisation (including the transfer to minority owners of the property of companies market out for permanent state ownership) began in the next round only. 44 of the 97 companies put up for sale were sold, and 36 were under liquidation/final settlement at the end of 1995. (*Fertő and Mohácsi* 1993; *Czárlné Ivanics, Szabó and Tassy* 1996; *Papócsi* 1993)

In summary, since 1988, options for so-called spontaneous privatisation (and later on self-privatisation at state farms), identical in nature to those in commerce and industry, have opened in agriculture as well. There have been a few extreme and unrealistic efforts for instance, to limit agricultural entrepreneurs operating other than large-scale production from conducting business on rented farms only, or to limit co-operatives to the leasing activity of manager-proprietors. Apart from these examples by 1992 it had become obvious that if trends inherited from the eighties persisted, it would be impossible to restore the predominance of private ownership in agriculture by a *land reform* similar to those implemented in the neighbouring countries. Therefore it was essential to avoid depriving of their property rights peasants who formally retained title to land that had earlier passed into a co-operative. (Such members of co-operatives would have received stocks/shares in exchange for land if such land was transferred to a joint-stock or limited liability company and their names as landowners would have been cancelled from the land register.) This, no doubt, was done due to political considerations, rather than economic or social ones. However, its consequences have brought to the surface conflicts of interest originating basically from the fact that Parliament and the new government (i.e. the Antall-Boross government) postponed the passing of several acts and regulations. As a result, parallel with the delay (and procrastination) of the other politically motivated reforms, compensation (*Fertő and Mohácsi* 1996a) and privatisation proceeded for two years in a direction incompatible with a real political (ownership) *caesura*.[8]

[8]Taking Gyula *Tellér*'s precisely developed ownership theory as a basis, a few years after the uniform proprietary class—i.e. the party-state hierarchy—had managed to swallow different types of co-operative property completely, under the acts of 1967 and 1970, and with the regime of the new economic mechanism, it delegated part of the proprietary decisions to co-operative leaders. Compromise with co-operative memberships striving for a middle-class type of existence also made it possible for skilled and independence-oriented management to operate a big part of

Act I of 1992 (the Association Act) nevertheless signified a compromise in that it did not include, and did not intend to support, any time-tested historical variant of co-operation based on family enterprise or any association of small producers (nor, indeed, any working co-operative of members possessing landed property). Such forms would have made it easier to adjust to the forms of producers' associations found in the European Union.[9]

Act II of 1992, the Transition Act, on the other hand, tried to give a *time preference* to long-term land users, to registered owners of co-operative landed property still in private ownership (nearly 2 million hectares) and to those eligible for compensation. This time enabled them to assert their lawful claims relating to landed, and to a smaller extent other, property against other claimants. It also attempted to persuade them to think their decision over in case they wanted to join a corporation. Furthermore, it wanted to give priority to small proprietors by providing an opportunity for those exiting with landed property to acquire other property shares for a short period of time. All this, however, had its price—namely, the division into two (for a long time and at the procedural level as well) of the privatisation of landed, and other types of property at co-operatives. Such a division obviously hindered the realisation of the plans of managers hoping to set up bigger private farms; it was also an obstruction to those intending to attract foreign capital, either in the form of capital investment companies or large-scale agricultural production based on wage labour. In fact, for some time, the last option was the only available one (apart from a few cases of renting and service provision as a side activity), although this went on without the entry of foreign capital. (This is what state capital allocation and other forms of subsidies have been meant to replace ever since.) The method of privatisation of co-operative lands clearly signifies a diversion for managers, compared to their original plans.

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co-operative property as capital, and in due time to transform it into its private property (in an individual or corporate form). In the eighties, assets and decision-making competences which had been centralised earlier were re-distributed by the absolute owner to the county, town or village level. As a result, co-operative managers, whether in industry or agriculture, did not have to share with former members of the party-state hierarchy when the political and economic transformation began. Expropriation was easiest if the co-operative form itself was liquidated, and this, in turn, was easiest if the majority of members could be "shaken off". In spite of that, co-operatives continued to exist in many places. This was especially due to the will of the members themselves who believed that they had a better chance to fight for their property from within and in the framework of the co-operative. (Tellér 1994)

[9] In holdings or holding-type co-operatives, production activities and material services are organised under companies/partnerships where employees and managers qualify as active members (i.e. if they are members they have a property share or some other property quota/business share in the co-operative). Members pursuing independent production on their own land by founding a farming co-operative, or one based on the shared use of machinery but relying on the services of the co-operative with respect to sales or other functions, do not qualify as active members. (*Phare* 1995, p. 12)

The land and those who cultivate it

Since 1990, every country in the region has implemented or launched a land reform of some sort (although in Hungary, for instance, the phrase itself has not been uttered once). (*Csáki* 1994; Fertő 1994a) The trend and prospective final results of the respective land reforms show many parallels with those in East Asia or Latin America. (*de Janvry* 1981; *Yujiro Hayami* 1991) That is to say, that their final goal is the establishment of a—capitalist—*large-scale export sector* (to be integrated, if possible, into international agri-business). The policy-makers of most countries regard a village middle stratum with peasant- or entrepreneurial-type farms as desirable, but not indispensable. They would also accept the survival of a large number of what are, effectively, part-time farms (whether producing for the market or satisfying subsistence needs only).

By way of illustration, it is worth quoting a few paragraphs of the agricultural programme which supplements the 1991–1994 economic programme of the Hungarian government:[10]

"The Government intends that larger-scale co-operative, private and state enterprises should produce the bulk of agricultural output in the emerging new agricultural structure. Therefore, it will take action against the unjustified fragmentation of holdings, and provide active support to the emergence of landed property of a sufficient size to make competitive agricultural production feasible." (pp. 8–9.)

"The process includes the formation of family farms based on private property or leasehold... Individual units operating within the co-operative framework will be transformed into companies... Activities that can be performed individually or in a small-farm framework will break away from co-operatives... The future fate of what will emerge as large-scale production branches will be defined by real owners according to criteria of economic efficiency and profitability." (p. 10.)

"We expect the number of first-job-holder entrepreneurs to undergo significant growth ... the economic background of the enterprise boom ... will be ensured by providing support to new agricultural enterprises starting operation now" (p. 23.).

In reality, however, no real plans were made to promote the development of the above-mentioned middle stratum, nor to provide interest representation to dwarf farms and deploy the procurement, sales and other infrastructures needed by them. Furthermore, no facilities have been created to provide vocational and business training for their staff. Pledges concerning the factors just mentioned soon disappeared from consecutive general economic and agricultural programmes; only recently have suggestions started to re-appear and these only indicate prospects

[10] The relevant economic programme was the so-called *Kupa Programme* (1991) The agricultural programme in question is "Government agricultural policy and programme", (*Földmüvelésügyi...* 1991)

for very small steps. The raison d'être and survival of so-called part-time farms (i.e. farm units operated by second job holders) was only codified under the Act on Agriculture of 1997. The combination of half-hearted land reform, digression from announced programmes and delay in the perception of the resulting situation is not just a Hungarian speciality: it is typical of the whole East Central European region.[11]

Except for part of Church property, in Hungary no privatisation took the form of restitution, and the majority of land was distributed in the framework of property compensation.[12]

There are at least two practical reasons for this situation. Firstly, both state farms and co-operatives cultivated land owned by the state and were acquired, according to the nullity acts, unlawfully or under some constraint imposed on previous owners. Secondly: land-owner entrants to co-operatives established in 1958–1960 (and earlier as well) retained cadastral ownership of their landed property and received a minimum amount of land rent from it. From 1968 on, co-operatives began gradually to redeem (at token payments) half of the total of approximately 4 million hectares of members' land (although they have still not got round to the other half).[13] The Compensation Act ensured the restoration of the proprietary status (not the property itself) of the two groups of former owners.

Given the mushrooming of private and semi-private enterprises based on landed property (owned by co-operatives among other things), land allocation to private operators preceded the satisfaction of similar claims by those eligible for compensation.

Accordingly, a *pre-emptive right* was granted to members of specialised co-operative groups with respect to co-operative land used permanently, to leaseholders and to persons using their redeemed land on a long-term basis (provided that the legal title in question had existed for at least five years).

It was only after the above process that co-operatives had to mark off different land funds—first that of members/pensioner members (occasionally former members and their heirs) who still had land in their own names (the so-called *quota owners*). Landless members and employees were to receive land worth 30

[11] For a detailed panorama cf.: *Csáki and Lerman* (1997)

[12] Compensation for lost property and land acquisition within it was inseparably intertwined with political compensation and, at the same time, became subject to every conceivable form of business manipulation, to the detriment of those having suffered political or ethnic prosecution. (Fertő and Mohácsi 1996a).

[13] Redemption was still going on in 1989. Redeemed land (including part of land in state ownership) constituted the so-called undivided land property of co-operatives. (In 1967 only one thousandth—i.e. some 5000 hectares of the land they used—was their own property.) Landed property of persons in retirement, of those who had left the co-operative or who had died was subject to redemption; this was the same as land owned by every member of a co-operative terminated by liquidation or merger.

and 20 gold crowns (GC)[14] to compensate them for the loss of household or wages-supplementing plots. Then came the demarcation of compensation land to be put up for auction, under the Transition Act. If land offered for compensation was not sufficient, a part equivalent to one quarter of the compensation land fund had to be marked off from landed property owned by state farms. (The Compensation Act preceded the Transition Act, so in practice co-operatives were the first to be involved in identifying compensation land areas.)

State-owned landed property held by co-operatives was either transferred to the compensation land fund or had to be handed over to the municipality. At the same time, no private-owned (privately used) landed property could be marked off for auction.

Even if the above takes place in an orderly fashion, if the land issuer and reconciliation committees do not dissolve without completing their task (some of them did this), if auctions actually take place (not all of them did) and if complaint cases are settled (there are still unsettled cases), the future owner is still only at the point of having a certain GC value registered under his/her name in connection with a given part of the fields. Should the owner wish so, he or she can, in principle, have the plot in question surveyed and staked off, and take it out. (Surveys have been made on preferential terms up to a certain deadline.)

Co-operatives marked off 814 thousand hectares of land for their members and employees, 764 thousand hectares for quota holders and 1,806 thousand hectares for those eligible for compensation. (Fertő 1994b) To these were added 475 thousand hectares of land marked off by state farms for compensation purposes. (*Takács* 1995) That is to say, the aggregate land area to be distributed was around 3.86 million hectares in 1991–1992. The quantity of land marked off for members and employees corresponded approximately to their number, but that designated for quota holders was surprisingly small compared to their almost 2 million hectares of landed property in co-operatives according to the relevant 1989 statistics.

Consequently, real ownership relations were to take shape only later on, through the acquisition of the right of disposal and/or through property concentration; these processes usually involve several steps.

In order to obtain a realistic picture of the initial situation one should know that, of a total of 8.2 million hectares of cultivated land (including forests), and of 6.4 million hectares (1991) of land under agricultural cultivation, approximately 70 percent and more than 80 percent, respectively, was assigned to (or to a smaller

[14] GC: traditional value unit of land. 20–30 GC corresponds to 1 to 1.5 hectares of good quality land (i.e. corresponding to the Hungarian average), and since it was ordered by Act XXV of 1991 (the Compensation Act), it may be considered as "compensation for compensation". At places where members and/or external owners had left land for common use, in principle they could agree to revive household plots.

extent distributed among) some 2 million or more individual proprietors.[15] Among the latter, however, the number of *new owners* was negligible: according to the 1994 census, there were only 7 thousand new owners compared to the 1991 status among individual farmers.[16] In this sense, non-residents who have received compensation certainly qualify as new owners, the same as the few thousands of families who have received landed property under the social land allocation schemes of the previous (1990–1994) government and the municipalities. As for the rest, reference can be made once again to what was said in the historical section: one cannot expect masses of *new* landowners in a country where two-third of households have landed property of some size.

The land issue for the period from 1992 to the present day is not defined by the number of landowners, but by the possibilities they have had to integrate as proprietors or managers into the holding or business form categories defined by size of landed or other property about to emerge now. The categories in question correlate with social categories: there are wealthy manager-entrepreneurs and individual big entrepreneurs with or without landed property; medium entrepreneurs related to co-operatives or operating on a family basis with less property; small and dwarf farms producing for the market (according to information provided by the chambers of commerce, some 700 thousand took out the original producer's certificate); the unemployed and temporary workers trying to survive on dwarf farms and at the most only satisfying their own food requirements (this category covers some 1 million persons, many of whom were entitled to some land but who sold their newly acquired plot at once); the pauperised village population invading denuded state farm settlements, uninhabited dwarf villages, and deserted farmsteads. Some of the people in the last category have put all locally available land area under cultivation. (Of course, as in Western Europe, the number of middle and upper middle class families setting up a second home in a village or on a farmstead or in a vineyard, and cultivating the land that goes with them (or having it cultivated by someone else), is on the rise in Hungary as well.)

As for the first category, we know most, in terms of statistics, of co-operative members. In 1989, co-operatives had 5.5 million hectares of land and 686.5 thousand members; they cultivated 4.5 million hectares themselves, employing 453 thousand full-time staff for that purpose, and had 327 thousand active members. By 1996, their total land area had shrunk to 1.9 million hectares, and the number of full-time employees to 94 thousand (and the steady decline is still evident today) and that of active members to 60 thousand. (All other members are "externals" in

[15] Source for statistical data hereafter, unless otherwise specified: relevant volumes of CSO's *Pocket-book of agricultural and food industrial statistics*.

[16] According to the estimate of Gyula Varga, the number of those receiving land compensation could be around 700 thousand; some 400 thousand landless members/employees were allotted pieces of land from the so-called members' land fund; and there were some 250 thousand old (i.e. registered) proprietors whose landed property was still in the co-operative. (*Varga* 1993)

comparison.) In other words, while the 1989 average was 14 hectares per member, by 1996 the corresponding ratio had increased to 30 hectares (in all probability this remains an insufficient area). However, active members today are authorised to have some landed property not only within the co-operative, but also without it; what is more, they can act as managers of enterprises operating on co-operative land. Co-operative managers suggesting (or even demanding) the buy-out of quotas of external proprietors (a total of 1 million hectares according to certain computations) and the gradual alienation of compensation and members' land areas leased out by proprietors to the co-operative (1994: 880 thousand hectares) actually only wish to end as soon as possible the process in which they still have to compete with the remaining active members for exclusive ownership. Subcontracted assets are not necessarily returned; some of the beneficiaries of compensation and of quota holders may have their piece of land surveyed and use it themselves or exchange or sell it. Moreover, in the meantime, managers have to contest with big entrepreneurs and leaseholders (although small in number) operating outside the co-operative, and apparently also with family farms and farm enterprises one step lower in the rank order. Statistics indicate the existence of 60 thousand of the latter (other sources speak of 51 or 66 thousand) and, according to several experts, approximately half of these do business with co-operative assets while the other half inherited part of their initial resources; also their contacts and know-how (especially skills relating to machinery, for it was not the average unskilled co-operative member who became an entrepreneur) from co-operatives.[17]

This extremely thin and vulnerable middle stratum (kept alive, in the absence of institutional support and an appropriate infrastructure, by their own wits and good fortune) hence qualifies as a rival, not an ally for the upper stratum undergoing the selection process now. Nevertheless, there exists one pillar which could seal their alliance (the likelihood of such an alliance only be of a potential character at present): both groups often protest against small and dwarf holders and also those withdrawing to subsistence farms because of their confused market channels and incapacity to generate demand in the near future for the products and services of the big ones.

Censuses of different kinds put the number of independent farms producing for the market—95 percent among them small farms—at 1.2 to 1.6 million. Some 600 to 800 thousand raise pigs, a few hundreds of thousands produce vegetable

[17] From among private producers figuring in the CSO's survey, in 1995 45.1 percent had earlier been independent; the proportion of non-manual workers was 11.4 percent, that of skilled workers 13.4 percent (with those coming from within and from without agriculture represented almost equally), and that of independent craftsmen, tradesmen and those pursuing other occupations was 11.7 percent. (*Harcsa* 1996) This recruitment distribution does not seem to be disproportional, considering the fact that already in the seventies less than half of the village population had an agricultural occupation, and less than half of those employed by big agricultural plants doing manual jobs actually worked directly in land cultivation or animal husbandry.

and fruit and some 150 to 200 thousand have vineyards. The majority are what the professional literature calls "part-time farms", although many family heads and members today have no other job. (Inclusive farms even smaller in size, their number totals around 1.8 million, some 3 million people are cultivating them, whose land or rather produce contribute to the living of some 4.8 million, corresponding to 46 percent of the Hungarian population. (Takács 1995; *Gyimesi* 1995)

Representatives of old, new and prospective big farms call attention to two, in their opinion anomalous, phenomena. The first one is that land is being squandered among a mass of new owners who have neither the money, nor the experience required to use it well. As mentioned already, however, the owners in question are not new; in fact, patchy as the relevant statistics may be, they make it evident that the average area of small and dwarf holdings keeps rising year on year, the same as both the number and total area of medium-size and larger holdings, albeit at a slow pace.[18] (The latter cultivated by big agricultural companies and co-operatives totalled 2.3 million ha. The harvested area of the major arable crops, on the other hand, amounted to a total of 3.9 million ha. A major part of the difference was obviously produced on the 557 thousand ha arable land of big and medium-size individual farms. In other words, the monopoly of the former socialist big farms with respect to the cultivation of major arable crops is a thing of the past.[19]

The other anomaly referred to is the divergence of land ownership and land use. However, there is no theory or experience to suggest that, in an ideal case, the two should coincide (i.e. that land monopoly will paralyse the farm structure and create an opportunity for land usury); this arrangement is not typical in Western Europe either. As we have seen, farm and land use patterns are *in statu nascendi*, and they endanger the operation of neither the export sector, nor domestic supply, despite altering ownership relations in both. One of the main arguments for putting things in order is security, the other is that, by pressuring co-operatives to lease land from former members, capital is withdrawn from agriculture. The experience, however, is that leasing of this kind has been very cheap so far (it is often free and sometimes it is the proprietor leasing land out who pays), and land rented so is often sub-let out by the co-operative to companies or private individuals. In the latter case the lease is rather expensive (in Hungarian comparison). (*Burgerné*

[18] 47.2 percent of individual agricultural entrepreneurs at least doubled their landed property from 1992 to 1995, another 22.9 percent increased it by a smaller extent and only 27.7 percent did not enjoy any increase at all. Those cultivating more than 20 hectares leased half or two-thirds of the area. (Harcsa 1996) The May 1996 statistics show that 3,346 hectares were being used by individual farms as opposed to 1,382 hectares two years earlier. Within that, small farms occupied 1,972 thousand ha instead of the earlier 841 thousand, medium-size ones 67 thousand instead of 62 thousand and big ones 630 thousand instead of 479 thousand. (*KSH* 1996) As can be seen, dwarf farms underwent the most spectacular increase—more than two-fold, by 1.1 million ha. Part of the difference is due to unregistered changes in previous years.

[19] The crops taken into account are as follows: grains, sugar beet, sunflower, potato, maize for silage, alfalfa.

Gimes 1996) One wonders if capital is withdrawn from agriculture in this case at all, and if so, whose capital that might be.

The same could be said of those demanding the accelerated consolidation of holdings. As long as the permanent location and size of holdings is not established on a more sound basis, and real ownership relations (which are starting to take shape now through the unification of family plots, land exchange between friends, land use based on personal favour, and so-called pocket contracts etc.) are not certified by land register or other documents, forced consolidation would give enormous privileges to some and do blatant injustice to others; what is more it would fragment many of the farms about to emerge and drive smallholders to poor quality or inaccessible land or simply swallow their existing piece of land.

A closer look reveals that the processes taking place are still those envisaged by the 1991 agricultural administration under the influence of contemporary interest representation organisation, bureaucracy and international trends rather than political parties. At least such processes bring closer the envisaged objective of modern land reforms. It is true that this transformation has confronted resistance in every country (Csáki and Lerman 1997), but it seems that in Hungary those showing most resistance have been the winners of the process. The main reason for this is the enduring absence of set criteria which would allow individuals or families to know for sure that they are going to be among the winners (perhaps even be topmost among them).

Of course, in the meantime, the historical problem of the combination of land shortage and rural over-population has returned. Some are of the opinion that the new distribution of holdings is worse and more polarised than that of 1935.[20] However, if land use data released recently carry a real meaning—according to CSO, land in private use increased by 2 million hectares over two years—the situation is certainly better than it was prior to the war.[21]

[20] If we consider those farms whose size exceeds 100 cadastral "hold" (57.6 hectares) to have been "big ones" in 1935, and accept the categorization of the CSO which differentiates between companies (i.e. co-operatives) and individual farms (the average size of the latter being 57 hectares if considered as "big" in 1994), we receive the result that in 1935 big farms covered 48.2 percent of agricultural land area, but in 1995 about 45 percent (and surely less than that in 1997). (KSH 1990; *Fazekas* 1995; KSH 1995; KSH 1996)

[21] From 1989 to 1991, the CSO data for land used by private individuals showed a reduction from 1.5 million hectares to 889 thousand. No data are available for 1992. As for 1993, statistics indicates 1,620 hectares as the average agricultural area held by individual owners. Subsequent data are as follows: 1994: 1,719 thousand ha, 1995: 2,789 thousand ha, 1996: 3,345.7 thousand ha. No. 6 of the *CSO Reports* for 1997 says that "in 1997, 56 percent of the agricultural area (3.5 million ha) was used by individual farmers, 26 percent by co-operatives and 17 percent by companies" (p. 11.).

The change is, understandably, the result of rather complex shifts and transactions. Business partnerships started with 936 thousand ha in 1989 and in principle lost 475 thousand through compensation; but in 1996 they had 1,090 thousand, so they must have acquired 630 thousand ha in the meantime. The increment consisted of land owned (used) by co-operatives and individuals.

Performance of Hungarian agriculture, 1990–1996

Publications in recent years have estimated the contribution of agriculture to the GDP and to employment to have fallen from 14 to 6 to 7 percent and from 16 to around 8 percent, respectively. Most analysts expect these ratios to remain unchanged in the future.

Gross average annual agricultural output growth already started to slow down in the eighties and turned negative, as mentioned already, in the second half of the decade. Plant cultivation underwent a more marked decline than livestock farming.[22] The poor harvest of 1990 had its effect on livestock farming as well (with the exception of pig rearing). From that time on, however, output fell irresistibly in both main branches (and in the garden and plantation sectors as well within plant cultivation itself) until 1993–1994. Gross output volume (productive absorption in agriculture included) reached its lowest point in plant cultivation in 1993 at 62 percent of the 1989 volume, and in animal husbandry in 1994 with about the same proportion. The aggregate minimum was 63.4 percent in 1993, signifying a much more marked decrease than that registered in industry, and it was especially low in the food industry where, its lowest point in 1993, monthly average gross output corresponded to 83.7 percent of that in 1985. Volume indices for procurement had dropped to less than half of those for 1990 by 1994.

Marked recession preceded the substantial decline in exports of agriculture and the food industry (the latter occurred in 1993 only, simultaneously with the general and very substantial loss of exports); in contrast, exports grew very fast in 1991 and to some extent even in 1992. (The increase, however, was not due to volume growth, but to the fact that accounts in convertible currency had become

(Takács 1997) Land marked off by co-operatives for distribution totalled 3.4 million ha—i.e. 2 million ha less than that registered by statistics in 1989. 1.2 million ha of the nearly 2 million hectares of quota-holders were conspicuously missing from the area marked off in this way. In reality, co-operatives must already have had less land than the registered quantity in 1989, and since then it has continued to decrease. The contraction of co-operative land areas prior to compensation must have been due to previous parcellisation, sales, exit of members, or the transfer of certain pieces of land to the municipality. This, together with land transferred to permanent use later on appeared in statistics as individual and company land areas. Apart from land leased permanently, co-operatives did not have to mark off for distribution plots necessary for the expedient operation of their equipment, nor those plots under mortgage. Presumably, therefore, co-operatives do not rent all the 1.75 to 1.9 million ha of land they use, from their members (or others), but they use (or utilise) land unsold at the auctions or over which there is a dispute (or occasionally not marked off at all). Sources of land used by individuals or co-operatives or companies today should, therefore, be examined one by one; also unidentified is the 2 million ha that turned up missing at the beginning of the distribution process, but they all have a share of that as well. Land utilisation ratios, on the other hand, have not been consolidated yet.

[22] Source of data unless otherwise specified: *CSO Pocket-book of agricultural and food industrial statistics*, Vols. 1989 to 1996. Source of foreign trade data: KOPINT-DATORG database.

exclusive. The volume of exported foodstuffs is still not more than 70 percent of the 1989 level.)

Three factors can be emphasized as having determined agricultural performance, and these factors also affected the general economic environment, including foreign and domestic demand and the transformation of related branches; all three are in connection with the trade and the banking system.[23] The first was the privatisation of the individual element of the production, processing and sales chains, in diverse ways and independently of one another at a strikingly high loss in their value and of mutual linkages. This method of privatisation could, in itself, have led to total collapse of the whole food system. The second factor has been that state regulation has been asserted most forcefully in two areas. Firstly, the export and import authorisation and tender system has acted, at least for a few years, against the stabilisation of production and sales; secondly, the situation of the so-called agricultural market arrangements. The system has two poles, one of them being the government's central administration system and the other the product councils (similar to commodity boards) organised according to the main commodity/commodity group. The latter, theoretically, represents every important actor of the given market segment. Standard prices (i.e. guiding prices, guaranteed prices) are set centrally, and occasional market intervention (i.e. subsidised procurement, exports, imports), in case there is surplus production or shortage, is decided upon through bargaining between the two. Specification of the distribution of actual prices and price margins is assigned to the competence of the respective product councils or decided upon by bargain between their members, provided that the major actors of the given market segment actually participate in such bargaining. The representation of small producers, for instance, is unresolved. The bargains in question are not public, and their results promote the consolidation of the given market segment only in the presence of an extensive contractual system or some other type of horizontal or vertical integration. The system cannot act as a substitute for a relatively uniform and well-informed market. The third influencing factor involves state subsidies. Central subsidies had disappeared or been cut drastically by the end of 1992 (export subsidies included). Under the impact of a drop in exports by 30 percent in 1993, subsidies started to increase again and new forms also appeared. From 1994–1995 on, they became the most effective market-organizing force, not so much owing to their consistence but rather due to the concentration of their potential advantages (in combination with the relevant regulations) to bigger companies. Furthermore, from 1995 on, they also carried the possibility of advantages to the

[23] Sources of the following summary of agricultural performance in addition to statistical publications referred to already, include especially the following: Czárlné Ivanics, Szabó and Tassy 1996; *Gyöngyösi* 1996; KSH 1997; *Németh and Vati* 1995; Fertő and Mohácsi 1996b; Takács 1996a and 1996b; Mohácsi 1994; *Orbánné Nagy and Szabó* 1996; *Alvincz* 1997; Szabó 1995; Mohácsi 1995a and 1995b; Mohácsi 1997; Fertő and Mohácsi 1997; KOPINT-DATORG Economic trend reports.

successor organisations of the former state farms and those co-operatives that have remained relatively large.

State support includes, in addition to subsidies in cash, some organizing activities, like the organisation for vertical co-operation/integration (consisting of state farms which have remained in state ownership) which is under development now; there is also assistance from the agricultural marketing agency, which is a state organ.

Budgetary subsidies mostly take the form of credit interest support for the purpose of financing procurement or the costs of livestock breeding; occasionally this goes with a state guarantee, as in the case of credits drawn to reduce damage caused by drought. The so-called reconstruction credits have been accompanied by state assistance (to establish stock farms, or purchase or modernise buildings, for example). Investment credits with interest subsidies are also available, although that option depends to a large extent on whether banks have funds (which they can place for more than twelve months) available for that purpose. After 1990, small producers, normally not rated as creditworthy, could also be granted re-organisation credit at the time of the sales of the superfluous equipment of big farms.

The subsidy system is about to be transformed again: direct export subsidies show a marked decline; the agricultural administration is introducing a system of cost-reducing subsidies under different titles, to be put in the so-called "green box" in the spirit of EU harmonisation, especially for large producer plants; they would prefer to allocate a bigger proportion of meat subsidies to primary producers instead of the food industry and food exporters, and would like to involve agricultural plants and their partners to a larger extent in subsidised regional development programmes. The importance of this last option is increasing. Co-operatives have been granted a few billion forints annually to buy out the share of so-called "external owners".

While, in 1990–1993, investments to the economy overall halved, the share of agriculture in national economic investments fell to about 1 or 2 percent, and it was only in 1994 that it started to rise again. Despite growth by 35 percent over one year, the share of investment in agriculture had only attained 3.6 percent by the end of 1997, and even that was primarily due to subsidies.

The degree of assistance to Hungarian agriculture (measured in producer subsidy equivalent, PSE) was estimated by the OECD at 23 percent in 1989–1991, 16 percent in 1995 and 11 percent in 1996. The 1996 subsidy ratio is among the lowest in the OECD. (*OECD* 1997) The level of subsidies calculated by OECD totalled around 1 percent of the GDP in 1996; consequently, the corresponding figure for 1997 must have been around 1.25 percent. In the past two years, leading interest representation organisations serving agriculture have demanded subsidies corresponding to 2.5 percent of the GDP, as guaranteed by law. This ratio is higher than the corresponding OECD or even the EU average, but the GDPs of the member states of those organisations are much bigger. Calculations based on

unit (i.e. one ha) agricultural area project a different picture altogether: some USD 180 for 1998—i.e. less (although not much less) than the OECD average and approximately one-fifth/sixth of that of the European Union (in 1992).

The new production, investment and market structure of Hungarian agriculture which has emerged, has up until now partly preserved the more or less spontaneous tendencies which manifested themselves in 1985 and after 1989, respectively. This is partly the result of the above three influencing factors (i.e. privatisation, regulation and budget subsidy).

The essential structural characteristics of the system are as follows:

The share of grains within the total sowing area grew from 58–59 percent to 62 percent; however, the total grain output (maize included) fell, as a result of the deterioration of cultivation technology and/or the selection of permanently more extensive methods, from 13–14 million tonnes to between 11 and 12 million.[24] Some 30 to 40 percent of the latter total and the other arable crops cultivated in large quantity (25 percent of that quantity comprising grain) was produced, as indicated earlier, by individual farms. Medium-size farms also produce sowing seed, maize for human consumption, sugar beet, sunflower and potatoes among the crops regularly for sale. Small and micro-enterprises, and the medium-size ones also, only sell fodder in exceptional circumstances (for instance, if they discontinue livestock-breeding).

It should be noted that within both the big and medium-size farm sectors companies (joint stock and limited liability companies) produce the best results with respect to both yield and quality.

85 to 90 percent of the potato, other vegetable and vine output has shifted to individual farms and almost exclusively to small ones among them. In recent years, approximately 70 percent of the total fruit output has originated from independent farms (and not forgetting that this output has contracted by nearly half its earlier figure).

Livestock breeding was characterised by the slow decline in stock all through the eighties (with the exception of poultry, which showed marked fluctuations), giving way to a fast decrease in 1989–1990; thus, by 1993–1994 only 57 percent of the initial cattle, 54 percent of the initial pig and 50 percent of the initial sheep stock remained.

The drastic fall in livestock farming (and milk production) seemed to have come to a halt in 1993–1994. In 1994–1995 the stock increased somewhat, followed by a decline which has carried on to the present day. Animal husbandry shrank to a minimum level or was stopped completely at most of the former co-operatives, while at bigger and very large farms, this activity was taken over by companies.

[24] It would be premature to draw conclusions from the 14 million tonnes output figure released for 1997. It is possible that the production systems are working efficiently once again, in which case a solution will have to be found for the market problem.

In the first half of the nineties, it was large-scale animal husbandry that showed the faster decline, although many small producers and individual farmers (mostly "forced" entrepreneurs) also gave up this line of activity. Nevertheless, one quarter of the cattle total, half of the pig and three-quarter of the poultry remained with the individual producers. In 1995, the stocks of all three grew. Over the past two years, on the other hand, it has been the stock of individual farmers that has contracted faster, with the majority of the small ones having given up production for the market and keeping animals only to satisfy the demand of the household (or occasionally of relatives). This situation has been brought about by the impact of the exceptional increase of fodder prices and the chaos reigning on the livestock market.

As for the purchasing and sales organisations, the first to revive have been relatively small new companies, former units of foreign trade companies of the previous era and industry-type production systems. The majority have preserved their creditworthiness and command a relatively secure share of the price margin and of export and other subsidies. Gestor farms have managed to have the grains produced and foreign trading companies have exported the produce; moreover, they have gradually ousted entrepreneurs appearing from here and there and rallying in an attempt to obtain subsidies. Surviving grain procurement companies have also acquired a certain amount of working capital. An "old-new" system of public warehousing has been established.

Livestock-breeders were in a more difficult situation. At one time, even meat processing factories modernised on World Bank loans were facing liquidation; big slaughter houses were working at half capacity and benefited from only a minor segment of the price margin; furthermore, over the past two years a certain proportion of their subsidies has also been revoked. The majority of companies involved in large-scale livestock-breeding and processing have not created their own efficient trading organisations. The companies in question suffer considerably due to the competition they face from the mushrooming small slaughter houses and processors. However, at the same time, if they wish to purchase from the small producers (who keep most of the animal stock) they are often forced to rely on the services of purchasing agents who are of rather dubious competence. The prices of small producers regularly lag behind those of their big rivals.

Sheep farming shrank more markedly than other branches of livestock breeding—to less than half—but even 70 percent of that has fallen into the hands of independent farms (of course, primarily to bigger ones). (Reports and rumours indicate that working conditions are the worst in this branch.) Typical features of this market include marked fluctuations in sales and prices, common with other branches as well.

The privatisation of the food industry is almost complete.[25] Nevertheless, plan which envisaged the integration of big producers and manufacturers by transferring processing plants to the ownership of the biggest producers (according to a later version, producers could buy them for compensation vouchers) has not been realised. Half of the food industry has been bought by foreign companies: the entire vegetable oil industry, almost all the breweries, the liqueur and champagne industry, almost the entire confectionary, sugar and refrigerating industries, a major part of soft drinks production, a much smaller part of the dairy industry, a few modern processing plants in the meat industry, very little in the manufacture of pasta, not much in the wine-bottling and canning industries, and practically nothing in milling. The entire tobacco industry is now in foreign hands.

Interestingly enough, foreign companies have organised raw material production and have become reliable partners for farms, especially in places where they have acquired a monopoly position. Yet recently they also seem to have become more negligent and peremptory. As far as their production, export and import programmes are concerned, they are not much different from other multinationals. As for the others, sharp changes in quantity, product mix and prices and a penchant for easy solutions—above all in the meat and dairy industries but to some extent in the tobacco industry as well—threaten to promote the complete downgrading of certain regions. Domestic suppliers of soft drinks companies, canning factories and of the refrigerating industry—almost exclusively small plants—have fared better: whatever raw material manufacturers purchase in Hungary (although this sometimes seems relatively little), they do so under a satisfactory contractual system. For example, half of vegetable production has been contract-based since 1995.

The spread of contract-based systems is especially marked at places where power is organised mainly through state subsidy or a big foreign company—such places enjoy many preferences and forms of assistance. Such systems affect big farms (or medium-size ones at the most) only. Due to the security which goes along with working with larger quantities of goods, these organisations are more capable of asserting their own interests, and more willing to observe contract discipline than small ones.

It is highly typical of this, the best-organised segment of the market, that food processing companies occupy strong positions and deliver directly (often on the basis of contracts which can be renewed regularly) to retail networks; even more among their number export (occasionally also import) independently. Many have their own outlet network as well. Conflicts concerning the sharing of the price margin between the food industry and major store chains have quietened down in many places.

[25] In 1995, there were 152 big plants in the food industry, 20 to 22 among them really big ones; 1220 small and medium-size enterprises; and 9,096 micro-enterprises (Czárlné Ivanics, Szabó and Tassy 1996).

Plants protection and veterinary health care services, provided by the state to agricultural producers earlier, have partly broken up and partly been incapable of adjusting to the new relations of ownership. Although in 1996 53 percent of the agricultural output originated from individual producers, so far no government organ or public body has undertaken to provide them with general technological, plant management, market, business and accounting training or to deliver useful market information to them on a regular basis. The farmers' own initiatives such as farmers' circles or co-operative-like informal associations, proposed partly by agricultural entrepreneur-intellectuals were relegated to the background owing to the lack of institutional, legal and political support.[26]

The wholesale system involving purchasing, distribution and delivery to the processor (i.e. the bulk of agricultural produce) has recovered exceptionally fast from almost total collapse. This is probably due to easily available high profits. Today we no longer hear and read about its absence, only about conflicts on the partitioning of the food margin. The former producers' and farmers' co-operatives that used to purchase the output of individual farms (i.e. household plots) and small enterprises, have terminated this line of activity (and renewed it at a few places only); wholesale markets typical of the pre-collectivization era have not opened anew and there is no demand for auction markets operated by co-operatives or markets which have adjusted to them in the absence of incentives to co-operation. Hence small farms, if they are the almost exclusive suppliers of a product, are exposed to purchasers or agents, or monopolists of the given sub-region. As for other products of which they are not the sole producers, they are often considered to be annoying rivals and obstacles on the market and they are treated accordingly.

The production and market organisation system which primarily integrates big farms has emerged from the above-mentioned gestor farms. They constitute the majority of the 28 companies which have remained in state ownership. Their primary role is to place preferential loans in kind—in the form of sowing seeds for instance—to the farms, and to contribute to maintaining and improving technological standards. Their function as purchasers of the produce of the given farm, or contributors to the sales thereof, has evolved gradually. In the first half of 1997 there was already at least one (specialised) integrator in every one of the 18 Hun-

[26] It is mainly agricultural chambers that have committed themselves to taking care of small producers. Now, they do not demand thousands of forints for the membership alone and thus the main obstacle to contact has been eliminated. The other institution is the network of farmers' notaries; there is one of the latter for every three or four villages, although they are overburdened with formal administrative tasks (e.g. the issuance of certificates). In some regions the agricultural marketing organisation is willing to establish contact with them, and there are regional development centres where a few companies try to lure them. Some integrators also consider it worth cooperating with them; the so-called "mountain communities" are, in principle, and often in reality as well, the individual vine-growers' own organisations. Young farmers have also been eligible for a few preferences (albeit difficult to acquire) since 1997.

garian counties, and credit amounting to approximately HUF 100 billion had been extended to farms through their auspices. The integrator also constitutes the main base for the maintenance and development of the export sector.

Within Hungarian food exports (that is, until the relatively early boom of privatisation in the food industry), the share of unprocessed products increased; however, parallel with privatisation and with supplementary investments by foreign owners, processed goods took the lead again, with the exception of grains. In the meantime, these investments were completed, but the steady shrinking of the domestic food market continued, and hence the food industry has had little opportunity for further growth (preliminary data for 1997 showed a decline). Moreover, it has been unable to provide any impetus, via its demand, to raw material producers.

Imports of agricultural and food products underwent alarming growth in the first transition years, but the process has been reversed significantly since then, and today food imports only represent 4–5 percent of all imports. (Higher customs duties and the import surcharge—which has been eliminated in the meantime—certainly played a role in bringing about the reverse.) Given the contraction of the retail trade, it has been impossible to increase the sales of import goods, which anyway are usually rather expensive in domestic comparison; furthermore, to a certain extent export subsidies motivate exporters to produce domestic raw materials.[27]

Exports of agricultural and food products, although they have attained USD 2.4 to 2.7 billion in good years, since 1994 have represented a smaller part of total exports than they used to earlier: some 18 percent instead of 20 to 22 percent (or occasionally more than that). (As a result of the alteration of the system of statistical accounting—which now covers the turnover of duty-free zones as well—this ratio is currently around 13 to 15 percent.) The figures match the tendency that agriculture now contributes a smaller part to the GDP and, after its predominance for a period of a hundred years or so, the food industry is no longer the first and foremost manufacturing branch in the economy. It is worth noting that, despite an "intermission" of a few years, Hungarian food exporters now sell half of their exports to the former socialist countries (30 percent to the successor states of the Soviet Union) once again; they are still unable to make complete use of the duty-free quotas offered by the association agreement concluded with the European Union (although today the main reason for this is the lack of exportable goods) and they yield customs preferences to the importer at all times, the same as before.

[27] The sugar, meat and milling industries are least the import-intensive, while vegetable and fruit processing and "other" industries (including the confectionery and soft drinks branches) represent the other pole.

Some possible conclusions for the future

For a country in Hungary's position, there is probably no fool-proof recipe against the emergence of a Latin American-type dual agricultural system and the concomitant final and massive pauperisation of the village population. A great majority of the village population have no job and even the distant hope for regular work has receded further. Although (for the time being at least) they seem to be surviving, there is no room here for complacency. A few decades ago, everywhere (including Southern Europe) programmes were implemented with the aim of achieving economic and social progress at the village level. These programmes enjoyed some results, but today they are no longer effective; this is because they cannot reckon either upon generous financial support or on adequate product, services and labour demands coming from the overall economy. What is more, an acknowledged need for security is also absent; earlier there was a system of security which adjusted the co-ordination of the food system to the demands of agricultural production and of those working in it.

In the absence of long-term prospects, and without appropriate theoretical foundations, the analyses of the state of affairs presented here only permit the offering of short-term or at the most medium-term recommendations.

The initial hypothesis presented here is for a rational, moderate social and economic policy devoid of extremes and too sharp changes; it should be a consistent policy and not a mere acknowledgement of spontaneous tendencies. Also, it is also assumed that a certain degree of *consensus* can be reached with respect to relevant social and economic goals.

Social goals requiring consensus include those aiming to:

— prevent the pauperisation of village families/groups/strata capable of earning a living;

— make basic production, business (household), administration and elementary market skills available to everyone without exception (in the rural regions);

— promote the development of industrial, services and intellectual activities in rural areas;

— sustain and promote the development, if possible, of a village middle stratum who opt for farming as a main or secondary line of activity and who actually live in the rural district (i.e. village, county town, farmstead). Members of this stratum have the potential to serve as a reference group for others in farming, especially with respect to the way of life associated with it;

— pay attention to ensure that politics should not harm the property or social self-esteem of groups involved in agriculture and to prevent the institutionalisation of existing abuses which negatively effect on the latter.

Economic goals requiring consensus include those aiming to:

— stop the further substantial decline of agricultural production (i.e. its output value) and exports (the value of exports), without insisting on the maintenance of the current structure;

— eliminate or at least make flexible the institutions which could make the structure of activities, of production or farm structure rigid at a certain point in the transition process;

— promote (support) the emergence (construction) of commodity markets for every stratum of producers and the horizontal and vertical cooperation of market actors;

— offer and support cooperation (association) opportunities for every group of farmers, micro-enterprises and subsistence farms included;

— allow village families to use subsistence farms as a last resort (and satisfy at least the food demands of the household) in the future as well, but prevent a situation in which they are confined to this form of living—i.e. not to hinder in an institutionalised way their integration into the market economy.

Consensus on issues similar to the above may be based on the recognition of two facts: first, the transformation of agriculture *is in process* and cannot be terminated arbitrarily—it can only be diverted in a desirable or an undesirable direction; secondly, the *relative absence* of serious conflicts and the avoidance of permanent social damage during the process of transformation so far should be seen as an *advantage*, not a drawback of Hungarian development.

The identification of the prospects for further development (i.e. expedient tendencies) would certainly be promoted if important groups and influential personalities in Hungarian agriculture were able to familiarize themselves with the agricultural system of the European Union and the social, cultural and economic objectives underlying it. This would make it possible to eliminate many uncertainties from domestic programmes and avoid the rather undecided character of economic policy (subsidy policy included). It would put an end to the sort of unhealthy competition among certain groups (i.e. the actors of different farm/enterprise/business forms) which is aimed exclusively at forcing events forward too quickly so that the government and its negotiating partners confront accomplished facts by the time of the Union negotiations.

If, on the other hand, a sufficient number of supporters can be rallied for the Union philosophy and practice among producers, agricultural experts and members of the state administration, this would almost automatically (and with little expenditure) imply two types of advantages. Firstly, it would be easier to convince foreign agri-business companies established in Hungary to act in conformity with Union practice and to realise and propagate a corresponding culture of cooperation among their local partners. Secondly, it would be easier (and would have been so earlier) to open the way to Union and national (i.e. regional, professional, interest representation, chamber of commerce, etc.) levels of assistance and support

(mediated by contacts) for familiarisation with, and the propagation of local organisations, institutions and forms of cooperation (e.g. co-operatives, simpler marketing organisations and procedures) at present still absent from Hungarian agriculture.

If a sufficient number of producers offering marketable products and new, young generations are to emerge, it is an elementary interest of society to provide them with training and information adequate to their situation and needs, as well as access to market organisations, market channels and options for co-operation. This is the best way to prepare for accession to the European Union. Countries which take accession seriously (and which aim to acquire a certain advantage, not disadvantage in this respect) will allocate most efforts to these forms of assistance.

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RESTRUCTURING OF THE HUNGARIAN AGRI-FOOD SECTOR

I. FERTŐ

Towards the end of the 1980s agriculture in Hungary began to fall into an increasingly deep crisis. After the political reforms of 1990 this process accelerated. The evaluation of agricultural policy reform and its effect on agriculture is a subject of debate among agricultural policy-makers and agricultural economists. The purpose of this study[1] is to summarise agricultural policy reforms and their effect on the Hungarian agri-food sector.

The first section of the study briefly reviews pre-reform conditions in agriculture. This is followed by a short account of the main elements of agricultural policy reform. The third section deals with the impacts of agricultural reforms on agri-food-sectors (especially on structures), and in the fourth, focus is upon barriers to adjustment. Finally, we summarise the most important lessons of the transition in agriculture.

Pre-reform conditions in agriculture

Before 1989, agriculture in Hungary, like other Eastern European countries, was characterised by various types of distortions (*Brooks et al.* 1991). The structure of agricultural production exhibited extreme duality. One part consisted of large scale farms: agricultural production co-operatives and state farms. In 1989 in Hungary there were about 1500 large-scale farms, which used 85 percent of the arable land. The average size of the area of large-scale farms was about 5000 hectares. These each employed on average, 540 persons. At the other extreme were the small-scale private farms. The average of the 1.4 million private farms was 0.62 of a hectare. The efficiency of this agricultural system, as mentioned above, was poor relative to developed industrial countries. The food processing, distribution and input supply were highly concentrated and characterised by pervasive state monopolies.

The main price distortions were the following (*Marrese* 1993): agricultural inputs were generally purchased by state farms and co-operatives at prices below prevailing domestic or world market prices; the provision of agricultural credit was meant to encourage government priorities irrespective of the enterprises' ability to repay; and the consumer prices of foodstuffs were kept low through subsidies. After 1989, the deepening economic crisis in Hungary made it impossible to maintain this supported system of agricultural prices and production.

[1]This study is based on the research on "The redistribution of property rights, corporate governance and company restructuring after privatization" supported by the Research Support Scheme of the Soros Foundation.

Agricultural policy reform in Hungary

Simultaneously with the political and economic changes in Hungary, the transformation of agriculture also began. The agricultural policy reforms represented one part of a stabilisation programme. The agricultural policy reforms contained three main elements: price liberalisation and the cutting of agricultural subsidies; liberalisation of foreign trade; and land reforms. The period from 1989 to 1997 can be divided into two phases: the first was the time of transformation (1989–1993) and the second, one of consolidation and solid recovery (1994–1997). The experience of agricultural policy during the transformation phase centred on building up the legal and institutional framework for the market economy. The second, consolidation phase of agricultural reform has focused on three main problems. First, the incumbent governments have tried to accelerate or to complete land reforms, and have attempted to consolidate land ownership relations, by amending land reforms, and have attempted to consolidate land ownership relations, by amending land laws and co-operation laws. Second, they have stabilised the domestic agricultural market by establishing a market regulation office, improving the activity of such institutions, and increasing production support. Finally, steps have begun to harmonise the legal environment of agriculture with that of the EU.

In Hungary, prices have been gradually liberalised since 1968. By 1985, some 40 percent of all prices were no longer controlled. But the breakthrough came about in 1989 when 90 percent of all producer and consumer prices were liberalised. In 1990 the respective prices of bread grain and milk were also liberalised.

The reduction of agricultural subsidies had already begun in the second half of the eighties and, by 1992, they had dropped even more, to 40 percent of the 1989 level. However, it must be noted that one reason was the changeover to dollar accounting in trade with the former Soviet Union. The previous rouble accounting involved substantial financial support. Thus, since 1993 agricultural subsidies have grown continuously but have not yet reached the level of 1989. The structure of subsidies also underwent significant changes. Consumer subsidies were abolished. Production and investment subsidies were greatly reduced at first, but since 1993 have begun to grow. A new type was created: namely, internal market intervention to counteract the frequent problems arising on the domestic agricultural market. Between 1989–1995 export subsidies represented the biggest share, being in general above 50 percent of total support. In 1996, agricultural support policy was changed due to GATT commitments, and the share of export subsidies was reduced to below 40 percent.

In 1990, the government decided to adopt a system of institutions similar to that of the developed countries for the regulation of agricultural markets. After a long gestation, the law on agricultural market order was passed in 1993. According to this law, domestic regulation operates on two levels. The first is the Office of Agricultural Regulation, which works out the market intervention programme and

rules of operation. At the second level of regulation are marketing boards. They negotiate about the regulation of a given product, and are responsible for ensuring their members abide by agreements (i.e. determination of target price, distribution of quota, voluntary reduction of production, etc.). In reality, however, this system does not work. For instance, by the end of 1996 there were no interventions due to low intervention prices. The Office's work has been characterised by a lack of systematic thinking (for example, exports and imports were restricted simultaneously). Since agricultural markets are underdeveloped, the measures—based frequently on vague and incomplete information—often have done more damage than if no intervention had been made at all.

In Hungary, the decision to begin liberalising foreign trade was made in 1988. Instead of four years, as originally planned, the liberalisation of non-rouble accounting trade was completed in three years. In 1991, the liberalisation was extended to the former COMECON. During the following year, 90 percent of all imports were liberalised. However, an import licence is required for nearly a hundred agricultural and food industry products. The licence is linked to import quotas if the products falls under a global quota. Exports were also liberalised and in 1991 licensing rules were greatly relaxed. After 1993, however, some of the new restrictions began to apply to foreign trade—for instance, customs duties. The honeymoon years for liberalisation had ended. The most recent increase in customs duties was introduced as part of the so-called stabilisation programme of 1995.

In Hungary, the change of land ownership was regulated by the compensation law passed in 1991. The goal was reparation for damages unlawfully caused by the state after 1 May 1939. At the beginning of 1992, the co-operative transition law and the law on co-operatives were passed. The aim was to put formerly indivisible co-operative property into private ownership, and thereby to give the new owners the right to decide about the use of their property. Another goal was the establishment of new types of co-operatives, corporations and private farms. The laws contained elements of compensation pertaining to arable land as well as to co-operative assets.

The transformation and privatisation of state farms also began, but at a much slower pace than foreseen by government. The many uncertainties about privatisation, and the frequently changing concepts and deadlines in the period between 1990–1992, illustrated the hesitation of decision-makers and also changing political reactions. Government adopted the concept of decentralised privatisation. Due to the uncertainties in connection with the land issue and poor earning prospects, the process cannot be expected to accelerate. Investors show very little interest in purchasing equipment piece by piece and investing in small farms. The final result of the privatisation of state farms by the end of 1996 was as follows: of the 120 state farms, 39 were liquidated; 47 had been privatised and 27 were in the process of privatisation and the rest remained in state ownership with a strategic purpose (i.e. aims of education, research and development).

Two phases can be distinguished in the privatisation of the food industry. In the first phase (1990–1992) it was dominated by direct foreign investment. More than 50 percent of privatisation revenue stemmed from privatisation of the food industry. In the second period (1993–1997) the pace of privatisation slowed. The government adopted the concept of decentralised privatisation (similar to the case of state farms) in order to accelerate privatisation. This idea was helped by complementary techniques—e.g. privatisation leasing, management buy-out, and employees' co-ownership programmes. As a result of the process, at the end of 1995 private ownership already exceeded 50 percent in the sphere of the food industry.

The effects of agricultural reform

Table 1

Share of agriculture and food industry in the national economy (percentage at current prices) 1990–1996

	1990	1991	1992	1993	1994	1995	1996
Agricultural GDP/GDP	12.5	8.6	7.2	6.6	6.7	6.7	6.6
Food industry GDP/GDP	5.2	5.0	4.7	4.5	4.3	4.2	4.0
Agri-food sector GDP/GDP	17.2	13.6	11.9	11.1	11.0	10.9	10.6
Agricultural export/export	n.a.	n.a.	10.0	6.8	6.8	8.2	6.0
Food industry export/export	n.a.	n.a.	16.0	16.6	15.9	15.4	15.6
Agri-food export/export	24.3	26.6	26.0	23.4	22.7	23.6	21.6
Agricultural employment/employment	14.3	15.2	11.3	9.1	8.7	8.0	8.3
Food industry employment/employment	4.2	4.2	4.6	4.4*	3.8	3.5	3.3

*from 1993 data about organizations employing more than 20 persons

Source: Agricultural statistical pocket-books 1990–1996. Central Statistical Office of Hungary (1990–1996).

Hungarian agriculture is still significant in the national economy, though its role has gradually been decreasing since 1986. The performance of agriculture has declined, as shown by various economic indicators. *Table 1* shows that the share of agriculture in GDP sharply declined between 1990–1993, then stabilised at the level 6.7 percent. On the other hand, the proportion of food industry as a part of GDP fell only slightly. At the end of the period analysed more than 10 percent of GDP still came from the food sector.

It is paradoxical that the proportion of agri-food exports in total exports was able to remain above 20 percent during this period and, moreover, actually improved in the critical years (1991–1992). In 1993 a smaller share of agricultural production went towards exports, and since then the performance of agricultural

exports have gradually declined. However, the share of food industry products in agri-food exports has increased.

The proportion of agricultural and food industry employment in total employment during this period also declined. The fall in the share of employment was much greater in agriculture than in the food industry. The reduction of the share of agriculture in employment was dramatic between 1990–1993; after that its proportion in overall employment has remained relatively stable. The share of the food industry in total employment went down only after 1994. The decrease, however, can be explained partly by changes in the methods of recording.

Table 2

Development of main indicators 1990–1997 (previous years=100 percent)

	1990	1991	1992	1993	1994	1995	1996	1997
GDP	96.7	88.1	95.7	97.7	102.9	101.5	101.3	104.6
Agricultural GDP	95.4	93.8	80.0	90.3	103.2	102.7	104.1	99.5
Share of crop production	51.9	56.6	52.6	52.9	56.3	54.3	59.6	55.9
Share of animal production	48.1	43.4	47.4	47.1	43.7	45.7	40.4	44.1
Food industry GDP	99.1	93.2	96.0	95.8	105.5	101.6	99.6	92.8

Sources: *Hungarian statistical pocket-books 1990–1997*. Central Statistical Office of Hungary (1990–1997).

Behind the process described above, a similar change in agricultural production can be found. Agricultural GDP between 1990–1993 continuously declined by about 28 percent. The reduction of agricultural production exceeded the decrease of GDP. From 1994 to 1996, however, there was a larger increase in agricultural production than in the increase in the total economy. Since 1996 the growth of agricultural GDP has stopped, whereas the GDP has continued to grow. Moreover, some preliminary estimations for 1998 suggested similar trends. Despite the drastic fall in agricultural production, the GDP of the food industry declined only slightly between 1990–1993. This is very interesting because some subsectors in the food industry were oriented to former Soviet markets, and the collapse of COMECON caused serious difficulties in these subsectors. On the other hand, the data suggest that the food industry was able to adjust more easily to market conditions than were agricultural producers.

In two major sectors (plant cultivation and animal husbandry), however, production developed differently. After 1988 the proportion of livestock raising strongly diminished, while the performance of plant cultivation fluctuated depending on weather conditions, and within the total output it increased from 46 percent in 1989 to 56 percent in 1997.

The numbers in agricultural employment also declined dramatically. In 1997 there were 310 thousand people working in agriculture (which amounts to about 36 percent of the 1990 level). The reduction of the number of active earners in the food industry was not so drastic. In 1997 the level of employment in the food industry was 50 percent, compared to the figure in 1990.

Development of prices

The planned economy was characterised by different types of price distortions. The prices of industrial inputs for agriculture were below the market prices due to production support. Simultaneously, food prices were cheap because of consumer subsidies. Within agriculture, crop prices were relatively low compared with livestock prices due to the poor efficiency of animal breeding on large-scale farms.

Table 3

Agricultural terms of trade (1990=100)

	1991	1992	1993	1994	1995	1996	1997
Industrial prices	132.6	143.2	171.8	202.9	250.9	351.7	404.8
Agricultural prices	99.1	107.6	127.5	159.3	202.4	260.0	294.8
Agricultural terms of trade	133.8	133.0	134.7	127.4	123.9	135.3	137.3

Source: Agricultural statistical yearbook 1997. Central Statistical Office of Hungary (1998).

Table 3 shows that, despite price liberalisation, in the first years of transformation the agricultural price conditions (i.e. agricultural terms of trade) became less favourable for farmers. Between 1986–1989 state purchasing prices for agricultural products moved parallel with the prices of industrial inputs. However, after 1990, the gap between the prices of agricultural and industrial products suddenly increased. The changes in the agricultural terms of trade eliminated the earlier price distortions between agriculture and industry on the one hand, and within agriculture, between crops and livestock prices on the other. After 1992 real market price conditions developed between agricultural products and industrial inputs. In general, it can be stated that farm prices have moved more or less parallel with input prices, but some fluctuations have occurred.

Transformation of agriculture

The agricultural policy reforms have had considerable effects on the distribution of property rights, especially on land ownership, land use, and on agricultural

structure (including the number of enterprises and the size of agricultural companies).

Transformation of land ownership

The most important change has been the termination of the co-operatives as a form of property and the recovery of private land ownership. Precise data about the distribution of land ownership are not yet available due to a lack of exact details about the registration of land. Therefore we can show data only about the change of land utilisation.

Table 4

Distribution of agricultural land use according to organisation forms 1990–1997 (percent of area)

	1990*	1991	1992	1993	1994	1995	1996	1997
companies and corporations	12.6	14.9	16.0	20.2	19.0	16.5	17.6	15.6
cooperatives	67.7	62.8	58.3	53.3	37.7	33.0	28.3	26.0
private farmers	19.7	22.3	25.7	26.5	43.3	50.5	54.1	58.4
total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

*1990s data refer to ownership relations, and companies equal state farms

Source: *Agricultural statistical yearbook 1997*. Central Statistical Office of Hungary (1998).

Table 4 shows some interesting findings with regard to the change of distribution of agricultural land use according to organisation forms. The most important changes are the considerable decrease in the number of co-operatives, and the offsetting rise of private farms in agricultural land use. But these results need to be interpreted with care. *Kovács et al.* (1998) point out that the real land use of private farms is probably shown as less by 10–15 percent of the true figure, owing to registration difficulties and tax avoidance. Furthermore, some co-operatives became joint-stock companies during this period, hence increasing the share of land use by corporations.

In 1989 the average area of state farms was 7138 hectares, while the average area of a co-operative was 4179 hectares. The average area of large-scale farms was below 2000 hectares in 1994. In the background of the process, the decrease in the number of large-scale farms above 3000 hectares and the increase in the number of farms between 500–3000 hectares can be found. It is interesting that large-scale farms above 10000 hectares have remained as state farms, as they were earlier.

Surprisingly, since 1996 the land use by firm size has more or less been stable. The most interesting results are that the land use of large- and medium-size private

Table 5

Agricultural land use by firm size 1996–1998

(thousand hectares)[2]

	1996	1997	1998
Total	6184.5	6194.6	6192.7
economic organisation:	2838.8	2578.9	2470.8
o.w. large	2613.1	2497.3	2369.3
medium	53.9	63.6	80.3
small	39.3	18.0	21.1
private farms:	3345.7	3615.8	3721.9
o.w. large	66.8	62.5	69.9
medium	630.1	622.2	665.2
small	1972.2	1940.7	1981.4

Sources: Statistical monthly bulletin 1996–1998. Central Statistical Office of Hungary.

farms has not grown markedly. In the case of economic organisations the land use of medium-scale companies has increased, whereas the land use of large- and small-size corporations has fallen. The share of land use in small-scale companies and large-size private farms—compared to total agricultural land use—can be neglected. This suggests that the concentration process in land use has stopped during this time (due mainly to the Land Law).

The change of agricultural structure

The number and distribution of registered corporations in agriculture changed radically in the period under scrutiny. Until 1989 the agricultural company system was characterised by a predominance of state farms and co-operatives. From 1990 to 1998, the total number of registered corporations grew by more than five-fold. The number of corporations increased at different rates in the various company categories.

The category of (state) enterprise disappeared in 1996 due to privatisation. The most dynamic growth was shown by business association forms—absent from agriculture before—such as limited liability and join stock companies, which make up about 40 percent of all agricultural corporations. The number of co-operatives

[2]In 1994 the Central Statistical Office introduced a new typology to identify agricultural organizations. Small-size farms operate on less than 30 hectares and have less than 2.5 standard animal units; the corresponding values for medium-size farms are less than 300 hectares and less than 30 animal units; large-scale farms have more than 300 hectares land and more than 30 animal units.

Table 6

Development of the number of registered corporations in agriculture 1990–1998[3]

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total	2112	2994	3308	4639	5547	9409	9639	10722	11210
o.w. enterprise	171	150	122	91	36	33	–	–	–
company	535	1309	1581	2575	3342	4263	4008	4729	4921
o.w. ltd.	451	1212	1511	2434	3140	3636	3805	4516	4724
join-stock company	39	40	41	109	171	186	191	204	197
co-operative	1405	1485	1605	1971	2048	2117	1930	1915	1715
non-legal entity company	–	–	–	–	–	2996	3009	3154	3382

Sources: Statistical monthly bulletin 1990–1996. The number of economic organisations 1997–1998. Central Statistical Office of Hungary.

increased continuously until 1995, but over the last three years their number has fallen by about 20 percent. Owing to changes in the statistical accounting system the data referring to non-legal entity companies are available only from 1995. Over the last four years the number of non-legal entity companies has increased by about 10 percent. At the end of the period analysed the share of limited liability and non-legal entity companies had reached about 75 percent of all the registered companies. Probably, these types of company are mainly small- or medium scale farms.

The rapid growth of the number of agricultural companies and the radical decline of the number of agricultural workers led to a fundamental transformation in the size structure of agricultural companies. At the end of the eighties, approximately one-half of the agricultural organisations had more than 300 employees. This was mainly due to the fact that co-operatives performed many activities over and above their basic ones. More than 90 percent of the agricultural companies had a staff more than 50.

By 1998, these proportions had changed. The largest group consists of corporations with a staff below 20, whose relative proportion was about 85 percent in 1998 as a result of the more than 230-fold increase of registrations in this category. The number of 21 to 50 employee-corporations also grew, with a share of 7 percent by 1998. The number of large-scale firms with more than 300 employees declined drastically; consequently, their proportion became minimal. The share of companies above 50 workers had not reached the level of 10 percent in 1998.

[3] *Registered corporation*: legally existing unit with tax number, figuring in the administrative register. In 1996 the statistical nomenclature changed; since this time the data have shown the number of active corporations. *Active corporation*: those enterprises which had tax reports in the subject year or in the preceding year (corporate tax, value added tax, etc.), or which were established in the reference year, and then registered as a budgetary, social security, non-profit and Employees' Co-ownership Programme organization.

As a consequence of transformation, the former extreme duality of the Hungarian agricultural system has been moderated considerably. One can distinguish three main types of farms. The first are what we might call *industrial farms and co-operatives*. They stem from former state farms (currently join-stock companies), co-operatives and newly established agricultural firms. They have their origins mainly in the break-up of co-operatives into smaller units. Most corporations with above 50 employees belong to this category. The important characteristics of these farms are based on hired labour and a hierarchical organisational structure. Despite transformation, these corporations have remained predominant in the Hungarian agricultural structure. They use about 40 percent of agricultural land and they have more than 100 thousand employees. The average area of these corporations was 1332 hectares in 1996.

Table 7

Distribution of agricultural organisations, according to number of employees 1990–1998[4]

	1990	1991	1992	1993	1994	1995	1996	1997	1998
– 10				1669	2420	3834	7256	8435	8958
11 – 20	413	1031	1471	991	1012	624	605	576	607
21 – 50	106	297	437	730	761	799	743	738	747
51 – 300	860	1060	1200	1188	1209	1061	963	906	817*
301 –	722	666	378	129	126	95	72	67	81**
Total	2101	3054	3486	4707	5528	6413	9639	10722	11210

*51–250
**251–

Sources: Statistical monthly bulletins 1990–1996. The number of economic organisations 1997–1998. Central Statistical Office of Hungary.

The second type is the *private or family farm*. They arise from: (1) the lands from former co-operative members and state-farm employees; (2) beneficiaries by compensation; (3) members seceding from co-operatives with their land; and (4) a combination of the above. These farms are based on family labour (farmers and their family members) and some of them also employ full-time and seasonal hired labour. However, it is difficult to determine the exact number of family farms. According to the last Agricultural Census (1994) there were 51 thousand full-time private farmers. They employ 10.9 thousand full-time and 20.6 thousand seasonal workers. The number of private farms has increased probably over the last four years by about 10–20 percent (Kovács et. al. 1998). However, the number of farmers

[4]The main sources of the significant data difference for 1995, compared to previous table, is that *Table 7* does not contain non-legal entity companies.

and farms do not necessarily coincide. In 1994 there were 1044 large-scale and 64.9 thousand medium-size farms, exceeding the number of registered full-time farmers by approximately 15 thousand.

On the other hand, the number of registered private farmers is markedly less. In 1998 the number of registered agricultural entrepreneurs was 27.9 thousand, out of which full-time farms represent 15.1 thousand, part-time farms 7.7 thousand, and retired farms 5.1 thousand. Moreover, one can assume that non-legal entity companies are also family farms. Similarly, most of the active corporations with less than 10 employees can be private farms as well. The number of registered private farms is about 30–32 thousand. The large- and medium-size private farms were using about 12 percent of the agricultural land in 1998 (*Table 5*).

The third group is made up of the *part-time farms*, which play a traditionally significant role in the Hungarian agricultural structure. According to the Microcensus (1994), 732 thousand active earners worked on their own land part-time. If one takes into account the inactive earners, the unemployed who work on their own land, pensioners and young people below 14 years of age, the number of people who are involved in agriculture was 1875 thousand. The number of agricultural households was less, at 1069 thousand.

There are two main types of part-time farms. First, the agricultural households which produce basically for the markets. Some of them have specialised in particular commodities—e.g. pigs, fruits and vegetables. In 1997, 800 thousand people registered as primary producers. Most of them produce a marketable surplus. The results of the survey by *Szijjártó* (1996) demonstrated that 40 percent of part-time farms produce for the market; this proportion was two-thirds in the case of retired part-time farmers. The second group can be called subsistence part-time farms. They number about 1 million. Their main production goal is to reduce household expenditure. However, some of the subsistence part-time farms sell their products—depending on their surplus—seasonally on the local market. The data of the Hungarian Households Panel show that between 1992–1994 the share of subsistence households increased from 34.4 percent to 44.4 percent (*Spéder* 1994). The growing role of subsistence farming is confirmed by some regional studies (Spéder 1997). However, recent research by *Laki* (1996) has shown that, in particular regions, surprisingly, agricultural production is not a part of a survival strategy to cope with rural unemployment.

The change in the structure of the food industry

Before 1989 the food industry was characterised by state-owned firms, but some companies worked as co-operatives. Privatisation has had a fundamental effect on the structure of the food industry. First, the number of corporations in

the food industry grew from 1990 to 1997: more than 16-fold. The increase came mostly from newly established private enterprises and partly from privatisation. However, this development had stopped by 1998 (*Tables 9–10*). It can be seen from *Table 8* that, between 1994–1998, the number of partnerships and unincorporated enterprises and co-operatives decreased after 1995.

Table 8

Development of the number of active corporations in food industry

	1994	1995	1997	1998
Total	3934	4353	4600	4442
o.w. limited liability company	2415	2731	2903	2775
join-stock company	226	235	247	245
partnerships and unincorporated enterprises	1168	1268	1255	1245
co-operatives	97	92	69	69

Sources: Oszoli (1998) *The number of economic organisations 1997–1998*, Central Statistical Office of Hungary.

Table 9

Size distribution of companies in the food industry, by number of employees 1989–1991[5]

	1989	1990	1991
1–100	80	373	983
101–500	49	70	100
501–	150	144	139
Total	279	587	1222

Sources: *Statistical monthly bulletin 1989–1992*. Central Statistical Office of Hungary.

The most popular legal business form was the limited liability company in the food industry: its share reached 60 percent in 1998. The proportion of joint-stock companies is below 6 percent, but they play a very important role in the food industry. The sharp increase in the number of companies in the food industry has had significant effects on the size of the industry. *Table 9* shows that in 1989 about 54 percent of companies in the food industry had more than 500 employees. The share of corporations with less than 100 employees represented only 28 percent of the total number of companies. From 1992 to 1998 the corporations with a staff below 50 grew nearly threefold. The number of corporations with 50 to 300 employees grew less, whereas the number of companies with more than 300 employees

[5] The basic source of the data difference for 1995 compared with *Table 8*, is that *Table 10* does not contain companies with less than 20 employees.

Table 10

Size distribution of companies in the food industry, by number of employees 1992–1998[5]

	1992	1993	1995	1997	1998
1– 50	1376	1929	2662	4208	4038
51–300	177	243	281	271	278*
301–	201	179	148	121	126**
Total	1714	2351	3091	4600	4442

*50–250
**250–

Sources: Statistical monthly bulletin 1992–1996. The number of economic organisations 1997–1998. Central Statistical Office of Hungary.

fell steadily. As a result of these processes the share of different categories has changed. In 1998 the proportion of companies with less than 50 employees was about 90 percent, the category of 51 to 250 employees was 6 percent and that with above 251 employees was 4 percent. The companies in the last group probably operate as join-stock companies. The data of the last two years suggest that a slow concentration process has started and this is confirmed by the decrease of small-scale companies.

As a result of the transformation (including privatisation) there are three groups in the Hungarian food industry (*Mohácsi* 1996). First, there exist foreign-owned companies (mainly multinational firms). Foreign investors have played a very important role in privatisation, especially compared to other post-socialist countries.[6] The proportion of FDI is significant in the following sub-sectors: vegetable oil, sugar, tobacco, soft-drinks, brewing, distilling, wine, confectionary, poultry, and starch-biotechnology. These respective sub-sectors can be described by one of the following characteristics: stable domestic markets, monopolistic-oligopolistic market structure, or relatively simple production technology (*Lakner and Somogyi* 1997). These companies produce for the Hungarian domestic market and the export market. They have good information on international market trends, developed marketing strategies and techniques.

Second, there are medium- and small-scale companies (in accordance with international measurements) most of which are owned by Hungarian investors. These firms are mainly domestic market-oriented with strong links to Hungarian and multinational food retailing companies.

Finally, there are small-scale corporations which are owned by agricultural producers, local governments and other entrepreneurs. The activities of these firms focus primarily on regional markets. They sell their products mainly via regional and local retail companies.

[6] A study by *Josling et al* (1997) shows that the share of FDI in agri-food sectors in the transitional countries was most significant in Poland and Hungary between 1990–1996.

The obstacles facing adjustments in agri-food sectors

The production in agri-food sectors decreased significantly between 1990 and 1993. It is generally agreed among agricultural economists that the causes are a combination of particular factors: (1) decrease of support for agriculture; (2) declining agricultural terms of trade; (3) imperfections of agricultural credit markets; (4) fall of domestic food consumption; (5) collapse of COMECON markets; (6) disruption caused by land reform and privatisation; (7) weather in particular years; (8) disruption of the traditional exchange system within the agri-food system; and (9) slow establishing of new market institutions. The differences in the respective evaluations of agricultural policy reform are based upon which factor is considered to have had the most significant effect in transition.

Despite a sharp decline in agricultural production, signs of a recovery still looked only slight at the end of 1998. A cross-country study by *Macours and Swinnen* (1997) has shown that between 1989 and 1994, in the case of Hungary, positive effects due to increased productivity offset negative impacts caused by disruption of former production structures.[7] Most of the economic conditions for agri-food sectors have improved over the last four years. The agricultural terms of trade began to stabilise after 1992. Support for agriculture has grown continuously since 1993. The agricultural credit constructions have become more favourable. Food consumption has started to increase. Given these details, why does the output of the agri-food sectors not increase much faster? The one possible key factor in explaining this phenomena is the slow restructuring of the exchange system in the agri-food chain and the lack of efficient and transparent agricultural markets.

It can be seen from *Figure 1* that particular groups of agricultural producers use different market arrangements or pricing mechanisms to connect with the food industry. Industrial farms and co-operatives usually have a production contract, sometimes long-term, with the food industry. They are rarely involved in the vertical integration offered by food industry companies. These farms can also sell their products on the organised markets. The products of private farms are purchased mainly via organised markets, but they sometimes have production contracts. Market-oriented part-time farmers sell their commodities basically through individual negotiations and organised markets. Subsistence part-time farmers do not sell their products, therefore they are not in *Figure 1*.

The choice among different pricing mechanisms depends mainly on the characteristics of particular products (e.g. storable or non-storable). Vertical integration is important in the poultry industry. The importance of production contracts is considerable for milk, beef, pork, and some fruit and vegetables. The commodity exchange market plays a significant role for grain. However, all types of pricing

[7] It must be noted that results by *Gow and Swinnen* (1998) are from a study that covers only the grain sector.

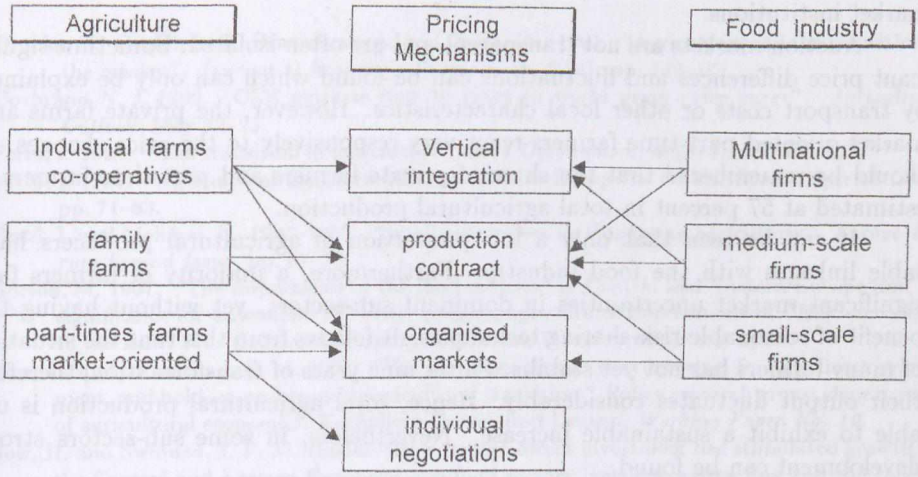

Fig. 1 Exchange systems within Hungarian agri-food system

mechanisms have special difficulties in current Hungarian agri-food systems. These failures cause inefficiencies within the agri-food chain.

In those sub-sectors where no type of production contract exists, agricultural producers face the problems of delay[8] (e.g. delayed payment for delivered products). These problems are stressed strongly by Gow and Swinnen (1998, 1998a).

Empirical evidence suggests that FDI in food industries encourages a solution of hold-up problems mainly via long-term contracts, especially in the cases of tobacco, sugar brewing, vegetable oil, poultry, milk and confectionery (*Kacsirek and Kóczián* 1997, *Lehota and Szűcs* 1998). However, it must be noted that in some cases, where multinational firms have dominant market positions, they create a new type of hold-up problem—for example, ex-post reduction of the contract price.

The use of organised markets causes some difficulties. Despite the growing importance of the commodity exchange market, it is not suitable for reasonable risk-sharing strategies for farmers. The grain exchange market reacts very slowly or irregularly to changes in the world markets. For example, it occurs often that world prices increase and domestic prices decline on the commodity exchange markets and vice versa (see, for example, *Cochrane* 1996). Furthermore, there is no such government intervention system which is able to secure efficiently the reasonable floor price on the grain market. Also, no crop insurance system works in Hungary. Hence the grain producers face considerable market uncertainties every

[8] "Hold-up problems occur when one of the parties has incentives to initiate ex post renegotiations of contractual terms in an attempt to extract a greater proportion of the quasi-rents accruing to the relationship-specific investment." (Gow and Swinnen 1998, p. 4.)

year. Consequently they cannot share production risks due to the lack of efficient market institutions.

Auction markets are not transparent and are often isolated. Sometime significant price differences and fluctuations can be found which can only be explained by transport costs or other local characteristics. However, the private farms and market oriented part-time farmers react very responsively to the price changes. It should be remembered that the share of private farmers and part-time farmers is estimated at 57 percent in total agricultural production.

It can be seen that only a low proportion of agricultural producers have table linkages with the food industry. Furthermore, a majority of farmers face significant market uncertainties in dominant sub-sectors, yet without having the benefit of reasonable risk-sharing techniques. It follows from this that the situation of many farmers has not yet stabilised after nine years of transformation; therefore their output fluctuates considerably. Hence, total agricultural production is not able to exhibit a sustainable increase. Nevertheless, in some sub-sectors strong development can be found.

Conclusions

The first years of agricultural policy reforms in Hungary have been characterised by a large decrease in agri-food output. Despite desirable structural changes in both agriculture and the food industry and the growth in productivity, and more favourable economic conditions, production has risen only slightly over the last four years. This phenomena can be interpreted as part of the process of development of a smaller and more efficient agri-food sector.

The key factor is the underdeveloped pricing mechanisms within the agri-food chain. Empirical evidence suggests that multinational firms and other large-scale companies in the food industry can solve some inefficiencies, including hold-up problems. However, their activities can cover only a small proportion of the Hungarian agri-food sectors. The majority of farmers are not able to adjust efficiently to the continuously changing economic environment. Their problems cannot be solved simply by government support. Consequently, without establishing and developing efficient and transparent market institutions, it cannot be assumed that sustainable growth in agri-food sectors is guaranteed. The main conclusion of this analysis reinforces the conclusions of Gow and Swinnen (1998)—that is, the focus of government activities should move from predatory-type subsidies to productive-type support; that latter would decrease the transaction costs of exchange systems within agri-food sectors.

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REGIONAL EFFECTS OF FDI-INFLOWS IN HUNGARY

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This article summarises the research results of a study (*Hamar* 1998a) which began in 1998; the study aims to measure the real and changing effects of foreign direct investment (FDI)-inflows in Hungary according to the respective Hungarian regions, and to identify the main factors of differences in the FDI-attractiveness of those regions. Looking for the answer whether FDI-inflows have increased the "splitting of the country into two parts" or, on the contrary, have contributed to a narrowing of the gap in the development ability of the respective regions, our research results do not suggest that there are growing differences between the regions. However, some border areas have obvious disadvantages in FDI-attractiveness, and our analyses underlined the overwhelming dominance of Budapest in the respective cases of almost every factor.[1] Nevertheless, our analyses show that the FDI-inflows outside the capital, even if they seemed to be almost negligible compared to the amount invested in Budapest, have contributed significantly to county development, lessened the unemployment level in nearly every county, increased export-ability and -orientation and improved company performance. At the same time, the foreign capital owners have gained a determinant role almost in each economic activity.

The regional characteristics of the FDI-inflows are summarised in Hungary as research results showing each double accounting firm's (legal and non-legal entity's) balance sheets as presented to the Tax Office.

The distribution and changes in the number of joint ventures (JVs), FDI-stock and company assets by counties[2]

FDI-inflows have focused on Budapest since the beginning of the transition: up to the end of 1992 more than 57 percent of total FDI-stock was invested in firms with headquarters located in Budapest. Out of the total number of partially or totally foreign-owned (12,363) firms 7,069 (57 percent) were registered in Budapest. Distribution of the statuary capital of the JVs (partially and totally foreign-owned firms together) was also concentrated in Budapest in the same proportion (58 percent). While, as a country average, every fifth company had FDI at that time, in Budapest this share was more than 28 percent. The FDI-value had already reached almost 11 percent of the statuary capital of all (more than 25,000) firms in Budapest. With this share of FDI the foreign capital owners could control more

[1] This is, however, also exaggerated by technical facts. (The only possible statistical base for the analyses is the double accounting firms' tax reports, these are based on the location of the headquarters of the firms, and not on that of the activities, or plants.)

[2] Since the formation of the new regions (in line with EU) is under discussion, this article uses the terms "regions" and "counties" as synonyms.

than double this amount of capital (the share of the total capital of the JVs as a proportion of the total amount of the statuary capital of all firms was 19 percent).

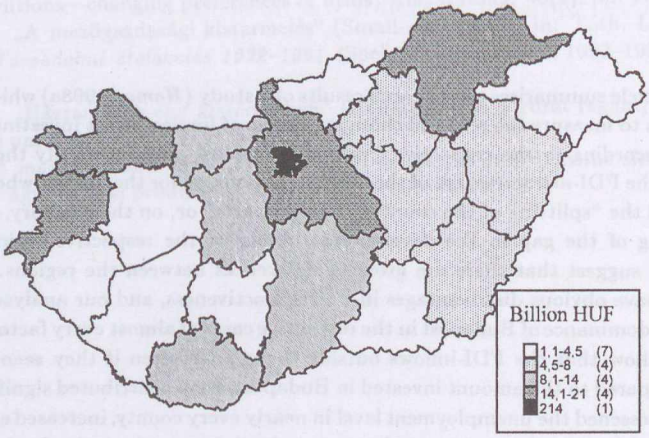

Fig. 1 FDI-inflows by regions, 1992

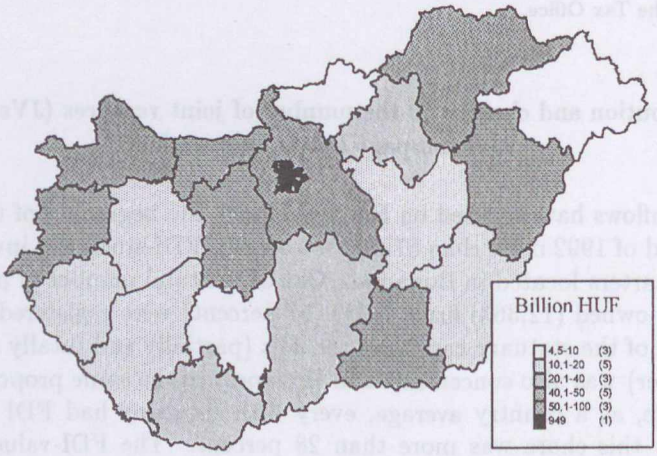

Fig. 2 FDI-inflows by regions, 1996

These outstanding shares, however, did not indicate any special behaviour on the part of foreign investors. Budapest had a dominant role in almost every respect. The share of the capital in the FDI-inflows in 1992 was only 3 percent greater than the share of the total capital of all Budapest firms; the FDI share in all statuary capital (SC) was only 0.5 percent higher than the national average.

While these differences in the West Hungary (in Vas county) were +14 percentage points, in Fejér county they were near to +5, and in Nógrád and Pest counties there were also more than +3 percentage points.

It is worth mentioning—and it was different from what we expected—that the largest investments did not happen in Budapest even up to the end of 1992. While the aggregated capital strength of all Budapest firms surpassed the national average by 25 percent, in the case of the JVs, this gap was only 1 percent, and the average amount of FDI invested in Budapest firms (30 million HUF, as a firm average) was similar to the national one. In contrast to Budapest, in Borsod-Abaúj county (Northeast), where relatively few companies (9 percent of all firms) had received any FDI up to the end of 1992, the average level of FDI per firms—80 million HUF—was more than 2.5 times higher than the national or the Budapest average. This amount was more than 50 million HUF also in Fejér, Heves, and Békés counties, but Nógrád, Jász-Nagykun, and Vas counties also reached near to 50 million HUF.

The picture had changed significantly by 1996, however, with FDI-inflows concentrated further on Budapest (59 percent). The largest number of the JVs had also been established in Budapest (out of the 105,717 double accounting firms 20,278 already had FDI in 1996, and out of these, 11,282 were registered in Budapest). The value of the total FDI-stock also increased by four times (by 442 percent, while the national growth rate was an average of 430 percent). The outstanding role of Budapest, however, was mainly due to the multiplication of the capital strength of the Budapest companies (both the respective average values of the total statuary capital and the FDI invested in a firm), mainly as a consequence of the increasing capital accumulation in the financial sector (predominantly focused on Budapest) and as a result of its opening up process for foreign investors.

The average capital of firms in Budapest increased 75 times in four years; firms with foreign capital raised their average capital amount by 87 times, and the average value of FDI increased more than 100 times, from 30 million to 3.1 billion HUF between 1992–1996; the national average was only 79 million HUF in 1996.

In Budapest, as with the national tendencies, more companies were formed without foreign capital between 1992–1996 (the number of indigenous firms increased from 18 thousand to almost 34 thousand), while the number of companies with FDI increased by "only" 60 percent (from 7,069 to 11,282). Therefore, the share of Budapest in the number of all JVs slightly decreased (to 56 percent), while according to the value of the FDI its share increased further (to 59 percent).

Considering the growth rate of the number of firms with foreign capital, some counties—such as Heves (213 percent), Somogy (200 percent), Győr-Sopron and Zala counties (199 percent)—produced much higher increases than the capital, or the national average during 1992–1996. In Vas- and Győr-Sopron counties more than one-quarter of the firms (26–27 percent) were already operating with foreign capital in 1996.

The rate of FDI to firms' total assets in 1996 reached the highest proportion in Vas county (47 percent), but the national average (32 percent) (or the 33 percent share in Budapest) also was significantly surpassed in Borsod-Abaúj, Pest and Győr-Sopron counties (39 percent), and also in Heves, Komárom and Fejér counties (35 percent). The foreign capital owners could control more than half of the total company assets in several counties (such as: Győr, Heves, Borsod, Csongrád, and Vas counties), and the capital strength of the JVs in Zala, Baranya, Pest and Hajdú-Bihar counties was quite similar to the Budapest share of 46 percent.

Employment and the unemployment rate

The double accounting firms employed altogether 2,250 thousand persons in 1992. Out of this total 39 percent (887 thousand) were employed in Budapest. The number of people (345 thousand) employed by the JVs (firms with foreign capital) accounted for 15 percent of the total employment at the national level; out of this figure 49 percent—almost every second person—worked in Budapest. Out of the total employment of Budapest almost every fifth person (19 percent) worked for a foreign-owned firm. The share of the employment of the JVs to the total by counties was higher than Budapest only in Borsod county, where every fourth person belonged to a foreign or partially foreign-owned firm already in 1992. The JVs also had a larger role in employment than the national average in Vas, Baranya and Jász-Nagykun-Szolnok counties (17–16 percent), and it reached almost the national rate (15 percent) in Győr-Moson-Sopron county. In contrast to this, less than 6 percent of the total respective workforces could find employment at the JVs in Szabolcs-Szatmár-Bereg and Békés counties; this proportion in Tolna was 8 percent, in Somogy 9 percent, and Veszprém, Pest, and Hajdú-Bihar counties also had a rate of only around 10 percent.

By the end of 1996, the differences in firm size by counties had significantly decreased. The indigenous and the foreign-owned firms showed definite and significant tendency alterations: while the average size of all companies country-wide decreased almost by a half (from 39 persons to 18 per firm) by 1996, the JVs' average size remained the same as in 1992 (28 capita as a national average).

In some counties the size of the JVs increased: in Fejér, Békés, Hajdú, and Szabolcs-Szatmár-Bereg counties the increases were significant; in Vas, Komárom, Pest, Veszprém, and Zala counties (similarly to Budapest) the expansion in size of the JVs was modest (about 10 percent or less). The opposite tendency was registered in Borsod and Jász-Nagykun counties, where it decreased by a half; a decrease in size also characterised the JVs in Baranya, Bács-Kiskun, Győr-Sopron, Nógrád and Tolna counties.

The smaller size of the JVs in Budapest was mainly due to the fact that the FDI flowed to the service sectors rather than to industry, while in the counties mentioned above it was invested into industrial sectors, with mainly labour-intensive activities.

It is important to mention that while the total number employed by all (double accounting) firms further decreased in the period 1992–1996 (by almost 14 percent as a national average), the partially or totally foreign-owned firms increased their employment one and half times by 1996, compared to the employment level of 1992 (the growth rate of employment in the JVs was 162 percent). The total number of employees in Budapest decreased by 15 percent, while the average employment level of the JVs increased by 169 percent.

The tendencies in the total employment level and that of the JVs showed quite strong links. Fejér county was the only one where there was no decline in the total level of employment during the four year period—in fact, an increase of 6 percent was registered. This is certainly connected with the fact that the JVs expanded here at the most dynamic rate (255 percent). The lowest falls (less than ten percent) in the employment level were generally found in those counties where the JVs had at least doubled their number of workers (such as in Somogy, Vas, Veszprém and Győr-Moson-Sopron counties). The increasing role of the JVs in employment certainly reduced the deterioration of the labour market situation to a significant extent in Zala, Heves and Pest counties, too. The largest fall in employment (30 percent) happened in Borsod. However, here the JVs also reduced the total number empoyed by them by a similar degree (28 percent).

These general tendencies brought about a situation in which, out of a total number of persons (1,947 thousand) employed by all (double accounting) firms in 1996, more than 749 thousand worked in Budapest; out of this figure 283 thousand were working in firms operating with foreign capital (38 percent, compared to the national average of 29 percent).

In 1996 more than half of the persons employed by all JVs worked for firms located in Budapest. Nevertheless, Nógrád and Tolna counties could not reach even a one percent share, and the largest share of Győr-Sopron county remained under five percent. However, the role of the JVs in the counties' employment increased almost everywhere in the period in question. 29 percent of the total labour force worked for foreign-owned firms (as a national average). In 1996 JVs reached an exceptionally high share in Vas county (39 percent) and in Budapest (38 percent), but in Győr and Heves counties every third person was employed by a JV, in Zalà and Komárom counties JVs accounted for 28 percent of the total employment, and in Baranya, Borsod, Csongrád counties every fourth person was employed by a partially or totally foreign-owned firm.

The FDI-inflows had, significantly, the most modest role in reducing employment problems in Tolna (12 percent), Békés, Szabolcs-Szatmár-Bereg (16 percent), Jász-Nagykun-Szolnok and Somogy counties (19 percent).

By comparing the share of the JVs in employment to the data of unemployment rates (for 1997) by counties, the positive effects of FDI-inflows on employment levels are clearly proved; however, the regional distribution and labour-market effects of FDI have also been determined by other factors (such as the structural differences and changes according to the labour-intensity and productivity, as will be mentioned below).

The unemployment rate, even in 1997, was highest in Borsod county (7.2 percent of the population of 15–74 year olds). Here, as was mentioned above, even JVs laid off employees at a rapid rate (28 percent of the total) during the four years. However, the role of the JVs in employment also increased here. Every fourth person in the total employment of the county worked for a foreign-owned firm in 1996. Those counties where the JVs' share in employment remained relatively modest (less than 20 percent) even in 1996, the unemployment rate surpassed 5 percent (with the exception of Bács county, where the rate of unemployment was only 4 percent). Whereas in Vas county, where the JVs reached an exceptionally high proportion in employment, the unemployment rate was significantly the lowest, only 2.5 percent. Similar links could be registered in Győr-Sopron and Pest counties, and in Budapest (in the first two cases the respective unemployment rates were 3.5 percent, while in Budapest it was 3.9 percent in 1997). Heves, Fejér, and Komárom counties showed an opposite tendency; despite the high proportion of JVs accounting for employment, the rate of unemployment remained relatively high (more than 4 percent).

FDI-inflows and salaries

The foreign-owned firms generally pay more as wages and salaries to their workers than the indigenous firms. This was characteristic for the whole country: the JVs contributed by a much higher proportion (41 percent) to the wage- and salary payments than to the total employment figures (29 percent). A similar tendency could be measured in their health, social security and pension contributions, too. In 1992 the average payment of a JV, as total wage- and salary expenses per capita, was more than 25 percent of the total average (0.5 million HUF per capita), and more than the average for all firms (0.4 million HUF per capita).

This gap in Budapest was even larger: even the all-Budapest companies paid more in wages and salaries altogether than the national average (0.5 million HUF per capita), and the JVs' "human expenses" were much higher (by almost 30 percent, at 0.7 million HUF per capita).

Despite the higher per capita wage-expenses the JVs (across the whole country and in Budapest also) paid out relatively less as wages and salaries (relative to their net income on sales) than their indigenous counterparts (13 percent, whereas

the national average was 16 percent). By 1996, this gap had increased further. The JVs tended to specialise on less labour-intensive activities; however, they (nationwide and in Budapest) paid out twice as much on wages and salaries than all firms, and more in Budapest than in other parts of the country.

In 1996, the JVs in Budapest paid 1.5 million HUF per capita as average salary expenses, and 1.3 million HUF per capita nationwide, whereas the figure for all firms was 0.9 million HUF/capita (as a national average salary payment), and 1.1 million HUF/capita in Budapest. However, these higher per capita expenses represent an even smaller part of their net income on sales (only 10 percent) in 1996, than in 1992.

The distribution of wages and that of social security contributions depended heavily not only on the different role of the JVs by counties but on the structural differences according to economic activities (sectors). Budapest's outstanding share in wage and salary expenses and in social contributions (besides the distorting effects of the methods of the registration of a firm and the location of its headquarters) can partly be explained by the fact that financial intermediation and other better paid activities are dominantly focused on the capital city.

It is worth mentioning that the wage-increase in Budapest was nowhere near the highest during the four year period: the national average growth rate was 82 percent, while in Budapest it was "only" 80 percent. (The health and pension contributions increased, like the national average, by 81 percent.) There were much higher increases in wage levels in almost half of the counties than was the case in Budapest, or compared to the national average (especially in Fejér, Vas, Veszprém, Heves, Győr-Sopron, and Borsod counties). The "negative record" in this field was "produced" again in this respect by Szabolcs-Szatmár, Hajdú-Bihar, Komárom and Somogy counties.

The expenses of the JVs (with respect to contributions to healthcare and pension funds) increased much faster almost everywhere: they paid twice, three or four times more in 1996 than their contributions in 1992 (the national average increase was 386 percent), and their average was more than that for all firms. This means that the firms with foreign capital contributed significantly to the increase in personal incomes and to social security, health and pensions everywhere. The rankings of the counties were quite similar to the rankings for all firms.

At the same time, there were some interesting and important differences between the tendencies in wage and salary expenses and that of the health and social security payments: in the case of all firms these two items increased at the same rate and in parallel; while the dynamics of the health-care and social security contributions of JVs (403 percent) greatly surpassed their wage and salary payment increase (386 percent). This was characteristic for all counties (with the exception of Zala). This gap between the dynamics of health and social security contributions and that of salary increases was largest in Heves (+48 percent), Fejér (+45 percent), Baranya and Pest (+25 percent), Somogy and Vas counties (+20

percent). Budapest showed a similar gap, with respect to the national average (+18 percentage points), between the growth rate of these two items.

The share of JVs in the wage- and salary income for the whole country reached 41 percent in 1996, while in Budapest it was 51 percent, and in Vas and Heves counties it was 46 percent and 43 percent respectively. One-third of the total personal income originated from foreign-owned firms in half of the counties, and their proportion in the other counties was at least one-fifth (with the exception of Tolna).

Net income on sales (NIS) and exports

The deepest point of the transitional crises was 1992. Therefore, it is not surprising that the net income on sales (NIS) had increased across the country two and half times by 1996, and at least doubled in each county (with the exception of Tolna, where the NIS was "only" higher by 197 percent in 1996 than in 1992.) The value of the NIS increased most dynamically in Vas county (3.5 times), and in Pest and Fejér counties it tripled.

The expansion of the JVs characterised the whole country: the value of the NIS produced by the JVs increased almost five times as a national average. The JVs in each county produced several times higher NIS in 1996 than in 1992 (again, with the exception of Tolna) and the increase was much higher than that for all companies.

The NIS of JVs in Vas, Fejér and Baranya counties increased more than eight times, in Borsod seven times, in Győr-Sopron, Pest and Zala counties it was six times higher in 1996 than in 1992, and in Hajdú-Bihar this was almost the same; but in Veszprém, Somogy, Komárom and Csongrád counties, the contribution of JVs to sales development was more than the average for all firms. The increase of the Budapest JVs, however, was less dynamic than the national average, but it still reached a more than 4.5 times higher value in 1996 than in 1992. The dynamic effect of the JVs even in Szabolcs-Szatmár-Bereg county was not negligible; here the NIS also increased four times, as in Heves and Baranya. In Békés county the growth of the NIS was also 3.5 times. The JVs of Nógrád, Bács-Kiskun and Jász-Nagykun-Szolnok counties expanded at a more modest rate. However, there was only one county (Tolna) where the indigenous firms developed their sales faster than the JVs (197 percent in contrast to 181 percent).

The share of JVs in sales increased at a high rate in all counties (with the exception of Tolna). (The national average increased from 24 percent to 47 percent, and respective figures for Budapest were 32 percent to 57 percent.)

The differences according to counties decreased significantly over the four years. However, Budapest kept its dominant share in sales for all companies. (In 1996 half of the total income on sales of all companies was produced by firms regis-

tered in Budapest, one point higher than in 1992.) In contrast, the JVs registered in Budapest had noticeably lost their positions (by almost four percentage points), but they still had 60 percent of the NIS produced by all JVs. This proportion was still much higher than their share according to the number of JVs, or that of wages or employment.

By comparing the development in NIS and in exports by counties and according to the different company groups, it turned out that the income on sales increased rapidly in those counties where the exports—and mainly the JVs'exports—expanded at a significant rate.

In Fejér and Borsod counties export-expansion grew more than 20 times; Pest, Győr-Sopron and Komárom counties produced ten times higher exports than four years earlier, but even in the other regions the export-growth reached a value at least four-five times higher in 1996 than in 1992. In Tolna and Békés exports grew "only" 3.5 times, and the most modest (3 times) expansion was registered in Nógrád and Jász-Nagykun counties, respectively.

As a result of the spectacular export-expansion, the JVs gained dominant positions in nearly all counties: their share in the total national exports reached 71 percent in 1996, but in several counties they dominated almost all the export markets (such as in Vas county at 94 percent, and in Fejér, Komárom, and Pest counties all with more than an 80 percent share).

The earlier dominant position of Budapest (both in total exports and in exports made by JVs) declined significantly between 1992 and 1996 (by 13 and 19 percentage points respectively). This change was certainly due to the new export-capacity of "green-field investments" made outside Budapest by foreign investors, and also to the rapid development of the Free Trade Zones.

The spectacular export-expansion over the last few years is frequently considered as a result of the activities of some (few) large multinationals. However, the standard deviation of the NIS and the exports per company indicates a much more sophisticated picture. The concentration of the NIS and especially that of the exports in Budapest decreased significantly between 1992–1996. In Jász-Nagykun county, also, where in 1992 the average export-value of the JVs (per firm) was almost three times higher than the national average, this figure had declined to 151 percent by 1996. (Hajdú-Bihar, Heves, Nógrád, Csongrád, Bács-Kiskun, Veszprém, Zala counties showed the same tendencies, albeit by a smaller degree.) On the other hand, in Fejér county the average export-value per firm compared to the national average increased from 124 percent to almost five times higher than that average (491.1 percent). The same tendency of the increasing concentration of exports in a smaller number of companies could also be measured in some counties (such as in Vas county—from 175 percent to 387 percent, in Borsod—from 68 percent to 311 percent, and in Komárom county—from 97 percent to 166 percent).

Considering our calculations on the degree of the "openness" of the counties, the export-orientation (i.e. export share compared to NIS) was in 1992 only 14

percent of the country average (and in the case of JVs it was only 21 percent). The same proportions in Budapest were 15 percent and 20 percent respectively. In certain counties, however, where the JVs already had an extra role in exports (for instance in Vas, Békés, Fejér, and Nógrád counties), the dependence on export-markets was already much higher than it was for the whole economy. By 1996 the export-orientation had grown rapidly everywhere (except Budapest), but especially in those counties where the JVs had acted as a catalyst in export-expansion.

In Vas county, for instance, more than half of the NIS was earned through export-markets and the JVs exported three-quarters of their production. The export-orientation in Fejér county also reached one-third of the total NIS, and in the case of the JVs the export-share in relation to their NIS was 59 percent. In Somogy county it was also the JVs which were the "engine" of export-development: the average degree of the openness in this county increased by ten percentage point during the four years, but it was still a modest level (less than 20 percent) compared to the national average; the JVs, on the other hand, had an average export-orientation higher than 50 percent. It is also interesting that the export-orientation in Zala, Csongrád, Hajdú-Bihar, and Veszprém counties increased (albeit at a modest rate), while the export/NIS in the JVs declined. In other words, the indigenous firms were able to increase their export-orientation more than the JVs.

Budapest showed a different tendency in the development of export-ability: here, all companies, including the JVs, became relatively less export-oriented in 1996 than in 1992, and the level of export-orientation was also the lowest in the country. This was especially remarkable in the case of the JVs. This indicates that the focus of the development of export and total sales seemed to move away from Budapest (for instance, to the Free Trade Zones).

Performance and profit-taxes

The more efficient company performance of firms with foreign capital (as in the national economy) could be measured by each county, too. At the deepest point of the crises, in 1992, however, the majority of the JVs—as with all double accounting firms—in general, produced losses.

As a result of the character of Budapest, as a "centraliser" for firms, the majority of the losses were also produced in the capital (47 percent of the total value of all losses, and 56 percent of the losses for all JVs). The second "loss-maker" county was Borsod, where the few JVs accumulated one-quarter of all losses produced in the whole economy. At the same time, Győr-Moson-Sopron county was the only county where all firms, including JVs, reached results which on average were positive in 1992.

Table 1

Export-orientation by counties between 1992–1996

(export-income to the net income on sales, percentage)

Export-orientation percentage	1992 All companies	1992 Joint ventures	1996 All companies	1996 Joint ventures
Total	13.9	21.3	17.3	26.0
Budapest capital	15.2	19.8	14.1	17.4
Baranya	8.3	17.9	12.8	24.3
Bcs-Kiskun	13.4	30.5	15.8	43.4
Bks	17.2	38.7	18.3	38.9
Borsod-Abaj-Zempln	13.8	9.6	17.3	30.9
Csongrd	9.5	27.3	12.6	22.9
Fejr	17.8	19.8	34.2	59.4
Gyr-Moson-Sopron	16.3	20.8	28.8	39.6
Hajd-Bihar	10.1	27.6	11.2	19.5
Heves	11.8	17.8	14.1	22.2
Komrom-Esztergom	10.8	16.6	20.4	33.3
Ngrd	17.6	30.8	17.5	33.4
Pest	9.1	16.3	18.6	37.4
Somogy	9.9	28.5	19.8	52.0
Szabolcs-Szatmr-Bereg	13.8	26.3	18.2	36.2
Jsz-Nagykun-Szolnok	12.7	30.9	16.8	34.7
Tolna	8.8	19.7	10.9	37.1
Vas	18.2	42.1	51.6	73.9
Veszprm	14.4	35.7	17.5	27.1
Zala	12.8	36.4	15.0	25.0

Source: Tax Office, and KOPINT-DATORG, double accounting firms balance sheets, and own calculations

The average size of losses for all firms before taxes was highest in Borsod in 1992 (8 million HUF); this was two and half times greater than the national average (3 million HUF), and two times larger than the average losses in Budapest (4 million HUF).

The JVs' performances varied by counties on an even larger scale. While out of the total negative results of the double accounting firms in the whole country before taxes only 16 percent was made by the JVs, this share of the JVs' losses reached one-fifth in Budapest, Békés and Heves counties, and almost one-third in Jász-Nagykun, Zala and Komárom counties. The JVs were "responsible" for almost half of the total losses in Fejér and Borsod (42 percent, and 45 percent respectively). On the other hand, in Győr-Moson-Sopron county the JVs had positive results before taxes—one and half time higher than the average for all firms in the county. In Tolna, the JVs reached almost the same positive results as the negative value

for all other firms. In several JVs counties lessened significantly the overall size of the losses.

Company results strongly improved in the average of each company group between 1992–1996. Both the JVs and all other firms on average had positive results (before taxation) in all counties in 1996. The national average for all other firms produced two times higher positive results in 1996 than the value of the average losses for 1992 in the case of their group, whereas in the case of the JVs the positive results were nine times higher than the 1992 average for the JVs, and ten times higher in Budapest. Out of the total profit for all firms, 46 percent was produced by the firms registered in Budapest, and out of the total profit of the JVs 64 percent originated in the capital city.

The most significant development was registered in Borsod, where the average losses of the JVs in 1992 was 15 times higher than the national average, while the average profit per firm in 1996 was twice the size of the national average.

The better performance of the JVs over their national counterparts was clearly recognisable in the whole economy: the main economic indicators per firm proved that the average positive results (before taxation) per firm reached 3.5 million HUF in 1996, while in the case of the JVs the figure was 14.5 million HUF. The difference in Budapest was even more striking: the all Budapest firms also reached better results than the national average (3.8 million HUF), and the results of the JVs in Budapest were really outstanding (16.6 million HUF) compared with the national average and that of all other Budapest firms.

By comparing the company results before and after taxation, we can form a picture about the distribution of the tax burden by counties. It turned out that the rank order of the counties according to company results (in 1992 losses, and profits in 1996) was quite similar after taxation with respect to the situation before it. However, some counties illustrated rather interesting deviations in this field: for instance in Budapest, all Budapest firms produced 41 percent of the total profit after taxation (4 percent less than before taxation), and the JVs in Budapest had 62 percent of the total profit produced by all JVs after taxation (this represents 1.5 percent less than before taxation). Thus the tax burden in general was higher in Budapest than the average for the whole country. On the other hand, in some counties—such as Vas, Pest, Fejér, Győr-Sopron, Somogy, Jász-Nagykun—the firms could keep a larger part of the profit after taxation. (And the indigenous firms generally enjoyed a larger rate of tax-deduction than that of the JVs, while in Budapest the case was the opposite.)

In 1992, the negative results of the firms after taxation were much higher than before it. In 1996, in general the paid taxes significantly reduced the disposable profit-income of firms (with a large standard deviation by counties). Due to the balance of tax holidays and extra taxes, all firms received profit-income which was in general less by 32 percent; this figure for the JVs was 18 percent. The JVs' contribution to the profit-income was significant everywhere, even determinant

in some counties (such as in Vas and Pest counties). The JVs in Budapest and Komárom produced positive results after taxation and these were much greater than the national average for all firms. Nógrád was the only county where the JVs produced negative results as an aggregated average even in 1996, and the value of losses was almost four times larger (before taxation, and twice as much after it) than the total losses produced by all firms in this county.

The JVs'contribution to the county profit-tax-income was negligible in 1992 in several counties.[3] However, in Budapest, out of the modest profit-tax-income 89 percent came from the JVs' profit-tax-payments. By 1996, the JVs'contribution had become determinant everywhere in the country despite the fact that several among them were still enjoying generous tax-holidays. Out of total tax-payments, 57 percent was paid by Budapest firms, and in the case of JVs this proportion increased from around 33 percent to 71 percent in four years.

The average tax-payment for all firms—similar to the rates per firm—was 1.1 million HUF, and it reached 1.5 million HUF in the case of the JVs. In Budapest, the same rates were 2.6 and 3.3 million HUF, respectively.

By 1996, the JVs'contribution to the county tax-income had become significant in each of the counties. For instance, in Borsod, the JVs paid 61 percent of all tax-income collected in the county, much higher than the nation average of 45 percent, or that of 56 percent in Budapest; in Veszprém 48 percent, in Vas county 42 percent, in Heves 37 percent, and in Győr-Sopron more than 30 percent of total taxes in these respective counties were paid by JVs. A modest tax-contribution from JVs was recorded in Békés, Bács-Kiskun, Fejér, Szabolcs, Jász-Nagykun and Tolna counties, respectively.

FDI-inflows and structural changes by sectors

The outstanding role of Budapest in FDI-attractiveness also determined the national trend of the FDI-inflows and its sectoral structure. Budapest was and is characterised by a much lower level of "material" activities (such as agriculture, fishing, mining, manufacturing, construction, and even public utilities) than in the whole economy. However, in the capital city a much greater proportion of firms specialise in services (with the exception of hotels, restaurants, postal services and transportation) than the national average. These differences, both in the number of all firms and that of JVs, can be clearly measured; the activities of firms operating with foreign capital showed almost the same structure as all Budapest firms.

[3] In this, the fact that the registration offices for firms in the counties were formed first only in 1992 certainly had an important role, too. Therefore, at that time the majority of JVs were obviously formed and paid taxes in Budapest.

Table 2

The role of FDI in tax-payments between 1992–1996 (distribution and shares, percentage)

Paid taxes, percentage	Distribution 1992 all companies	Distribution 1992 JV	Distribution 1996 all companies	Distribution 1996 JV	Shares JV/All 1992	Shares JV/All 1996
Total	100	100	100	100	4.4	44.7
Budapest	1.5	30.5	56.7	70.9	88.6	56.0
Baranya	6.9	3.9	1.8	0.9	2.5	21.0
Bcs-Kiskun	8.2	53.9	2.3	0.8	28.9	15.8
Bks	1.9	0.8	1.7	0.5	1.9	13.3
Borsod-Abaj	3.9	0.7	5.3	7.2	0.8	60.8
Csongrd	5.5	0.0	2.3	1.1	0.0	21.3
Fejr	5.7	0.0	2.6	1.0	0.0	17.4
Gyr-Moson-Sopron	11.0	4.8	3.6	2.6	1.9	31.9
Hajd-Bihar	0.4	0.0	2.7	1.2	0.0	20.4
Heves	1.1	0.0	1.2	1.0	0.0	37.1
Komrom	3.1	5.2	1.9	1.1	7.2	27.5
Ngrd	0.2	0.0	0.5	0.3	0.0	28.1
Pest	3.9	0.0	5.3	3.4	0.0	28.8
Somogy	4.2	0.0	1.2	0.6	0.0	20.7
Szabolcs-Szatmr	2.2	0.0	1.6	0.7	0.0	18.5
Jsz-Nagykun	0.1	0.0	1.7	0.7	0.0	18.2
Tolna	35.8	0.0	1.6	0.7	0.0	19.4
Vas	0.4	0.0	1.8	1.7	0.0	42.1
Veszprm	1.6	0.0	2.6	2.8	0.0	48.3
Zala	2.3	0.0	1.7	0.9	0.0	24.0

Sources are the same as those cited in the previous table.

The greatest number of JVs were formed in Budapest (about the same as the national average) in trade (53 percent according to the number of JVs) and in real estate, renting and business activities (18.3 percent). A much lower proportion of JVs (only 12 percent of all Budapest firms) could be found in manufacturing industry (relative to the share of all firms in Budapest), almost as low as in the construction industry (4.4 percent, in contrast to the total share of 8 percent for all other Budapest firms.) However, according to the value of invested FDI by sectors, the highest share was in the manufacturing sector: 31 percent. (However, this share was modest relative to the national average of 40 percent, the share of the value of invested foreign capital in manufacturing by 1996.) Similarly to the national average, one out of every five of Budapest firms in manufacturing had already attracted FDI. FDI comprised 53 percent of the total assets of JVs (the national average was 51 percent); with this proportion they could control 75 percent of the

assets of firms in Budapest (the national average share of the JVs' assets relative to all other firms was 68 percent). A relatively smaller number of JVs was formed in the construction industry in Budapest (14 percent), but the capital-strength of these firms was much higher than their indigenous counterparts. (The ratio of the FDI to all assets was 62 percent in the Budapest construction industry and, in this way, the JVs controlled 66 percent of the total assets of the Budapest construction industry.) FDI invested in the financial services in Budapest had the same features: the foreigners invested into relatively few firms, but with a significant value of FDI, and in this way foreign investors could gain control of almost 70 percent of this sector.

Therefore, the FDI-inflow in Budapest raised the sources available for firms to a higher level than for the whole economy (with the exception of some activities, such as mining, electricity, transportation, logistic activities, education, and the public and private services). The share of FDI in the total assets of these latter-mentioned sectors was lower in Budapest than outside the capital city, but the control foreigners could exercise over other sectors was much higher in Budapest than the national average: 75 percent in manufacturing, 75 percent in health care, 69 percent in financial intermediation, 66 percent in the construction industry, and also 60 percent in hotel and restaurants, according to the assets of those sectors. They controlled more than half of the total assets in trade, too.

However, the FDI invested in Budapest had a much higher role in the whole economy and in each of the sectors, if the number of Budapest firms and their capital-strength are compared to the national characteristics of each sector. Due to this it turned out, that the distribution of the FDI-stock in Budapest followed almost totally the feature of the structure of the activities of all Budapest firms. The share of Budapest in each respective service sector (by number of all firms, by all assets and mostly by the FDI in the sector) was significantly higher (and modestly higher in construction) than Budapest's general share in the whole economy. Parallel with this, the capital city had a relatively lower role in agriculture, fishing, mining, and manufacturing, in electricity and generally in the public services. The capital-strength of the Budapest firms (i.e. the general size of the assets per firm, with the exception of agriculture, fishing and mining) significantly surpassed, in each sector, that of those firms which operated outside Budapest (in the case of the public services the assets were four times greater, but even the lowest difference, in the manufacturing, was +19 percent).

The FDI in certain sectors (such as financial services, health care, but in all service sectors except education and public services) flowed almost exclusively, or at least predominantly into the firms registered in Budapest. This also characterised the construction industry (89 percent of the total FDI invested into the construction industry increased the assets of Budapest firms.) In contrast to this, out of the total FDI-inflows in manufacturing, only 45 percent was invested in Budapest (however, the average size of the FDI-value per firm was much higher in Budapest than the

national one). In the case of power stations, mining, fishing and agricultural firms, even the average value of the FDI per firm was less in Budapest than outside it. This indicates that the foreign capital owners, by investing in a Budapest firm, could gain almost total control over the whole country in the case of several activities.

FDI-inflows and "industrial density"

The majority of the FDI invested in Hungary by the end of 1996 (in the first years half of it and since the respective bank- and the energy sector-privatisations its lowest proportion, altogether 40 percent), had gone to the manufacturing sector. The delocation of certain industrial segments (especially the labour-intensive activities with continuous or three-shift requirements) outside Budapest had happened long before FDI-inflow was liberalised. However, this process gained speed clearly due to FDI-inflows. This was already apparent from the high and increasing presence of Budapest in services, and its lower and decreasing share in industrial activities and in exports of goods. Despite this (as mentioned above) manufacturing is still focused on Budapest (similar to other economic activities but at a lower level). Therefore, it is not surprising that Budapest had an outstanding role in attracting foreign investment, even into the manufacturing industry: 45 percent of total FDI in manufacturing was invested in Budapest.

Outside the capital, even the most attractive areas for the foreign investors (such as Fejér, Komárom-Esztergom, and Vas counties) could get hardly 6 percent FDI out of the total invested in manufacturing industry. The rank order of the counties according to their shares in FDI-inflow showed a high similarity with their general shares in the manufacturing industry. Some deviations from this general link were due to the higher average size of the FDI per firm; in some counties this was due to the smaller amount of FDI per firm, but invested into a greater number of JVs. In the three counties mentioned above (and in Borsod) the average amount of FDI per firm was one and half times or twice as large as the national average. In Vas county a relatively greater proportion of JVs were established than in other parts of the country (40 percent of all manufacturing firms in the county already had FDI by 1996). The manufacturing JVs in Győr-Sopron county were formed with relatively less FDI, but in a relatively large number (according to the number of firms, the JVs accounted for 37 percent of the total in 1996). The firms with foreign capital also represent a higher proportion than the national average in Zala, Komárom, Baranya, Veszprém and Somogy counties.

The FDI-inflows everywhere increased the capital of the firms: the FDI as a proportion of total assets for all firms in Vas and Komárom had already reached more than 75 percent of the total assets in manufacturing in 1996, and 58 percent in Fejér county. Even in Tolna county, where the amount of the FDI in manufacturing

did not reach one percent of the total FDI invested in the Hungarian manufacturing industry, out of the total assets of the manufacturing industry in the county more than one quarter was of foreign origin in 1996, and the foreign owners thus controlled more than half of the total manufacturing assets. The JVs dominated at least one-half of the total manufacturing assets of the counties almost everywhere (except in Veszprém, Csongrád, and Tolna counties).

The development potential by regions is obviously determined to a great extent by the structure and characteristics of the industrial activities. (The firms have specialised rather on simple, low wage-, labour-intensive activities or innovative, high-tech-, knowledge-, and/or capital-intensive activities; these structural changes are determined on the bases of the existing labour-force in the county, etc.) These kinds of linkage would need further research.

Summary

The disposable data-sets (i.e. the tax reports of the double accounting firms in 1992–1996 and the regional statistics of the Central Statistical Office) did not make possible systematic (model-type) analyses of the main factors of the distribution and sectoral features by counties. However, simple statistical analyses of the existing data resulted in important information about the real effects of FDI-inflows by counties and also the main explanatory factors behind them. It turned out that there is a clear positive correlation between the intensity of the FDI-inflows, company performance, export-ability, value-added, wage- and salary levels, and social security-contributions (i.e. health care and tax-payments)—similar to the whole economy—at the county level, too. The FDI-inflows significantly reduced employment problems, and the unemployment level; however, the dimension of this effect certainly depended also on the industrial structure, its labour-intensity and productivity changes by the counties.

Our research results did not prove that the country had been divided into two parts. The disadvantageous positions of some counties (mainly near to the south, east and north borders, respectively) with regard to FDI-attractiveness are doubtless. In this, the "industrial density" (which we could not measure exactly) and the actual level and quality of the existing labour-force had determining roles. The analyses underlined an "overconcentrated character" of Budapest with regard to nearly all factors, even if there has been some change from the capital to outside Budapest in recent years. As a result of the effects of the Free Trade Zones and the intention to help regional development (e.g. the SME project launched by PHARE, special industrial zone program, etc.) the focuses of export-growth and trade seem to have moved away from Budapest. Budapest was not the leader in the growth rate of the FDI-stock in the period under analysis. The outstanding share

of the capital in services explained the fact that the FDI-inflows directed towards some sectors (such as financial services, other public and social services, postal and telecommunications, business services, restaurants, etc.) mainly or almost exclusively went into firms registered in Budapest. Therefore, the foreign capital owners, by investing into firms in Budapest, have been able to gain control over whole sectors in Hungary. In contrast to this, in manufacturing Budapest absorbed only 45 percent of the total FDI invested in this sector (however, the average amount of the FDI per firm in Budapest was generally much higher than in the countryside.) It is worth repeating that the overcentralised character of Budapest is exaggerated by the distortive effects of the existing data-sets (i.e. the way that the firms presented tax-reports according to the location of their headquarters). (The lack of other type of data-sets, however, does not yet allow for the correction of this distortion.)

The results of the study underlined the expectations: namely, that the "industrial density" and, parallel with this, the professional structure of the existing labour-force had important respective roles in altering the sectoral direction and volume of FDI-inflows. (For instance, in the region of Székesfehérvár the accumulated knowledge based on the earlier development of weapons and engineering industries.) The links between the FDI-inflows and the unemployment level proved that intensive FDI significantly reduced the employment problems in several counties. In 1996, out of total employment, in Vas county and Budapest almost 40 percent already worked for firms operating with foreign capital, every third worker belonged to a JV in Győr, Heves, Zala and Komárom counties, and every fourth in Baranya, Borsod, Csongrád counties. The improving effects of FDI on employment were clearly most modest in Tolna, Békés, Szabolcs-Szatmár-Bereg, Jász-Nagykun-Szolnok and Somogy counties.

The generally better company performance and the higher productivity increase of the JVs let them pay more to their employees than the indigenous companies. In 1996 the firms with foreign capital were already "giving" 41 percent of all wages and salaries—that is, in relation to the national average. The JVs paid the 1/3 of all salary- (and salary-type) incomes in half of the counties, and at least 1/5 in the other counties (except Tolna). The distribution of wages and salaries by counties depended not only on the role of the JVs, but also on the different professional structures according to the particular county. The higher share (51 percent) of Budapest in the salary and social security-payments can partly be explained by the fact that financial services and other better paid activities are focused mainly on the capital (as well as the registration of firms due to the location of their headquarters). It is worth noting that salary-increases were not the most dynamic in Budapest between 1992–1996. Almost half of the counties (especially Fejér, Vas, Veszprém, Heves, Győr-Sopron, and Borsod counties) produced much higher increases in salary levels, while the "negative record" happened again in Szabolcs, Hajdú, Komárom and Somogy counties. It is also an important fact, considering social security contributions, that the JVs increased their payments at

a much higher rate than the county average almost everywhere (with the exception of Zala). (Social security payments generally grew faster than salary-payments and the largest gap could be measured in Heves, Fejér, Baranya, Pest, Somogy and Vas counties.) Company performance improved significantly in each company group during 1992–1996. The respective averages of both the JVs and the indigenous firms produced positive results (before taxation) in all (except one) counties in 1996. The advantages of the JVs over the indigenous firms could be clearly recognised in this field, too: according to the economic indicators per firm all other companies produced (before taxation) 3.5 million HUF positive results on average in 1996, while the JVs' average positive result reached the value of 14.5 million HUF. Out of the total profit, 46 percent, and in the case of the JVs 64 percent, was produced respectively by firms registered in Budapest. However, in general the Budapest firms had relatively higher tax-burdens than firms in other counties (such as, for instance, in Vas, Pest, Fejér, Győr-Sopron, or Jász-Nagykun-Szolnok counties.) Despite the higher tax-burden, the Budapest firms paid a higher proportion of tax-payments (57 percent) in 1996, and in the case of JVs (despite their still high level of tax-holidays) this proportion increased from 32 percent to 71 percent between 1992–1996.

The JV's tax- and social security contributions had reached a determinant size by 1996, even considering the whole state budget income. But in some counties, such as Borsod for instance, the JVs increased the county tax-income at a much higher rate (their tax-payment reached 61 percent), than the national average (where the JV's proportion was 45 percent) or than the rate in Budapest (56 percent). However, in Veszprém and Vas counties respecively more than 40 percent, and in Heves and Győr-Sopron counties respectively more than 30 percent of the county's tax income originated from the JVs. The JVs'contribution to the tax-income in Békés, Bács-Kiskun, Fejér, Szabolcs, Jász-Nagykun and Tolna counties was the most modest.

One of the most important outcomes of our analyses was that the FDI-inflows outside Budapest—even if they seemed to be negligible in comparison with the value invested in the capital—significantly contributed to the development at the county level; they reduced the unemployment level almost everywhere, and improved considerably the export-orientation and efficiency of company performance. At the same time foreign owners gained dominant or determinant roles in almost all activities. This must call the attention of policy-makers at local and governmental level to the fact that the intention to attract more foreign capital must be harmonised with the intention of helping local entrepreneurs to accumulate and to develop, even to the point of using positive discrimination.

Some conclusions

The experiences of other countries in closing the gap between regional development also underline certain basic linkages (well-known, but in the Hungarian economic policy frequently neglected). For example, a country's development (and in it, that of its regions) is basically determined in the long-term by the level of education, labour-force mobility, professions and locations. Therefore, for instance, in France at the end of the sixties, or in Belgium at the same time, the answer to the crises of the declining areas (i.e. those specialised in mining, shipbuilding, or low-wage labour-intensive industries), caused by the increasing delocation of these activities to the low wage countries, was that universities (university cities with the necessary infrastructure) and research centres were built-up as bases for knowledge-intensive activities. (For example, Louven La Neuve, as a university city next to Bruxelles, or the university city with a hyper-modern metro line in the surroundings of Lille in North-France.[4]) Similar developments happened in England (for instance, in the "cradle" of the textile industry, Bradford, the newly-established computer industry absorbed some of the unemployed textile workers, and the old textile machines were exhibited in a museum of industrial history formed for fostering tourism[5]). At another level, in Spain and in Portugal, accession to the EU revealed the adjustment barriers raised by structural and territorial inflexibility and the insufficient educational level of the labour-force. The answer, here, was also education, and re-education (with the support of the EU, the government, and the regional funds), and the development of universities, and industrial and research centres—in the developed areas as well as the underdeveloped ones. (Hamar 1995a; 1995b; 1998b) The main lesson of these examples is that the most efficient tools for closing the gap in development between areas and regions is the development of the existing education and research, and establishing new bases for knowledge in the underdeveloped areas. Without this even the existing possibilities cannot be fully utilised.

The future FDI-attractiveness of Hungary will further depend on the FDI-absorbing ability of Budapest, and the attractiveness of the capital will also depend on the investment worthiness of the national economy. In certain activities—such as logistics, even in research—the multinationals focusing on the whole Central-European area have already chosen Budapest as a central location. In the case of advantageous development, the idea that Budapest could become a regional centre for FDI is not without good grounds. However, this would need further development in several respects (such as improvement in public security, and in infrastructure and solving the parking problems, and also reducing air-pollution and promoting tidiness of the city. The administration (in ministries, chambers of commerce, and

[4] According to the author's personal experiences and interviews in 1993.

[5] Interviews in London, Cambridge, Leeds, and Bradford, in 1985.

other authorities) has to become more efficient, less corrupt, more transparent, and produce information and services. Further improvement in financial and banking services, and especially in the legal sphere would also be needed, and they would need to be controlled more efficiently.

The study has been able to provide more information about the effects of FDI on regional development. The special industrial and free trade zones have already influenced and helped to narrow the gap between Budapest and the counties, especially in export-ability and industrial development. Further improvement in this field, however, also requires several conditions (e.g. building new airports and highways in the country areas with a parallel and horizontal line of roads and transportation in a territorial network; also, developments in education are vital, as well as raising the general cultural level, especially in the underdeveloped areas and in Budapest, by improving the ability to answer the new challenges of the future).

One of the most important results of our analyses—that the FDI-inflows even in the counties where the invested amount of foreign capital seemed to be almost negligible—has now become so determinant that the simple presence of these firms hinders the development of indigenous companies and hardly allows newcomers to enter the markets. Therefore, to attract further FDI into the underdeveloped areas needs special care. It is obvious that local FDI-attractiveness would and should be increased by giving tax- and other preferences in order to improve the prospects of further development, to help in the establishment of new kinds of activities and to promote the diffusion of marketing and management knowledge. Nevertheless, to reduce the already recognisable signals of the *dual type* economy, and mainly to avoid its growing social and political tensions and the concomitant and specifically distorting effects at local level—in small villages, for instance—it is necessary to put extra importance on the responsibility of the local decision-makers. (It is well-known for instance, that the multinational companies are easily willing to close down their production units if they are no longer efficient. Consequently, the problems raised by this behaviour in a region, where this unit is the main employer (and gives the main source of tax-income and social security contributions) demonstrate the harm of dependence on one or a few foreign investors. It means that education and information also have a special importance in the improvement of the abilities of local decision-makers.

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REVIEWS

PORTUGAL'S EUROPEAN INTEGRATION AND ITS EFFECTS ON HER FOREIGN TRADE

A. NAGY

Introduction

The many-sided economic integration, accommodation to community regulations, the breakdown of internal customs borders, and transformation of the level and structure of import duties for outsiders, naturally have a great effect on the volume and dynamics of exports and imports, and on their commodity structure and market shares. Research carried out on the static and dynamic influence of economic integration, and first of all the analysis of processes in the European Union, have many references and settled methodology. Their conclusions helped a lot in our research, and also the fact that the formation of the European Union has been gradual, and differently developed economies joined the West-European integration at different periods.

In our research project we investigated the integration experiences of three South-European countries: Spain, Portugal and Greece. We chose them because their levels of economic development were similar to Hungary's when they joined the EEC, and because sufficient time has passed since then to enable the measurement and analysis of the influences of integration. As its results have been unlike in many respects, we expected to draw different conclusions and lessons about the effectiveness of divergent integration processes.

The present study looks closely at Portugal's accession to the European Community, how it happened, its motivations, and especially the influence it has had on foreign trade. It was very a great help that I could visit Portugal to collect literature and data, and also to have consultations with Portuguese experts.[1]

[1] I am thankful to Paula *Fontoura* and Joao *Dias*, professors of the Department of Economics at the Lisbon Technical University; to Teresa *Moura*, General Secretary of European Affairs; and Katalin *Muharay*, correspondent in Portugal, for their assistance. In data collection and processing Dr. Vitor *Ramos*, Zoltán Ákos *Kovács* and Gergely *Fazekas* helped me very much.

The present situation: the results of participating in European integration

Twelve years have passed since Portugal's accession to the European Economic Community. Before following the precedents of this process and its influence on foreign trade, it is worth surveying—at least, looking at the general outlines of—the results of integration, and what the present situation is. Naturally, it is very difficult, if not impossible, to separate the changes caused by accession from those reached by Portuguese economic and reform policy independently of European integration.

The most important result is that Portugal's income per capita at purchasing power parity in 1986, was slightly over one half of the EEC's average, and in 1997 it reached nearly 70 percent of the fifteen member countries' average. (Fontoura 1998; *OECD* 1998) Economic analysts evaluate the development of Portugal and the present situation very positively (OECD 1998). The Portuguese economy has been characterised by an unusually balanced growth for the last four years, and this has caused significant improvement in all basic economic indices. The stability of the exchange rate and the fall of the budget deficit have raised the confidence in economic policy. Portugal is apparently going to fulfil the Maastricht criteria, and is likely to be a founding member of the European Monetary Union. According to the OECD's forecast, in the next two years in Portugal there will be dynamic economic growth and a fall in unemployment without higher inflation.

The GDP increased by 3.5 percent in 1997, and it has a growing tendency. The main driving force for this comes mainly from investments. Industry's utilisation of productive capacity grew to 80 percent from 73 percent in 1993. Economic activity was stimulated by both domestic demand and by the increase of export capacities. Falling inflation rates, growing employment, and an increase in foreign transfers are the causes in the growth of personal consumption. Further prospects for an increase in demand should also stimulate investments.

In the years following the accession inflation rates in Portugal significantly exceeded the rates of EC countries: between 1987 and 1992 it fluctuated between 10 and 15 percent. Since then, over the past seven years, it has shown a smooth pattern of reduction. Last year it was only a little over two percent—that is, it approached the average of the EU countries and the terms of the common currency criteria. The price rise of tradable products has been scarcely one percent despite the escudo's devaluation (which was the result of the dollar's strengthening); the price rises of real estate, construction and services have remained relatively high (4 percent) despite their falling tendency. The increase in unit labour costs has been kept on a low level according to exchange-rate stability, the restraining of wage rises, and a significant growth in productivity. The "Strategic Social Pact", concluded at the end of 1996, fixed nominal wage rises at 3.5 percent, inflation at 2.5 percent, and the rise in productivity at 2.2 percent. It seems that this goal has been achieved. The return on capital has increased smoothly, partly because of

the relative reduction of unit labour costs, and partly because of better utilisation of productive capacities. One should not forget, of course, that despite the rapid rise in income per capita, the wage levels of Portuguese workers are considerably below those of their main European partners. This is partly the reason for the competitiveness of Portuguese products, and it also makes possible a relatively high return on capital despite the productivity differences. All this attracts foreign direct investments and encourages the privatisation of state-owned companies.

Parallel with fast economic improvement, Portugal's participation in the international division of labour has grown and its quality has got better. Its export volume and market share have also risen considerably. According to the OECD report Portugal's export performance since 1990 has increased approximately 20 percent—i.e. the rise in its export volume has surpassed the increase of the demand growth of the importing markets. Import penetration has also risen on the Portuguese market: since 1990 its import volume has been increasing approximately 30 percent more than the gross domestic demand.

Exports have been rising faster than imports for the last five years and the terms of trade have been favourable for Portugal during this period. The rising share of the means of production in imports can be regarded as very favourable, as this contributes to productivity rises and further improvements in quality (More details in *Pereira* 1996). The trade deficit has consistently made up 9–10 percent of the GDP since the beginning of the 1990s, but it is balanced by the surplus coming from tourism and transfers.[2] As a consequence, the deficit of the current account is around 2–3 percent of the GDP.

Both foreign investments in Portugal and Portuguese investments abroad have shown a rapid increase. In the first case the assumed level of capital income has motivated the rise of portfolio investments, while the capital exports have been the consequence of a gradual liberalisation of the financial markets. Privatisation has been an important factor in capital inflow: since 1990 around forty state-owned companies have been privatised, and the income from these made up 14 percent of the GDP. The state-owned energy sector was—eventually—also privatised. Parallel with privatisation in certain areas—for example, telecommunications and the energy industry—control commissions have been created to defend consumer's interests and develop state regulations.

Four basic goals were set of privatisation: to improve competitiveness, to widen and deepen the capital market, to reduce state debt, and to maximise revenues from selling state assets. While in 1988 the companies which were majority-owned by the state produced 20 percent of the GDP; after fulfilling privatisation plans, by the end of 1999 this share is expected to fall to 5 percent. Among the significant successful privatisation cases some earlier protected branches can be found.

[2]The foreign transfers are divided 50–50 percent between the European Union and that of the Portuguese workers' transfers from abroad.

In the respective cases of the latter the dismantling of state monopolies has led not just to productivity growth and technical improvement but to the creation of many new jobs through increased competitiveness.

Catching up and European integration

At the beginning of the 1980s the openness of the Portuguese economy was similar to that of the Western European countries; this was partly a follow-up of EFTA membership and partly the long tradition of trading with colonies. When Portugal joined the European Community its average tariff level was 5 percent, and this suited the Community's average[3] (although quotas and a licensing system restricted imports). Portugal's backward agriculture differed greatly from the developed European countries. In 1980 agricultural production was 10.3 percent of GDP, and 27.3 percent of the labour force worked in agriculture; these shares were on average 4.8 percent and 14.3 percent in the OECD countries.[4] Portugal's agricultural productivity was scarcely one-fourth of the EEC's average as a consequence of strongly subsidised prices, the low qualifications of agricultural employees, backward production technologies, an underdeveloped infrastructure and poor marketing practice.

Another source of the difficulties of economic development was the enormous size of the state sector where price controls and state interference restricted considerably the functioning of market forces. The share of the state sector was 17 percent in gross value added and in investments, while budget subsidies reached 4.3 percent of the Portuguese GDP in 1985 (*CEEP* 1987). Most of state-owned companies worked with low productivity levels and, cushioned by subsidies, they produced deficits. The subsidies were a burden to savings and made the resource allocation irrational and rigid.

Financial markets were underdeveloped, there was no competition among the banks, the capital market was tight, opportunities to save were few and consisted mainly of state securities, the credit market and interest rates were controlled by the state, and subsidised credits were widespread. The different regulations distorted the allocation of resources and increased transaction costs. The social infrastructures (i.e. education and health care) and economic infrastructures (i.e. transport and communication) caused many problems as they were much more backward in Portugal than in other West-European countries. This made catching up all the more difficult. In 1987, for example, 81 percent of the 25–34 age group and 89 percent of the 45–54 age group had completed only primary school (some

[3] There was an important difference between Portugal and Spain in this respect. In Spain the average tariff level was 17 percent before accession to EEC.

[4] See: *Larre and Torres* (1991), using OECD and IMF National Accounts statistics.

have not even achieved this) (*OECD* 1989), and only five percent of young people had attended a technical or other qualification-oriented school. According to the data of Eurosat, infant mortality was 64 percent higher than in the EEC countries, and at the same time Portugal had one-third of telephones and two-fifths of cars per thousand capita, compared to the EEC countries.

When joining the European Community significant reforms were introduced and, despite the delay, Portugal managed to apply community rules. Import licensing, extra-tariff taxes, and many quantity restrictions were repealed; other quotas were scheduled for repeal over the following three years. The value-added-tax system introduced in place of the previously very differentiated tax system automatically reduced the hidden export subsidies and import restrictions, while many allowances for exporting companies were preserved.

The reduction of trade barriers increased the demand for the products of the countries joining the EEC, which changed the volume and structure of their trade flows. In Portugal's case the trade-creation effects surpassed trade-diversion effects significantly and, as a result, the export share in the GDP started to rise after some time lag. This increased the average productivity of the economy because there were increases in the productivity and exports of those branches which were competitive internationally (or would become competitive following new investments) and which benefited from the dismantling of trade restrictions and subsidies. The growth and changes in the production structure of the industry corresponded to the country's revealed comparative advantages. This underpins the theory according to which catching up with the level of the developed countries is basically an endogenous process (*Abramovitz* 1986). In other words, although it depends greatly on external conditions, it is basically the consequence of the improvement of the formerly underdeveloped country's internal economic and institutional structure, allocation of resources, and the development of the resources themselves.

As a result of structural reforms the structure of Portugal's export supply and market shares changed, and this was the result of the extension of those products for which demand rose rapidly, the concentration of exports on those markets on which the products were or could become competitive, and appropriate improvements in the quality, competitiveness and marketing of the products. Following these changes a significant improvement in the Portuguese terms of trade could be observed. Comparing it with other countries, it can be stated that the influence of accession to the EEC due to structural changes had more positive effects the higher was the pre-joining tariff level, and the more quantitative restrictions there were.

The only exception from these positive influences mentioned by the experts is agriculture, where structural changes were less successful than in industry. One of the reasons for this could be that the agricultural tariffs of the Community were higher than those in Portugal before accession to the EEC.

Another obstacle to further modernisation was the unsatisfactory flexibility of the Portuguese workforce. The deregulation of the labour market attracted

foreign investments, but the lack of qualifications and insufficient retraining schemes created a further serious obstacle to the catching up process. Both the development of the infrastructure and improvement in labour adaptability required increases in public expenditure; thus the state's tasks did not decrease but became greater in these areas. Solving these problems without raising the budget deficit was a very difficult problem for the government. The only possible answer seemed to be the stricter control of state expenditures in other spheres, and improvement of the efficiency of public services.

Winning the trust of foreign investors played a very important role in accelerating economic development. It influenced strongly both direct investments and the success of the privatisation process. Confidence in the economic development of a country depends mostly on how successful the balancing of the macroeconomy is, how far state debt, budget deficit and inflation are reduced, and how much the government seems to be determined to accomplish the structural and market-conforming institutional reforms, including the necessary but unpopular steps.

Precedents of accession to the EEC

In the opinion of *Macedo* (1990) the necessity of European integration became evident only four years after Portugal joined the European Community. Up until that time this question had been dealt with ambiguously by governments, in fact somewhat similarly to the British attitude. Although the idea of integration started to mature in Portugal before 1975, the revolution had taken an opposite turn: the regime opposed Western-type development and tried to introduce East-European type nationalisation and central planning. The idea of the "Portuguese fortress" remained after the revolution too, but the image of the besieged colonial empire was changed for the socialist fortress. (*Krugman and Macedo*)

Although this experiment did not last for a long time, it did result in an increase in the state sector's share in the Portuguese economy very much, and this situation remained frozen up to 1989. After the revolution of 1974 banks and insurance companies, public utilities and transport companies, petrochemical, artificial fertiliser and paper factories, cement and steel-works, ship-building and tobacco industries were nationalised (*Balassa* 1981). The 100 percent state-owned companies made up 10 percent of industrial production, while the partly state-owned companies made up another 5 percent. However, in reality the state controlled or managed a much higher proportion of production through the nationalised banks and an elaborate system of industrial regulations.[5]

[5] Some of the companies occupied by different worker's self-managing organisations could be listed here too.

The other important outcome of the revolution, considering its economic and social significance, was the agrarian reform and the spontaneous land-seizures. This virtually abolished the system of large estates typical for the Southern part of the country. Although the fundamental change in property relations created the long-term conditions in Portuguese agriculture for enabling the establishment of modern farms and for significant productivity rises, (thus improving the living standards of the peasants population), in the short-term it caused serious difficulties in agriculture. Since the new small and medium-size farms did not get enough support, the level of their production and productivity decreased, and the trade balance of agricultural products became strongly negative despite Portugal's favourable geographical conditions.

Portugal's ambiguous and long integration policy was related to the dual structure of her economy. The complex administrative regulations of her economy preserved a dual structure, in which a competitive sector existed alongside a non-competitive, non-adaptable state sector. The latter had the effect of substantially decreasing the productivity of the whole economy. Gradual trade liberalisation—which started in the 1960s—revealed the existence of an unrecognised competitive and export-capable industrial sector in the Portuguese economy; alongside this sector, industrial and financial regulations created conglomerates which could be successful only in the privileged trade with African colonies. After the liberation of those colonies the failures of the conglomerates came to light and this was one of the reasons why they were nationalised.

From this point of view the revolutionary "achievements" have been subject to a new interpretation: it was not the most profitable enterprises that were taken over by the "people" during the nationalisation process, but the bankrupt, or almost bankrupt, big non-competitive firms. Thus the extreme "left-wing" demands coincided with the interests of some of the big monopolies. This explains why resistance to the nationalisation was not stronger. An article of the Portuguese constitution passed in 1976 froze the large and extensive state sector, according to which nationalisations were seen as "irreversible conquests of the working class". Consequently state interference and bureaucratic regulations were extremely widespread and the private sector had great difficulties in dealing with such obstructions.

The accession

The rigidity of the large public sector[6] underlay the ambiguity that characterised Portugal's intention to join the process of European integration. Politically, it meant balancing the consequences of joining the European Community and the

[6] According to the data of the Hungarian Institute for World Economics the share of the public sector in GDP rose from 22 percent in 1970 to 40 percent in 1982. (*VKI* 1994/b p. 63)

socialist principles laid down in the constitution. In the opinion of some analysts (e.g. Macedo 1990), during the seven years of negotiations on the accession this contradiction hindered the progress, and it often appeared as the conflict between Prime Minister Soares and President Eanes. The prime minister represented those interests which supported accession to the European Community, while the military commanders of the African wars insisted on maintaining the "achievements" and institutions of the revolution during the sessions of the Revolutionary Committee, presided over by the president of the Republic. However, other experts held the view that linking up with the capitalist West was opposed by only some of the military commanders. Until the Revolutionary Committee was wound up with a constitutional amendment in 1982, the president's loyalty was divided between the citizens, who voted for him, and the army, represented by the Revolutionary Committee. This conflict, and the indecision associated with the social and political problems hidden behind it, probably had something to do with the sixteen governments which Portugal had in the decade following the revolution.

The ambition to join the process of European integration was an important and necessary step for the presidency of Soares, and this is partly the reason why the government forced the pace of the negotiations. Business circles criticised the government, arguing that domestic industry would not have enough time to get prepared for the competition with more developed member EEC member states. When Soares became president of Portugal in 1985, the mainly presidential system was changed for a parliamentary system; furthermore, the socialist government was replaced by a rightist government. It remained in power for another two election cycles. Accession to the European Community in 1986 coincided with the change and stabilisation of the political system, and obviously contributed to it. (*Kovács* 1994)

For Portugal, joining the European Community meant a policy of opening and a commitment to the European integration, in contrast to its earlier economic and trade policy. It also meant striving for the stabilisation of parliamentary democracy and observation of human rights in domestic policy. Parallel with this, it offered several economic advantages: the extension of export markets and the prospect of considerable financial transfers from community funds. Despite the benefits to be expected, there was doubt about the extent to which EEC member states would increase imports compared to the advantages which had been secured in earlier free trade agreements; moreover, how would EEC membership compensate for a further strengthening of import competition? At the same time, they had to take into account the considerable disadvantages of staying outside the European integration, especially, as it became evident that orientation towards the CMEA and the "Third World" was neither desirable nor possible.

Politicians in the European Community emphasised that the respective accessions of the South-European countries had served primarily political aims, and thus the indication was that only moderate economic advantages could be expected. This

was especially true in the case of Portugal, where the Community, being well aware of the country's ambiguous integration policy, wanted to strengthen and stabilise the democratisation process with full membership, after fifty years of right-wing dictatorship. An important part of this plan was that it was expected that accession to the EEC would drive the Communist Party out of power; the presence of the latter in the government was regarded as ominous for European security from NATO's point of view.[7]

The member countries of the European Community did not expect, especially not in the short-term, considerable advantages from the growing markets of the new South-European countries, given that the latter were much less developed than themselves. However, they had to calculate for a considerable increase in the common expenditures. Yet in Portugal's case there were long-standing privileged trade relations with its earlier African and Brazilian colonies—this situation held out the prospect of advantages for the Community countries as well. In the event, reality considerably surpassed these expectations, especially in the medium-term. The transfer of production to Portugal through foreign investments proved to be advantageous in many cases.

Public opinion polls showed that the majority of the population was not particularly interested in joining the EEC, and many Portuguese citizens did not even know what it really meant. (*Éltető* 1997) It was neither put on the agenda in the Portuguese National Assembly, nor was it much discussed by the media. This was not just the result of the country's long-standing relative isolation, but also the chaos of domestic crises and other problems that eclipsed the importance and likely effects of accession.

Changes in the dynamics and structure of foreign trade in Portugal between 1988 and 1995

In the following Portugal's trade structure is analysed: that is, its commodity composition and market share are considered from the viewpoint of the medium-range influence which accession to the EEC has had. On the one hand, how did integration and removal of trade impediments influence the dynamics of its trade flows, and how did it strengthen and change trade relations with the member states? Furthermore, to what extent did it substitute domestic production with imports? On the other hand, how far did participation in the common external tariff system change the dynamics and structure of trade with other areas to the advantage of internal trade with member countries? Our analysis was carried out using different

[7] *Kramer* (1983, p. 254) quotes a European Parliament MP: "No one knows what the outcome of the accession will be but we should want it for political reasons."

disaggregations: first, according to the two main commodity groups of primary goods and manufactures, and then using a one- and two-digit SITC breakdown of the UN statistics. Nine commodity groups belong to the first and 72 to the second disaggregation.[8]

The regional breakdown used by the OECD has been altered at many points because it contained several strange groupings—for example, it included the Soviet Union, not as part of Europe but of Asia and, in contrast to that, it mentioned Turkey as belonging to the European region. We categorised the Soviet Union (or, after 1992, the European CIS countries) and the three Baltic States as part of the European region, while the other former Soviet republics were left in the Asian area. Japan is dealt with independently, separate from the East-Asian region. Oceania has been merged with the East-Asian countries.

Table 1

The growth of Portuguese trade between 1988 and 1995 (in percentage) 1988=100

Regions	Exports			Imports		
	Primary goods	Manufactures	Total	Primary goods	Manufactures	Total
Total world	143	223	206	173	189	184
Europe	151	227	213	229	189	194
European Union 15	154	230	216	235	190	196
Eastern Europe	54	270	187	520	124	199
North America	63	167	141	100	169	126
Japan	151	336	217	100	114	114
Africa	214	163	176	148	170	150
South America	437	523	494	176	117	154
Asia-Oceania	199	252	239	152	217	187

Source: OECD Trade by Commodity Statistics, CD-ROM, 1997 March. This source is used in the other tables and figures, if no other source is mentioned.

Between 1988 and 1995 Portugal's exports and imports grew faster than world trade or the European Union's trade and this was obviously a consequence of the trade-creation effect of accession to the EEC. While world trade rose by 80 percent, and the EU's exports rose by 73 percent and its imports rose by 67 percent in this period, Portugal's total exports increased by 106 percent and its total imports by 84 percent (*Table 1*). Its turnover with the member countries of the European

[8]The source of these data is the OECD's International Trade by Commodity Statistics CD-ROM issued in March 1997; this contains the trade flows of the 1988–1995 period in current US dollars.

Community rose faster than the average: its exports to the Community rose by 116 percent and its imports by 96 percent.

It can be seen that the rapid rise in Portugal's exports was primarily due to the export of manufactures; the rise in the latter was much higher, while exports of primary goods was much lower than the average.[9] Manufacture's exports to the European Union rose faster than total exports, whereas the total of Portuguese exports to Eastern Europe, North America and Africa increased slower than the average; however, there was a remarkably large export rise to South America (394 percent).

Despite the fact that imports grew at a slower rate than before, Portugal's trade balance showed a remarkable deficit during this whole period. It was 6.8 billion dollars in 1988, and it rose to over 10 billion dollars in 1995 (*Table 8*). Imports from the European Union countries also rose faster than total imports; even so, it is remarkable that Portuguese primary goods imports rose much quicker (135 percent) than imports of manufactures (90 percent). The increase of Portuguese imports originating from Eastern Europe—as opposed to its exports there—was comparatively fast, especially in primary goods (420 percent). The rise of Japanese imports was remarkably low (14 percent), and it is surprising how much the increase of imports from South America and Asia lagged behind exports there.

Table 2

The shares of Portuguese trade in 1988 and 1995 (in percentage)

Regions	Exports				Imports			
	Primary goods		Manufactures		Primary goods		Manufactures	
	1988	1995	1988	1995	1988	1995	1988	1995
Total world	20.62	14.29	79.38	85.71	26.18	24.54	73.82	75.46
Europe	18.32	13.00	81.68	87.00	14.08	16.63	85.92	83.37
European Union 15	18.38	13.14	81.62	86.86	12.66	15.17	87.34	84.83
Eastern Europe	38.50	11.19	61.50	88.81	19.02	49.63	80.98	50.37
North America	25.32	11.33	74.68	88.67	62.13	49.10	37.87	50.90
Japan	64.41	44.85	35.59	55.15	0.35	0.31	99.65	99.69
Africa	25.00	30.50	75.00	69.50	92.23	91.22	7.77	8.78
South America	33.36	29.50	66.64	70.50	62.64	71.58	37.36	28.42
Asia-Oceania	24.09	20.04	75.91	79.96	45.46	36.82	54.54	63.18

[9] In this classification the SITC commodity groups from 0 to 4 belong to primary goods and those of 5 to 9 belong to manufactures. There are many inaccuracies in this of course—for example, food industry products belong to the first group and metallurgical products belong to the second. However, the major shares and tendencies are not altered by these distortions.

Changes of Portuguese trade shares with respect to the main commodity groups by regions between 1988 and 1995 are shown in *Table 2*. The share of manufactures was growing and that of primary goods declining on both sides of the trade turnover, but it was more marked on the export side. It can be observed that in the exports to the European Union the share of manufactures grew (from 82 percent to 87 percent) and, in contrast to this, in the Portuguese imports from the Union the share of manufactures dropped surprisingly (from 87 to 85 percent). As a consequence, the share of primary goods increased. There has been a similar but much stronger change in the commodity structure of Portuguese—East European trade. While the share of primary goods declined and that of manufactures increased in Portuguese exports, the share of primary goods in Portuguese imports rose from 19 percent to 50 percent, and in accordance with it, the share of manufactures was reduced.

Table 3

The shares of Portuguese trade by regions and commodities in 1988 and 1995 (in percentage)

Regions	Primary goods		Manufactures		Total	
	1988	1995	1988	1995	1988	1995
Exports						
Total world	100	100	100	100	100	100
Europe	74	78	86	87	83	86
European Union	70	75	80	83	78	82
Eastern Europe	2	1	1	1	1	1
North America	8	4	6	5	7	5
Japan	2	2	0	1	1	1
Africa	5	8	4	3	4	4
South America	1	3	1	1	1	2
Asia-Oceania	3	4	3	3	3	3
Imports						
Total world	100	100	100	100	100	100
Europe	41	54	88	88	75	79
European Union	34	46	83	84	70	75
Eastern Europe	1	2	1	1	1	1
North America	14	8	3	3	6	4
Japan	0	0	5	3	4	2
Africa	21	18	1	1	6	5
South America	9	9	2	1	4	3
Asia-Oceania	17	15	7	8	10	10

The share of primary goods in the Portuguese imports from North and South Africa and Asia in 1988 was remarkably high. There has been a significant re-

duction in the imports from North America and Asia, the share of manufactures has risen from 38 to 51 percent in the case of North America, and from 55 to 63 percent in the case of Asia. In the case of Africa and South America the dominance of primary goods has remained or even grown. As it can be seen in *Table 3* the majority of Portugal's foreign trade is with Europe, and within it, with the European Union countries. 86 and 82 percent respectively of its exports are directed there, and 79 and 75 percent respectively of its imports originate from there. This was its characteristic even in 1988, and stronger integration brought another 3 or 4 percent growth in these shares in the following seven years. Trade in manufactures was even more concentrated on the European markets in both directions than trade in primary goods. It is conspicuous that the European Union's share in Portugal's primary goods imports rose (from 34 to 46 percent), and in contrast to this, the respective shares of Africa, Asia and North America decreased, even if they remained high.

In the opinion of some Portuguese experts,[10] as a consequence of integration Portugal's foreign trade has been concentrated excessively on Europe, primarily on the European Union. The country has lost a remarkable proportion of its earlier export and import markets and this has engendered several disadvantages. Previously, Portugal purchased a remarkable proportion of its agricultural imports from the United States and Canada, but it became apparent that substituting these with imports from Western Europe was more expensive. The concentration of Portuguese light industry exports on the European Union countries has made vulnerable those traditionally important branches which employ many people. Such opinions are of the view that it is disadvantageous to have very limited imports from Japan and the Asian countries. It is pointed out that Portugal could purchase machinery products much cheaper from those countries than from EU member countries.

If Portugal's exports are analysed in more detail—that is, by SITC one-digit breakdown in nine commodity groups (*Table 4*)—it is clear that the fastest developing commodity group is machinery exports, which increased by 239 percent over a period of seven years; furthermore its share rose the most—by 11 percent—in the total of exports (from 17 percent in 1988 to 28 percent in 1995). Consequently, machinery exports became the second largest commodity group after clothing industry products in the share of Portuguese exports. This unusual dynamics caused a reduction of the shares of other commodity groups because their growth was less than the average of 106 percent. Only the growth of food exports followed the average pace and thus its share remained almost the same.

The changes in the values and shares of the four main commodity groups in Portuguese exports can be seen in *Figures 1* and *2* where one and two-digit SITC groups have been aggregated. In *Figure 1* the changes of the export values can be followed between 1988 and 1995. It is clear from this that the largest export group

[10] Personal communication of Teresa Mouran, Under-Secretary of State of European Affairs.

Table 4

The shares and growth of Portuguese exports between 1988 and 1995 (in percentage)

SITC numb.	Commodity groups	Total world			European Union 15			Other regions		
		1988	1995	Growth	1988	1995	Growth	1988	1995	Growth
0	Food and live animals	4.16	4.14	205	3.08	3.90	273	8.07	5.25	112
1	Beverages and tobacco	3.48	2.58	153	3.43	2.31	146	3.69	3.75	175
2	Inedible crude materials	9.62	6.48	139	10.35	6.27	131	6.97	7.42	183
3	Mineral fuels	2.92	0.42	30	1.25	0.50	86	8.95	0.06	1
4	Animal and vegetable oils and fats	0.43	0.67	322	0.27	0.15	122	1.00	3.01	518
Primary products		20.62	14.29	143	18.38	13.14	154	28.67	19.48	117
5	Chemicals and related products	5.98	5.00	172	5.28	4.87	199	8.53	5.61	113
6	Manufactured goods	24.46	23.44	198	23.48	22.22	204	27.99	28.96	178
7	Machinery and transport equipment	16.81	27.61	339	18.05	28.55	341	12.36	23.36	325
8	Miscellaneous manufactured articles	32.02	29.56	190	34.76	31.22	194	22.14	22.07	171
9	Other commodities and transactions	0.11	0.10	189	0.05	0.01	37	0.32	0.52	276
Manufactures		79.38	85.71	223	81.62	86.86	230	71.33	80.52	194
Total exports		100.00	100.00	206	100.00	100.00	216	100.00	100.00	172

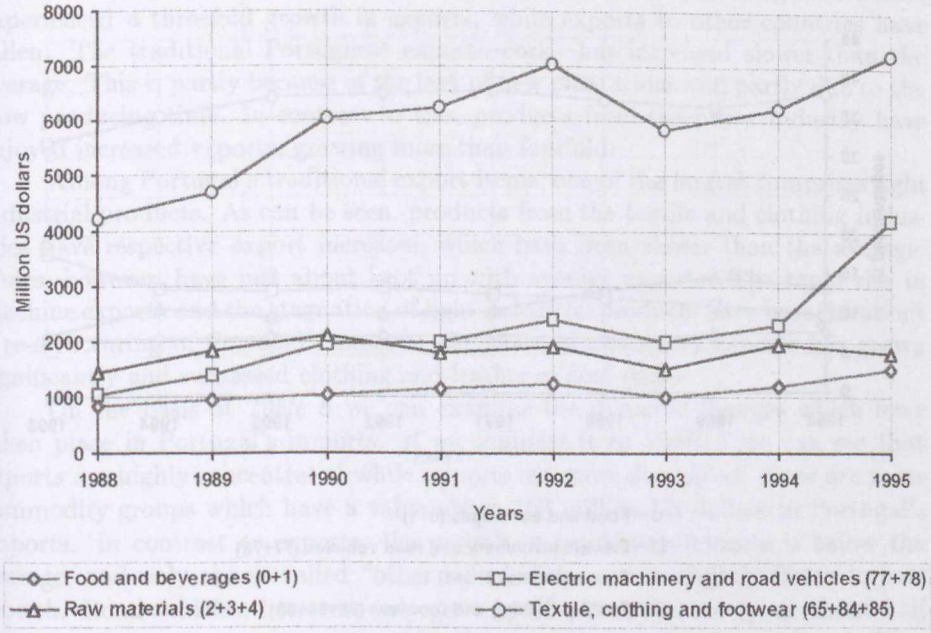

Fig. 1 Main commodity groups of Portuguese exports

is still that of textile, clothing and shoe exports; this illustrates a rising tendency despite the recession of 1993. The sudden 80 percent leap in the increase of electrical machinery and vehicle exports in 1994 is remarkable, given their previously consistently smooth rise. The export values of the other two commodity groups—i.e. food and drink and other primary goods—changed little until 1993 when the first group started to rise and the latter started to decrease. It can be seen that primary goods exports (excluding food) surpassed the value of exports of the two main machinery groups up to 1991, but later the latter rose much higher.

In *Figure 2* we can see the variations of the export shares of the same four commodity groups. In contrast to *Figure 1* this reflects that, since the beginning of the 1990, the proportion of textile and clothing exports has had a consistently falling tendency. This is in spite of the fact that their values have increased significantly. This decline is mainly a consequence of the growth of the export shares of other manufactures—the diagrammatic representation of the increase in the export proportions of the two machinery groups show this clearly.

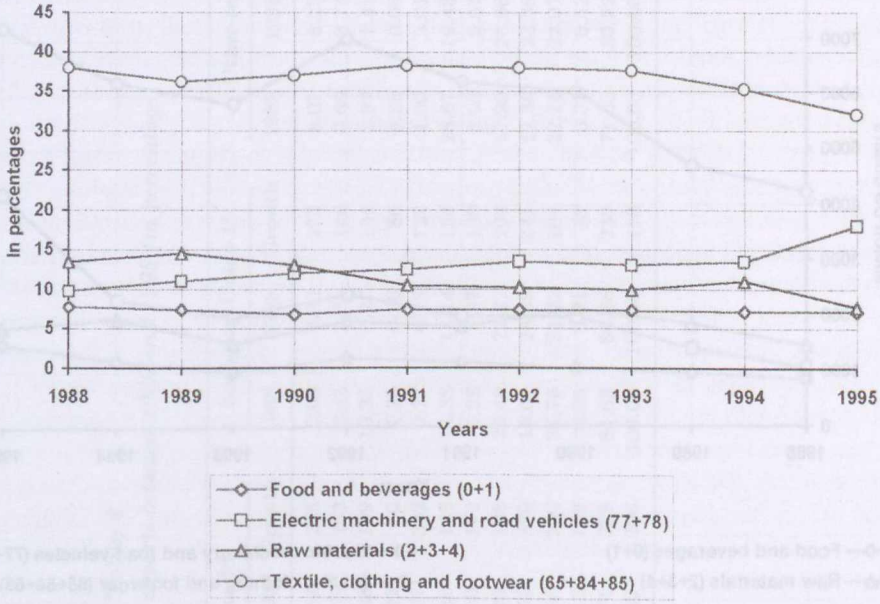

Fig. 2 Export shares of the main commodity groups in Portuguese trade

The European Union, as the largest buying market, has determined the make-up of Portugal's exports—with respect to composition of the goods, and the dynamics of the commodity groups; on this plain we can see similar variations to those found among total exports (*Table 4*). The single significant difference is that food exports to the EU countries have been above average and that is why their share has grown within exports.

On the basis of two-digit SITC groups we have examined Portugal's exports developments in more detail (see *Table 5*, which includes export commodity groups of more than 100 million US dollars). It is apparent that exports of instruments have increased more than sevenfold, while exports of telecommunications and electrical equipment and road vehicles have grown fourfold over the seven years under consideration here. In the latter a few newly established large car-assembly plants (e.g. Ford, Renault) have played a significant role. It can be seen that machine exports increased not only on the EU markets, because the growth of exports to other countries was sixfold.

In the exports of agricultural and food products, attention should be paid to the fact that the effects of integration have meant that exports to EU countries have grown very strongly. For instance, dairy products, fruits and vegetables have experienced a threefold growth in exports, while exports to other countries have fallen. The traditional Portuguese export—cork—has increased slower than the average. This is partly because of the lack of new plantations and partly due to the slow producing time. In contrast to this, products from the paper industry have enjoyed increased exports, growing more than fourfold.

Among Portugal's traditional export items, one of the largest comprises light industrial products. As can be seen, products from the textile and clothing industries have respective export increases, which have been slower than the average. Shoes, however, have just about kept up with average exports. The rapid rise in machine exports and the stagnation of light industrial products have brought about a re-structuring of Portugal's exports: the share of machinery exports has grown significantly and surpassed clothing and leather export items.

On the basis of *Table 6* we can examine the dynamic changes which have taken place in Portugal's imports. If we compare it to *Table 5* we can see that exports are highly concentrated while imports are more diversified: there are more commodity groups which have a value above 100 million US dollars in Portugal's imports. In contrast to exports, the growth in machinery imports is below the average, and only the so-called "other vehicles" have seen slightly faster import growth. Road vehicles, however, only grew by 49 percent—namely, at about half the rate of exports. In contrast to this, the respective import figures for clothing items, shoes, pharmaceuticals, cosmetics, vegetable oil, meat and dairy products have grown between three-fourfold. All these dynamically growing imports are a consequence of the growth of imports originating in the EU. It should be noted that all those commodity groups, which are imported from other non-EU countries and which have grown comparatively fast, have not been significant in their value.

From *Table 7* the results of those calculations can be seen. These show, according to the SITC one-digit detail, the extent of the trade increment over the period of the seven examined years. It should be noted that Portuguese exports increments were significant: out of a growth of more than 11 billion US dollars, a value of nearly 10 billion was absorbed by EU countries; namely, (with the exception of raw materials, fuels) 85 percent of export increments were directed towards the member countries. The situation is different with imports: total increments were much greater, reaching more than 15 billion US dollars; but out of this "only" 80 percent originated from EU countries. It is striking that in the sphere of food imports the increment from EU countries was higher (90 percent), and their share in the increment of machine imports was lower.

In *Table 8* and *Figure 3* the values of the trade balances are shown with respect to a breakdown of the main commodity groups. Portugal's trade balance (as has been mentioned) shows a significant deficit for the whole period examined;

Table 5

The changes in Portuguese exports by commodities in 1988 and 1995

SITC numb.	Commodity groups	Total world 1988 M. USD	Total world 1995 M. USD	Total world 1995 1988=100 percent	European Union 15 1988 M. USD	European Union 15 1995 M. USD	European Union 15 1995 1988=100 percent	Other regions 1988 M. USD	Other regions 1995 M. USD	Other regions 1995 1988=100 percent
02	Dairy products and eggs	43.51	125.52	289	33.46	111.50	333	10.04	14.03	140
03	Fish, crustaceans, molluscs	177.62	301.24	170	112.99	241.00	213	64.63	60.24	93
05	Vegetables and fruits	153.38	272.61	178	67.08	212.99	318	86.30	59.62	69
24	Cork and wood	205.79	203.39	99	174.77	171.96	98	31.02	31.43	101
25	Pulp and waste paper	671.11	739.18	110	592.25	644.12	109	78.86	95.06	121
28	Metalliferous ores and metals+A32	58.34	324.27	556	48.42	229.27	474	9.93	95.00	957
33	Petroleum, petroleum products	320.35	56.77	18	106.57	55.13	52	213.78	1.65	1
42	Fixed vegetable oils and fats	44.16	142.75	323	21.97	26.16	119	22.19	116.58	525
51	Organic chemicals	148.70	316.12	213	108.11	264.52	245	40.59	51.60	127
57	Plastics in primary forms	154.36	195.78	127	88.83	153.77	173	65.53	42.02	64
58	Plastics in non-primary forms	39.37	110.55	281	28.97	94.56	326	10.40	15.99	154
59	Chemical materials and products	147.47	179.88	122	136.88	165.46	121	10.59	14.43	136
63	Cork and wood manufactures	557.91	923.01	165	424.45	646.00	152	133.46	277.01	208
64	Paper and paper manufactures	156.34	680.06	435	134.55	606.19	451	21.79	73.87	339
65	Textile yarn and related products	1056.42	1626.82	154	831.31	1264.22	152	225.11	362.59	161

Table 5 *(continued)*

The changes in Portuguese exports by commodities in 1988 and 1995

SITC numb.	Commodity groups	Total world 1988 M. USD	Total world 1995 M. USD	Total world 1995 1988=100 percent	European Union 15 1988 M. USD	European Union 15 1995 M. USD	European Union 15 1995 1988=100 percent	Other regions 1988 M. USD	Other regions 1995 M. USD	Other regions 1995 1988=100 percent
66	Non-metallic mineral manufactures	471.59	1010.36	214	318.79	767.39	241	152.80	242.97	159
67	Iron and steel	65.68	185.02	282	41.18	156.04	379	24.49	28.98	118
69	Manufactures of metal n.e.s.*	242.02	653.60	270	161.54	504.95	313	80.48	148.65	185
71	Power generating machinery	187.78	399.09	213	170.86	336.85	197	16.91	62.24	368
72	Specialised machinery	79.16	184.92	234	49.23	106.25	216	29.93	78.67	263
74	Other industrial machinery A7	177.81	490.80	276	108.78	332.71	306	69.03	158.10	229
76	Telecommunication equipment	188.81	727.99	386	174.95	680.57	389	13.86	47.41	342
77	Electrical machinery	489.52	2135.40	436	440.21	1844.40	419	49.31	291.00	590
78	Road vehicles	570.36	2084.02	365	543.99	1899.06	349	26.37	184.96	701
79	Other transport equipment	76.34	176.54	231	14.72	65.94	448	61.62	110.60	180
82	Furniture and parts thereof	72.49	284.02	392	62.37	252.03	404	10.12	31.98	316
84	Articles of apparel & clothing	2296.36	3805.12	166	1972.44	3400.64	172	323.92	404.49	125
85	Footwear	877.95	1846.82	210	776.63	1554.66	200	101.32	292.16	288
87	Professional instruments	27.87	205.49	737	19.60	174.99	893	8.27	30.50	369
89	Miscellaneous manufactures	188.95	406.05	215	115.01	283.51	247	73.93	122.55	166

Note: Commodity groups with more that USD 100 million export values
*n.e.s.—not elsewhere specified

Table 6

The changes in Portuguese imports by commodities in 1988 and 1995

SITC numb.	Commodity groups	Total world 1988 M. USD	Total world 1995 M. USD	Total world 1995 1988=100 percent	European Union 15 1988 M. USD	European Union 15 1995 M. USD	European Union 15 1995 1988=100 percent	Other regions 1988 M. USD	Other regions 1995 M. USD	Other regions 1995 1988=100 percent
00	Live animals	29.04	102.96	355	28.49	95.72	336	0.55	7.24	1316
01	Meat and meat preparations	164.65	490.08	298	151.30	468.18	309	13.35	21.91	164
02	Dairy products and eggs	36.29	165.19	455	30.78	162.37	528	5.51	2.83	51
03	Fish, crustaceans and molluscs	459.95	806.55	175	123.77	364.78	295	336.18	441.77	131
04	Cereals and cereal preparations	259.71	693.81	267	83.10	561.37	676	176.60	132.44	75
05	Vegetables and fruits	291.16	591.04	203	121.37	378.81	312	169.79	212.23	125
06	Sugar preparations and honey	142.42	199.92	140	33.74	40.67	121	108.68	159.24	147
07	Coffee, tea, cocoa and spices	111.84	254.62	228	47.74	131.90	276	64.10	122.72	191
08	Feedstuff of animals	221.04	257.11	116	44.88	98.44	219	176.16	158.67	90
09	Other edible products	29.07	116.97	402	26.83	112.76	420	2.24	4.21	188
22	Oil seeds and oleaginous fruits	391.97	319.86	82	124.98	31.05	25	266.99	288.82	108
24	Cork and wood	186.81	382.25	205	58.50	113.42	194	128.30	268.82	210
26	Textiles fibres and their wastes	435.23	500.53	115	92.24	149.58	162	342.99	350.95	102
29	Crude animal and vegetable materials	45.94	106.83	233	35.61	78.46	220	10.33	28.37	275
32	Coal, coke and briquettes	152.48	260.02	171	16.86	4.12	24	135.63	255.91	189
33	Petroleum and petroleum products	1246.91	1757.49	141	257.13	75.24	29	989.78	1682.25	170
34	Gas, natural and manufactured	65.23	162.70	249	63.76	140.55	220	1.47	22.15	1504
42	Fixed vegetable oils and fats	23.12	215.67	933	9.39	178.66	1903	13.73	37.00	270

Table 6 *(continued)*

The changes in Portuguese imports by commodities in 1988 and 1995

SITC numb.	Commodity groups	Total world 1988 M. USD	Total world 1995 M. USD	Total world 1995 1988=100 percent	European Union 15 1988 M. USD	European Union 15 1995 M. USD	European Union 15 1995 1988=100 percent	Other regions 1988 M. USD	Other regions 1995 M. USD	Other regions 1995 1988=100 percent
51	Organic chemicals	478.09	651.54	136	351.99	499.75	142	126.10	151.79	120
52	Inorganic chemicals	127.37	172.75	136	114.13	150.27	132	13.25	22.48	170
53	Dyeing and colouring materials	184.21	356.31	193	152.07	334.62	220	32.14	21.69	67
54	Pharmaceutical products	219.29	630.02	287	166.52	505.34	303	52.78	124.68	236
55	Essential oils for perfume materials	110.80	388.15	350	99.61	369.21	371	11.19	18.94	169
57	Plastics in primary forms	249.87	550.34	220	235.32	513.17	218	14.55	37.17	255
58	Plastics in non-primary forms	119.46	253.59	212	115.05	240.69	209	4.41	12.89	292
59	Chemical materials and products	244.16	403.07	165	218.94	362.60	166	25.22	40.47	160
61	Leather and leather manufactures	266.76	467.90	175	153.99	283.29	184	112.77	184.60	164
62	Rubber manufactures, n.e.s.*	158.59	349.99	221	146.07	289.85	198	12.53	60.14	480
63	Cork and wood manufactures	26.83	116.89	436	22.35	91.48	409	4.49	25.41	566
64	Paper and paper manufactures	266.73	691.13	259	247.22	652.10	264	19.51	39.03	200
65	Textile yarn and related products	1103.35	1953.82	177	924.96	1628.38	176	178.39	325.44	182
66	Non-metallic mineral manufactures	293.23	452.48	154	235.63	416.90	177	57.59	35.59	62
67	Iron and steel	587.67	1264.53	215	544.73	1164.36	214	42.95	100.17	233
68	Non-ferrous metals	379.93	583.03	153	233.13	475.24	204	146.80	107.78	73
69	Manufactures of metal, n.e.s.*	294.23	700.46	238	266.95	636.06	238	27.28	64.40	236

*n.e.s.—not elsewhere specified

Table 6 *(continued)*

The changes in Portuguese imports by commodities in 1988 and 1995

SITC numb.	Commodity groups	Total world 1988 M. USD	Total world 1995 M. USD	Total world 1995 1988=100 percent	European Union 15 1988 M. USD	European Union 15 1995 M. USD	European Union 15 1995 1988=100 percent	Other regions 1988 M. USD	Other regions 1995 M. USD	Other regions 1995 1988=100 percent
71	Power generating machinery	269.76	638.31	237	203.81	548.06	269	65.95	90.25	137
72	Specialised machinery	1196.86	1056.81	88	983.54	898.08	91	213.32	158.74	74
73	Metal working machinery	132.54	142.61	108	108.58	107.02	99	23.96	35.59	148
74	Other industrial machinery	754.59	1079.17	143	668.96	943.05	141	85.63	136.12	159
75	Office machines and data processing	488.70	802.85	164	368.10	684.45	186	120.60	118.39	98
76	Telecommunication equipment	565.65	931.89	165	438.82	693.98	158	126.83	237.91	188
77	Electrical machinery	791.99	2314.54	292	656.36	1663.43	253	135.63	651.11	480
78	Road vehicles	2593.04	3868.97	149	2290.86	3402.15	149	302.18	466.82	154
79	Other transport equipment	71.53	500.68	700	51.70	369.77	715	19.83	130.91	660
81	Sanitary, heating and lighting fixtures	39.71	113.95	287	38.07	107.92	284	1.64	6.03	367
82	Furniture and parts thereof	62.17	196.94	317	60.39	187.81	311	1.78	9.13	513
84	Articles of apparel & clothing accessories	201.92	851.40	422	190.52	781.36	410	11.40	70.04	614
85	Footwear	83.19	292.15	351	79.74	213.56	268	3.44	78.59	2282
87	Professional instruments	206.79	401.08	194	152.19	308.22	203	54.60	92.86	170
88	Photo and optical goods, watches	169.76	290.44	171	119.67	199.28	167	50.09	91.16	182
89	Miscellaneous manufactured articles	423.82	1169.04	276	344.78	993.99	288	79.04	175.06	221
94	Gold, non-monetary	4.25	176.73	4157	1.98	170.52	8595	2.27	6.21	274

Note: Commodity groups with more that USD 100 million import values

Table 7

Increment of Portuguese trade between 1988 and 1995 (in million USD and percentage)

Commodity groups	World	EU 15	Other reg.	EU/World (percent)
Exports				
0+1	683,927	594,934	88,993	87
2+4	517,774	279,284	238,490	54
3	−227,262	−15,370	−211,892	7
5+6+8+9	6,309,975	5,369,645	940,330	85
7	4,423,067	3,757,244	665,823	85
Total	11,707,481	9,985,737	1,721,744	85
Imports				
0+1	2,168,828	1,961,837	206,992	90
2+4	518,183	292,191	225,992	56
3	730,525	−102,905	833,430	−14
5+6+8+9	7,236,627	6,399,148	837,479	88
7	4,471,158	3,539,267	931,891	79
Total	15,125,321	12,089,537	3,035,784	80

The titles of the commodity groups can be seen in *Table 4*.

in 1988 the deficit was 6.9 billion US dollars, but by 1995 it had grown to above 10 billion US dollars. The import surplus was characteristic of most commodity-groups with the exception of two: beverages and textile/clothing items. The greatest deficit could be witnessed—in each year—in machinery trade; however, its significance has decreased: in 1988 the total deficit amounted to 73 percent while in 1995 it was only 49 percent. It is worth mentioning that trade in food products also had an import surplus, its value doubling over seven years.

As a consequence of participation in European integration—as was expected—the respective proportions of intra-industry and inter-industry trade have changed greatly in Portugal.[11] According to the theory of Hekscher-Ohlin and neo-classical concepts, the international division of labour and especially the development of integration, by increased specialisation lead towards a decrease of competitive branches and activities in the individual countries; and the share of inter-industry trade grows. The exports of competitive activities are extended, while their position on the domestic market is not endangered by import competition. In contrast to this, those branches that cannot stand up to the competition are unable to overcome the rivalry from imported goods and are gradually squeezed out of the market.

[11] The results of the computations for "inter-industry" and "intra-industry" trade are based on the findings of Fontoura (1998). See also Balassa (1963; 1974); *Grubel and Lloyd* (1975); *Greenway and Miller* (1983); *Halpern, Kőrösi and Richter* (1985); Nagy (1995); Éltető (1998).

Table 8

Portuguese balance of trade by main commodity groups (1988–1995)

SITC numb.	Commodity groups	1988	1989	1990	1991	1992	1993	1994	1995
0	Food and live animals	−1286	−1193	−1669	−2043	−2417	−2188	−2465	−2737
1	Beverages and tobacco	290	209	299	301	355	269	201	255
2	Inedible crude materials	−288	85	−34	−149	−113	−107	−170	−196
3	Mineral fuels	−1142	−1575	−2136	−1949	−1897	−1620	−1576	−2100
4	Animal and vegetable oils and fats	10	−30	14	−4	2	−77	−76	−82
5	Chemicals and related products	−1116	−1042	−1446	−1639	−1977	−1663	−1835	−2338
6	Manufactured goods	−681	−761	−1146	−1213	−1461	−612	−728	−1252
7	Machinery and transport equipment	−5011	−4562	−6133	−6395	−7626	−5358	−5424	−5059
8	Miscellaneous manufactured articles	2330	2636	3352	3092	3200	2642	3104	3359
9	Other commodities and transactions	7	−8	−56	−65	−106	−112	−119	−155
Total exports		−6887	−6241	−8955	−10064	−12040	−8826	−9088	−10305

In contrast to this appealing and logical conception, it is already nearly 20 years since observation of the facts has led to the drawing of strongly divergent conclusions. It has turned out that it is in the trade of the most developed countries that the turnover has grown fastest within the same commodity groups. Also, trade among different groups has not shown consistent or unambiguous increases. The differentiation of products, the demand for the increase in varieties available, the exploitation of economies of scale and the significant spread of product ranges with imperfect competition: these are the main factors which have refuted the expectations of greatly simplified neo-classical theory. Balassa (1974) pointed out that most of the fast development of intra-industry trade is a result of the spontaneous operational effects of market forces. However, in this, trade liberalisation and economic deregulation—i.e. the trade policies of the states—have had vital roles to play.

Tables 9 and *10* include the results of investigations carried out by Fontoura (1988). The development of inter-industry trade over a period of 30 years shows that in the main commodity groups protectionist measures brought about an extraordinarily strong isolation. In other words, domestic needs were satisfied by home production, independent of efficiency considerations and consumer demands. Imports were only present where domestic production was unprotected. It can be seen that in most of the commodity groups (e.g. paper, textiles, clothing and shoes)

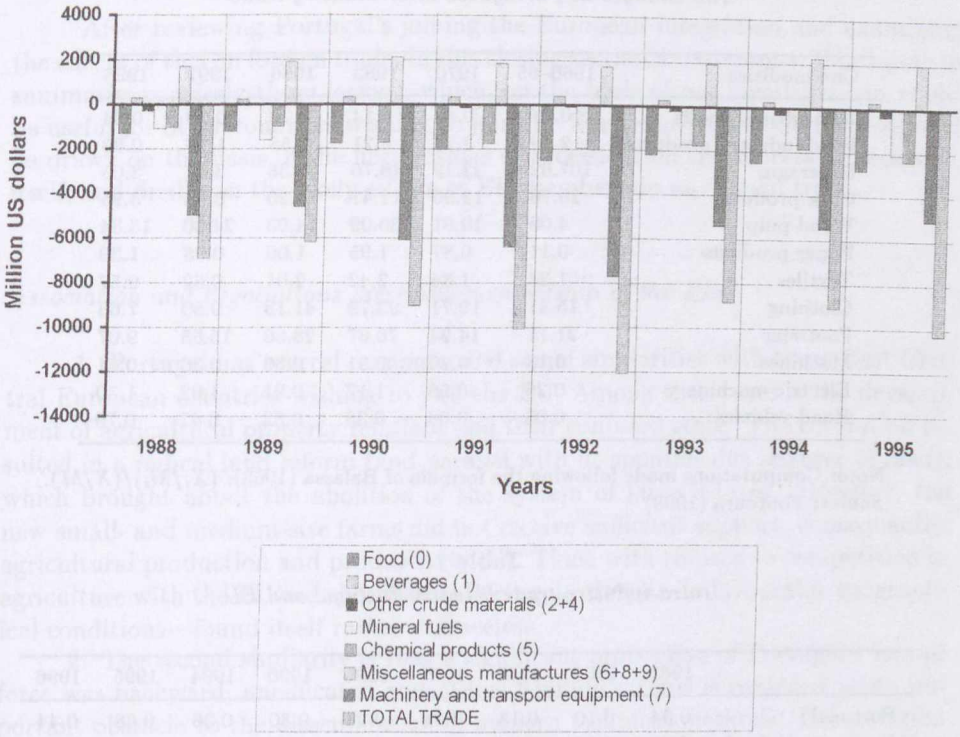

Fig. 3 Trade balance of Portugal by main commodity groups

the effect of inter-industry specialisation was not only very high but also significantly increased, right up to the beginning of the 1980s. However, due to the effects of integration in all commodity groups the index of inter-industry trade decreased strongly (although in some areas, even in 1995, it remained comparatively high).

The examination of intra-industry trade in *Table 10* reveals that, in Portugal's case, it was at an extraordinary low level up to the beginning of the 1980s, when it began to rise strongly. In the 1960s the parallel imports and exports of products belonging to identical commodity groups were negligible. The Grubel-Lloyd index was only 0.14 in 1977 and it gradually rose to 0.44 in 1996. Compared with the average of the EU countries this is still at a comparatively low level. However, taking into account the tendency towards growth, it is to be expected that Portugal will soon have similar intra-industry trade indices to the other countries partici-

Table 9

The changes in Portuguese inter-industry trade

Commodities	1960–65	1970	1983	1986	1992	1995
Agricultural goods	0.44	0.42	0.14	0.20	0.28	0.24
Food industry products	2.49	3.28	4.21	3.58	1.16	0.86
Beverages	107.62	22.49	46.76	12.38	3.47	3.05
Cork products	20.76	12.00	11.41	10.20	6.48	3.25
Wood pulp	4.08	19.81	36.09	24.03	24.30	13.34
Paper products	0.11	0.87	1.95	1.06	0.98	1.39
Textiles	1.34	1.84	2.42	2.01	0.62	0.57
Clothing	15.41	19.71	93.79	41.13	9.80	7.63
Footwear	21.77	14.24	76.67	28.90	13.55	9.07
Machines	0.13	0.20	0.51	0.36	0.36	0.51
Electric machinery	0.25	0.96	1.17	0.91	1.02	1.30
Road vehicles	0.05	0.08	0.38	0.32	0.41	0.70

Note: Computations made following the formula of Balassa (1963): $(X_i/M_i)/(X/M)$.
Source: Fontoura (1998)

Table 10

Intra-industry trade between Portugal and EU

	1961	1967	1972	1977	1985	1990	1994	1995	1996
Portugal	0.04	0.10	0.13	0.14	0.24	0.30	0.36	0.38	0.44
European Union*	0.48	0.56	0.57	0.59	0.58	0.59			

*Average of eleven EU countries, weighted by values of intra-EU manufactured trade.
Note: Unadjusted Grubel-Lloyd indices of manufactures in four digit commodity groups.
Source: Eurostat-Comext, quoted by Fontoura (1998)

pating in European integration.[12] On the basis of Éltető's (1998) calculations, at the two-digit commodity breakdown level she was able to make the statement: "In trade with France, Germany and Great Britain, Portuguese intra-industry trade visibly grew in the 1990s. In this, growth was primarily trade in 'non-railway vehicles' (almost 25 percent of the total), secondly, the trade in electrical machines and equipment had a growing turnover; these increases can also be attributed to the effects of foreign capital" (p. 50).

[12] Portuguese intra-industry trade indices during the 1970s and 1980s were comparatively low, even compared to the more developed members of CMEA countries. See: Halpern, Kőrösi and Richter (1985); Nagy (1995).

Some conclusions

After reviewing Portugal's joining the European integration and examining the effects of this on foreign trade, in this closing section an attempt will be made to summarise concisely those lessons, which, on the basis of our investigations, could be useful for other countries wishing to join the European Union. Conclusions will be drawn on the basis of the negotiations of accession, on the process of accession itself, and finally on the likely effects of EU membership on foreign trade.

Association and negotiations preceding membership of the EEC

1. Portugal has several economic and social similarities with those East Central European countries wishing to join the EU. Among these, one is the development of agricultural property relations and their confused state. The revolution resulted in a radical land reform (and parallel with it, spontaneous seizures of land), which brought about the abolition of the system of large estates. However, the new small- and medium-size farms did not receive sufficient support; consequently, agricultural production and productivity fell. Thus, with respect to competition in agriculture with the EU member states, Portugal—despite its favourable geographical conditions—found itself rather defenceless.

2. The second similarity is that a significant proportion of Portugal's labour force was backward, uneducated and of low flexibility. This is regarded as an important obstacle to the dissemination of modern technical methods. Deregulation of the labour market improved the situation somewhat but the lack of professional skills and insufficient efforts at retraining are still causing serious hindrances to catching up with the developed countries. Following accession, it seems that structural transformation and economic advance largely depend on the type of institutional instruments available and the degree of success in improving the skills and employability of the labour force.

3. Another similarity is the comparatively backward state of the infrastructure; development of the latter is one of the most urgent tasks to be dealt with in order to join the EU. The EU can be counted upon to provide significant support for this but—as with the case of improving the quality of the labour force—public expenditure will have to grow: namely, the tasks of the state will not decrease but will increase in these areas. One of the keys to Portugal's successes is that it was able to increase such expenditures without pushing up the budget deficit. This required stricter supervision and greater efficiency in other areas of state expenditure—especially with respect to the abolition of subsidies to large state-owned companies and banks.

4. One of the factors that had a great role in speeding up Portugal's economic development was the degree of confidence of foreign investors in Portugal's

economic and political stability. This had an important role both in foreign direct investments and in the process of privatisation. Confidence in Portugal's economic progress depended largely on the success in establishing macro-economic stability. This involved reduction of the national debt, the budget deficit and inflation. Another vital role was played by the ostensible determination of the government to implement structural and market-conforming institutional reforms, including unpopular but indispensable measures.

5. In the negotiations on accession to the EU it soon became apparent there could be no question of refusing the terms of the community, or transforming these. Rather, the discussions focussed on the sustainability of the circumstances for, and the time in which Portugal would be able to comply with the terms of the EU. In other words, in which cases would Portugal need help (and what kind of help) in order to gradually fall in line with the *acquis communautaire*? Moreover, how much time could be allowed for this process to take place?

6. After the accession negotiations, the opinion of some experts was that it would be more advantageous for Portugal if it was to negotiate alone in Brussels—i.e. without its much larger and more protectionist neighbour, Spain. During the course of negotiations, some of the experts in Brussels were against certain concessions to Portugal because they feared a precedent would be set up for Spain. This could be an important lesson in the preparations for the negotiations over the accession of the three East Central European countries. According to the experiences of the South European countries, parallel negotiations with other countries not only make the process more difficult but also slow it down.

7. The accession negotiations were many-sided and the level of difficulty in the problematic themes to be resolved differed greatly. According to Portuguese experiences, due to the complexity of the problems and their connection with each other, discussions can drag on for some time. The success of this process (and its speeding up) can be better ensured if themes for debate are divided up according to their respective degrees of complexity, with easier ones being dealt with first and then moving on to more difficult issues. Once an item has been discussed and agreed upon there should be no return to that particular issue; yet thought must be given to the way in which the solution of individual questions can be brought into harmony with other issues.

8. At first, Portugal's efforts to join the European Community were characterised by a considerable degree of ambiguity. They tried to politically balance the requirements for accession with the principles of socialism that had been laid down in the post-revolutionary constitution. However, behind the latter—with regard to economic interests—there were inherent tendencies towards protectionism and inflexibility in the state sector, which had also increased in size. This ambiguity was particularly responsible for the long-drawn out discussions; the solution was to develop unequivocally a democratic and Europe-friendly political system (which meant squeezing the communist party out from positions of power). The European

Community wanted to bring about this political settlement mainly from a security point of view, in order to allow accession to go ahead. It can be presumed that this goal of political settlement is valid for East Central European countries in order to prevent the return of the former communist dictatorship and the renewal of Russian influence in the region. This is an important factor for EU accession, even if it does not actually play such a determinant role in the course of discussions and agreements.

9. Portugal's accession was also hindered by frequent political changes, government crises and, within these, inconsistencies related to the frequent changes in officials responsible for negotiations. In order for new officials to become acquainted with the on-going procedures, time was needed; the concomitant uncertainty negatively affected the credibility and reliability of the country. It was at such times that Portugal's negotiating position was weakened. The success of negotiations depends largely on the expertise and mindfulness of the delegations of the countries seeking accession. The maintenance of continuity—regardless of political changes—is highly important.

10. Portuguese experts have emphasised that, in the course of seeking integration, the liberalisation of the trade and financial systems should take place alongside one another; the way in which this takes place and the timing of the changes are important. Moreover, the deregulation of rules influencing production also needs to be connected with the above processes. Thus it is not enough to decrease the role of the state in the economy, to liberalise and deregulate the numerous types of restrictions. This is because success mainly depends on details—i.e. how, with what methods, and in which order the changes take place. One aspect mentioned, as an example, concerned Portugal's large external and internal debts (which were a consequence of preference being given to state borrowing). This significantly narrowed, and made more expensive the opportunities for acquiring resources for the competitive sphere, which retarded structural changes and held back competitiveness.

Integration effects on foreign trade

a) European integration has had a strong trade-creating effect for Portugal: both exports and imports grew rapidly in the wake of EEC accession; in fact, growth was faster than world trade and average EU trade. The rapid growth in exports was primarily due to trade in manufactures. Imports originating in EU countries also grew comparatively quickly. However, it is striking that Portuguese imports of agricultural goods and raw materials from EU countries grew faster than the importation of industrial goods. This phenomenon contradicts the supposition that integration with developed European economies leads to "colonial-type" connections with the weaker economies—i.e. raw material exports from the weaker

economies increase while their exports of industrial goods are restricted, and opposite tendencies can be expected on the import side.

b) The overwhelming share of Portugal's trade is transacted with EU countries—in 1995 the EU accounted for 82 percent of Portugal's exports and 72 percent of its imports. The turnover of industrial goods is more strongly concentrated in the EU countries than the turnover of raw materials. Because the participation of EU countries in Portugal's raw material imports has grown, the volume of such imports from Africa, Asia and North America have fallen. In the opinion of some experts the effect of integration on Portuguese foreign trade has turned too much towards the EU, and thus it has lost some of its earlier advantageous export and acquisition markets. On the one hand, because of this agricultural imports have become more expensive and, on the other hand, the market concentration of light industry exports has increased their vulnerability. For those East Central European countries aiming to join the EU an important objective of trade policy should be, alongside the attraction of integration, to find out how existing and advantageous export and raw material import markets can be preserved. In other words, how to profit from integration through trade-creation, without losing existing advantages by trade-diversion.

c) Following accession it was Portugal's machine exports which grew most dynamically. For example, the export of instruments grew sevenfold; the respective export figures for telecommunications products, electrical equipment and road vehicles grew almost fourfold between 1988 and 1995. The successful growth of machinery exports was not only due to trade with the EU but with other parts of the world as well. These came second to textiles and clothing—traditionally the main exports. The value of the latter increased significantly, although their share in total exports has had a consistently decreasing tendency since the beginning of the 1990s. Thus European integration has not led to a decline in Portugal's traditional exports but, rather, has resulted in significant growth alongside the production of new, up-to-date goods. The latter have markedly surpassed the traditional ones in export growth.

d) Exports of agricultural and food products have grown strongly, e.g. dairy products, vegetables and fruits. Exports of these grew threefold in under seven years, mainly to the EU markets; however, exports to other regions of the world declined. It can be presumed that the reason for this was that the EU's protected agricultural market offered better prices and more favourable conditions for exports than elsewhere.

e) In the case of Portugal one fear about integration has proved to be groundless—namely, that machinery imports from the developed European countries would flood Portugal's market and damage the machine industry and its export capacity. The growth of machine imports has remained around the average, and the import of road vehicles has increased only half as rapidly as exports. In contrast to this, there have been notable increases in imports—primarily from the EU countries—in

the spheres of clothing, shoes, pharmaceuticals, cosmetics, meat and dairy products. Thus industrial competition within West European integration has spread virtually to every branch of production; nevertheless, the competitive productive activities have not only been able to maintain their position but have also been able to increase their exports significantly.

f) The increase of Portugal's industrial production and its structural transformation owe much to integration in the EU. Investigations indicate that the changes have actually proceeded according to Portugal's revealed comparative advantages. Although the effects of external markets have had a big role in this, it can be stated that Portugal's catching up with developed countries has mainly been due to endogenous changes—namely, to transformations in the formerly backward economic and institutional structures, in the allocation of resources, and in the restructuring of those resources themselves.

g) As a consequence of the opening up of the world economy and of the results of European integration policy—in contrast to the earlier period of protection—inter-industry trade specialisation has declined and the importance of intra-industry trade has significantly increased. Similar developments can be hoped for in the respective cases of the East Central European countries seeking EU membership. Nevertheless, this is not a rapid process and its success depends on a decisive transformation of a country's internal institutional structure, and also the removal of obstacles to international co-operation between enterprises.

h) The positive development of the commodity structure of Portugal's foreign trade corresponding to its comparative advantages can be put down to the extension of those products which have experienced a comparatively fast growth of demand on the world market; and also on those markets where exports were, or became competitive. The effect of all this has been a remarkable improvement in product competitiveness, quality and marketing. Compared with other countries it can be seen that the positive effects accession to the EU were the stronger, the higher the pre-accession tariff level was, and the more quotas impeded the free flow of trade.

i) Before Portugal's accession, and during the long process of negotiations, there were strong doubts about what advantages could be expected. The Portuguese knew that they could count on a certain increase of their export markets as well as generous funds from EU transfers. Yet, alongside the expected advantages, there was great doubt as to whether EU membership would produce more advantages than the guarantees of earlier trade agreements. Given the latter concern, it was asked whether it was worth getting involved in stronger import competition, with all the risks and disadvantages which could arise from it. However, the very serious long-term disadvantages of staying away from West European integration had to be carefully considered also. Experiences have proved that these doubts and a certain unsteadiness of Portuguese economic policy were without foundation. The advantages of accession, in parallel with processes of structural and institutional

modernisation have led to developments that have surpassed the expectations of nearly all the experts.

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BOOK REVIEWS

VARGA, J.: *Oktatás-gazdaságtan* (The economics of education). Budapest: Közgazdasági Szemle Alapítvány. 1998. 162 p.

Well, is there any difference? A few months ago the hostess of the press presentation of Varga's book and my colleague at BUES, Katalin Szabó, replied in such a way to the responses to my attempt to catch the audience's attention with the following, seemingly absurd question. "What do university studies and pigsties have in common?" All this might seem curious and I will try to increase curiosity by first saying a few words about why I like my colleague Júlia Varga's book.

Psychologists say that one of the reasons for explaining psychological phenomena is that there is no reason. Yet here I do have more than one.

Firstly, I like this book because it is by no means a boring compilation of literature thrown together in the spirit of "(s)he who cannot practice it, teaches"; rather, it is an exciting intellectual venture of an author who knows and practices the economics of education. Or as another maxim says: I have heard and forgotten, I have read and remember, I have practised it and I understand it. Those who may not know Varga's research work will certainly realize from her book that she has not simply "read and remembers" but "practised and understands it".

A second reason is that Varga is the sort of teacher who is able to pass on knowledge without giving up accessibility to competence. Presumably this is not simply because she happens to be an economist of education, just as a physician's degree is no guarantee for a healthy way of life. Upon reading her book, I do understand the economics of education.

A third reason is the deliberately discussion-like treatment of the topic. Of course, this is not in the sense of the old-fashioned style of the peripatetic school but, as a rare strength of some textbook authors, with regard to a clear, authentic and proportional treatment of conflicting views.

Finally, I like this book for its elegant and friendly style, while maintaing a high level of academic seriousness.

So, what do university studies have to do with pigsties ?

The Nobel prize winner Theodore *Schultz* appeared suddenly on the economics scene with his 1961 article on human capital investment. Shortly after W.W.II Schultz spent a semester at Alabama University as an agrarian economist interviewing farmers in the neighborhood. According to his memoirs (Schultz 1988) it was then that he met an elderly couple who, though visibly in dire straits, were surprisingly content with their fate. He was at a loss to understand the case until the couple explained that they were by no means poor. They had exchanged their riches for the academic education of their children. It was true that they used to have chicken coops and stockyards, pigs and mules; now all these properties were, in the form of intellectual capital, in the brains of their children. "How on earth could we feel poor?" the couple asked. Schultz's article came before basic works by renowned authors like Gary *Becker*, another Nobel laureate. His book, published in 1964, was the first systematic treatment of human capital theory; Schultz also preceded Jacob *Mincer* who, in his article in 1962, drew attention to the importance of knowledge and skills acquired through on the job experience and whose human capital theory inspired the earnings function, proposed in a study of 1974, and which is widely applied in labour economics even now.

Does the reader still need an explanation for my question mentioned earlier in this review? It would be unfair to Adam Smith if we were to leave unmentioned his early explanation in 1776 of the basic principle of the theory of human capital: the impact of the efforts, money and time people invest in learning a trade on the difference between the wage of skilled and unskilled work.

Let me now quote Júlia Varga's words from the introduction to demonstrate the thematic structure and approach of her book: "We are looking into three theories: the *theory of human capital*, which asserts that ed-

ucation increases the productivity of participants; the *filter theory* of education, which claims that education simply provides information on the performance capacity of individuals; and the approach *based on labour demand* which says that economic growth requires a given number of employees with a certain degree of knowledge and skills. Thus the main task of educational policy is to provide the supply thus required. A most detailed account will be given of the theory of human capital since this is the most influential approach, so much so that even those who do not adhere to it cannot completely avoid its inspiration.

Hence we will first have a closer look at the theory of human capital. We will examine the characteristics of individual and corporate investment decisions and how individual and social costs and benefits justify the role of the state. This will be followed by the treatment of the cost-benefit analysis of education (also based on the theory of human capital) and a review of the research into the impact of education on economic growth. A separate chapter will be devoted to the filter theory and then another to the labour demand approach. Finally, problems associated with the financing of education and methods of assessing the efficiency of education will be discussed. Each chapter, beside dealing with theoretical issues, will also summarize the relevant results of the most important empirical investigations." (p. 8)

Of the above seven chapters, this review is confined to comments upon the first five, of which Chapter I deals with the theory of human capital and Chapters II–V are partly based on the theory of human capital, and partly are reflections on it.

With regard to Chapter V, this counterpoises the two basic versions of educational planning—i.e. planning based on labour demand versus rate of return calculations. I have to remark at this point that this is where the author ought to have gone beyond the standard textbook requirement of presenting a particular school of thought and those (and this is a sort of reproach) of the major Hungarian players in the field; she refers to János *Timár*'s 1989 book, but fails to mention János *Kovács*'s from 1968. With respect to Chapters VI and VII, it is enough to note that they offer up-to-date theoretical, methodological and factual fixed points (largely in accordance with conclusions drawn in 1997 from an examination of American public education by an internationally reknown expert in the field, Henry M. *Levin*, whose two earlier works are included in the list of references in Varga's book). These points provide orientation in delicate and highly practical questions like:

— on the one hand, the desirable magnitudes and methods of state subsidies for public and higher education (e.g. should they be sector-dependent or sector-neutral, based on per capita institution financing or on vouchers given to those entitled to educational services, or should there be a tuition fee in non-private higher education?)

— on the other hand, the effectiveness, economies of scale and cost-efficiency of educational institutions.

I begin my comments with the confession that I did not refer to Schultz's Alabama experience simply as an anecdotal example of scientific perception born of a propitious encounter, or to Smith's disquisition solely as a homage to the achievement of a scientist who was far ahead of his time. I did so mainly to illuminate reservations that should hardly have been forced into the framework of a textbook-like treatment of the theory of human capital (although it might be excusable to raise such issues in the context of a book review).

The analogous treatment of human and physical capital investments as part of the hard core of the theory of human capital—discussed in Chapter I—raises some concern. This is mainly because it puts into brackets the pivotal difference that, in normal cases, physical investment for the investor is today's sacrifice for a future profit (i.e. immediate pleasures are forgone for higher future pleasures, or as *Elster* (1997) puts it when criticizing Becker's latest (1996) book: first one step back, then two steps forward)—but learning is, in normal cases, a basically positive, self-rewarding experience (namely, one step forward, then more steps forward). Had I not believed so, I would surely feel frustrated as a professor, and as a reviewer—without such belief I would have to feed prospective readers of Júlia Varga's book

not so much with the promise of intellectual excitement but with the prospect of sizable monetary returns.

Should we still presume that education is, for the individual, an investment (sacrifice) but one that yields positive external effects (benefits for others); if the latter is the case, then the state should indeed co-finance education to the extent of such positive externalities; otherwise people's willingness to learn would be suboptimal—i.e. less than socially desirable. (There should not be any misunderstanding here: the net individual profit from higher education will thus increase only temporarily since, according to the theory of human capital, individuals keep on getting higher wages and other pleasantries in proportion to the extra educational expenditures borne by themselves. In other words, as a consequence of education getting cheaper, more people will wish to participate in higher education, which will then result in a fall in the gross individual returns of higher education later on. This is an implication of the theory of human capital that seems to be supported by differences in the individual costs and returns of higher education between Great-Britain and the US.) At the same time, from the fact that the part of the costs of education which is not covered with public money is borne not so much by those participating in education but their—in this regard altruist—rather profit-minded parents. The parents are happy to make a sacrifice for the education of their children, as is clearly the case with Schultz's couple; the eventuality of supra-optimal human capital investment follows, even without state subsidies, to education. Note, however, that the very term (sub/supra)-optimality makes sense only to the extent that we think of learning in the spirit of the theory of human capital: as a "one step back" sacrifice which increases future productivity and not as "one step forward" consumption.

Reservations with regard to a treatment of education which is analogous to physical capital investment proliferate if one reads rate of return calculation principles, techniques and results in Chapter II. As it is, these calculations select from cost and return factors mostly on the basis of technical difficulties with respect to their measurability in monetary terms. One could thus hardly play the Karl Popperian game: to reach an agreement in how much, say, a university degree against a high school diploma should be worth to justify the theory of human capital. The truth is that whatever it is worth, it is a question of taste whether we make conclusions from the result about the validity of the theory or, taken its validity for granted, focus on the specific preferences of individuals: i.e. their attitudes towards various elements of costs and returns. Following from all these, educational policy conclusions that may be implied by rate of return calculations for the desirable amount and composition of human capital investments are, in my view, to be treated with more serious reservations than in the case in Chapter V. This chapter deals with such conclusions with regard to assessing the capacity of educational planning using these conclusions (cf. *Freeman* 1976b).

In spite of the above objections we might consider education in terms of its effect on economic growth at the national economy level—that is, as an investment similar to the renewal or increase of physical capital stock, provided that a clear dependence of an effect upon a cause between educational expenditures and economic growth could be proven. (A rigorous critic may still find fault, saying that this might represent a dependence of effect upon a cause whereas consumption, including education, is the powerhouse of economic growth.) Yet the methodological difficulties and calculation results presented in Chapter III suggest doubts again, notwithstanding the results of recent attempts to explain the huge international disparities of productivity (for instance *Hall and Jones* 1996, and especially *Barro* 1997).

Investigation results reviewed in Chapter IV seem to tip the scales in favour of earnings functions induced by the theory of human capital in order to explain earnings differentials across groups with various levels of education. This is in contrast to the explanation of the filter theory which has been a challenge ever since the later Nobel prize winner Kenneth *Arrow* published his famous article in 1962. This claims that the positive association of earnings and education does not confirm the positive impact of schooling on productivity; it

might be that inherently more intelligent and more ingenious, and consequently more productive individuals have better chances of reaching a higher education level. Since employers tend to judge their productivity by their qualifications—that is, discriminate on the basis of educational level—such people get more lucrative jobs. At the same time, we learn from this chapter that results are far from being in line with each other and that, partly because of methodological difficulties and partly due to gaps in data sources, there is no realistic hope for certainty regarding the relative validity of the two—possibly sociological—explanations. The terms used are telling anyway: Why is the exclusive validity—i.e. the "strong version"—of the filter theory being rejected in the face of empirical evidence? Why not that of the theory of human capital?

To add to the confusion, let me refer to the return of education which is positively dependent on the size of the company, an observation that may be explained in a better way on the basis of the filter theory—i.e. that smaller companies do rely on formal education so much when judging the individual productivity of their employees (cf. *Green, Machin and Manning* 1996). Also there is the well-known experience, seemingly in contradiction with both theories, that employers do not care about their junior job applicants' school reports. Finally, there is the phenomena, compatible with both theories, that they do pay attention to the reputation of the institution issuing the school report. (For more information on this subject see, for instance, *Rosenbaum and Binder* 1994, and *Rosenbaum and Kariya* 1991; for the Hungarian experience see the as yet unpublished results of a follow-up survey conducted by Péter *Galasi* and János Timár with reference to recently graduated cohorts.)

With all these doubts and objections, why is there such a huge scientific aura around the theory of human capital?

The so far unmentioned Nobel prize winner Milton *Friedman* was one of the early proponents of the concept of human capital and the first (in 1955, six years before Schultz, and then later in Chapter VI of his epoch-making book of 1962) to urge a switch from the direct financing of education to the more market-conforming voucher system. Anyone familiar with economics must know that this discipline is not too particular with regard to the validity of its presuppositions. According to the methodological approach especially popular among members—like Friedman and Becker—of the so-called Chicago School, it is sufficient if conclusions drawn logically from presuppositions prove to be true. The theory of human capital has proved to be apt for explaining otherwise unaccountable phenomena.

The cobweb phenomena cited in Chapter I of the book (beside the aforementioned positive external effect) can be given as an example of a possible reason for state intervention in education. The essence of this phenomenon is that—just like in the case of the so-called "pig cycle", literally conceived—if (1) returns from investment accrue with considerable delay, and (2) investors react frantically to changes in expected returns and (3) are irreparably naïve in their adjusting their expectations of future returns to current returns, then unexpected rises or plunges of returns will be followed by wild swings of investments and returns. The presumption that this cobweb phenomenon may in fact occur, and not only in pig production but in higher education (and not only in the US as analyzed by Freeman (1976a) but in Hungary as well) has been rendered probable by conclusions drawn in *Kertesi and Köllő*'s recent (1999) study of the return of higher education and the proportion of continuing studies in post-socialist Hungary.

On the other hand, consumption theory seems to be suitable enough to explain the secular rise in demand for education: like other normal "consumer goods", demand for school as a consumption service grows in line with rising real incomes. For an interpretation of this kind it is paradoxically Becker's path-breaking work (1960) on demographical economics that may offer an example: for the purposes of modelling the family planning decisions of households in industrialized countries he considers offspring (although the decision to have children may be influenced by fear of deprivation and poverty in old age) as consumption goods and not as investment goods. (By contrast, in a recent economic explanation of over-population in the Third World, *Dasgupta* (1993) regards households' decision to have children as an in-

vestment dictated by the sheer need to subsist, which is in turn maintained by the resulting over-fertility itself.) In the case of other phenomena, such as when human capital investment happens in the form of short courses completed in order to change jobs, the deployment of the theory of human capital is like breaking a butterfly on the wheel; the no less elegant but perhaps less sophisticated theory of compensating wage differentials, also directly originated from the economics of Smith (1776), will do perfectly; moreover, the theory of consumption demand is at least as convincing as an explanation of the negative relationship of university tuition fees and the demand for higher education as is the human capital theory. There is one thing, however, that must be avoided: the obviously indefensible implication that the theory of human capital promises a theoretical assessment of the economically optimal amount of education in a given country at a given time—in a way similar to an assessment of the optimal amount of investment in pigs and pigsties—ignoring the non-investment, personal consumption aspect of education—i.e. its resemblance to pork eating or keeping pigs as pets. By confessing my reservations with the theory of human capital my main aim has been to call attention to such abuses of theoretical orthodoxy more emphatically than Júlia Varga's The economics of education does.

Attention, pig farmers, pig lovers and pork eaters! Studying Júlia Varga's The economics of education may turn into a profitable human capital investment for those working in the education branch. It is certainly a good read for anyone who (I quote from the author's Introduction to the book): "...are simply interested in what economics may contribute to education policy disputes".

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I. R. GÁBOR

HALPERN, L.—WYPLOSZ, C. (eds): *Hungary: Towards a market economy*. Cambridge: Cambridge University Press. 1998. xx+390 p.

The editors of this volume, who are both economists of international standing, have put together an excellent collection of essays on the second phase of economic transformation in Hungary. The "Hungarian *problematique*" has always featured prominently in professional literature, as was the case even before the start of economic and political transformation; both Hungarian and international economists have followed closely the transition process in Hungary. This notwithstanding, the present volume stands out with its valuable insights into the specific features of the Hungarian economy in the 1990s and thus it is an important contribution to the literature on the transition from plan to market in general.

I must confess that I opened the volume with some apprehension, given that the allusion to the well-known book *Hungary: An economy in transition* (I. P. Székely and D. M. G. Newbery, Eds., Cambridge University Press, 1993) is inevitable. However—to the full credit of the editors and of the contributing authors of the new volume—with every page of the book it became increasingly obvious that here was a book with impeccable and genuine merits of its own. In fact, Halpern and Wyplosz have not tried to escape the allusion—in fact, they are not afraid of it; rather, they have wisely and innovatively built on the success of the previous volume.

The list of Hungarian authors (all chapters were written by Hungarian economists) represents a carefully matched balance between established and familiar names and some relatively less well-known but very promising, younger Hungarian economists. The list of international authors (who have contributed discussion notes to each "Hungarian chapter") is even more impressive: it includes acclaimed international economists who specialize in the economics of transition.

There is nothing particular about the way the volume is structured (it contains more or less the traditional cocktail of macro- and micro-economic topics, mixed for more flavour with a policy-*cum*-institutional polemic). Nevertheless, the topics of the chapters are well selected and balanced and they do provide a broad overview of some of the most important and interesting features of the Hungarian economy, which has now been approaching a market economy for several years. Indeed, both the topics and contents of practically all the chapters reflect fairly precisely the title of the volume: they present convincing evidence that the first phase of transition in Hungary is over; however, it is shown that there is still a long way to go before it reaches the state of a developed market economy.

What is perhaps most impressive is the very high quality of *all* the selected studies—this has resulted in the volume being of outstanding quality. In this respect the book is a rare exception among the growing body of edited volumes on transitional topics (many

of which have, unfortunately, became infamous for the uneven quality of individual contributions). In this volume I cannot mention even a single study that could be regarded as being weak or, for that matter, that would not merit publication in a respected journal.

Furthermore, the volume is indicative of the progress which economic research has made in the course of transition—both in terms of the methodological approach and in terms of the depth of the analysis; in general, the book presents a mature and sophisticated insight into the range of topics selected. Some of the chapters, on macroeconomic themes, especially *Chapter 3* by *B. Világi and J. Vincze* (on monetary transmission mechanisms) and *Chapter 4* by *I. Hamecz, J. Vincze and I. Zsoldos* (on the nature of inflation in Hungary), are really innovative within the stream of transition literature.

Among the other studies I am tempted to single out (not at the expense of the rest of the volume and probably due to my subjective preference!) the respective chapters of: *L. Halpern and G. Kőrösi* (which presents a rare analytical perspective on Hungarian corporate performance, pre- and post-transition); that by *J. Koltay* (containing a rather unconventional view on the nature and function of the minimum wage in Hungary); and also the study of *Á. Ábrahám and G. Kertesi* (which focuses, in unusual detail, on some specific demographic aspects of Hungarian unemployment which are sometimes not mentioned in public discussion).

This is not to say that there is nothing in the volume which deserves discussion. In fact, reading a number of the chapters (including some of those that I found most interesting) I realised there are many questions to be answered and actually they could serve as a good starting point for lively debates; not all the conclusions drawn by the various authors are convincing. However, what is indisputable is the professional approach and the impressive depth of the analytical insights that most of the authors of the volume offer to the reader.

Hungarian economists, who are famous for their scepticism with regard to the Hungarian economy, have been caught by surprise by the unexpectedly solid economic performance of Hungary in the late 1990s. Indeed, most of the studies in the volume were written in 1995, when Hungary was in the midst of a painful macroeconomic adjustment and success was still beyond the horizon. Hence (and regrettably!) the volume stops short of revealing the driving forces of the economic revival that followed. In fact, Halpern and Wyplosz have tried partly to make up for this by writing an extensive and more up-to-date introductory chapter. The latter is titled "The hidden Hungarian miracle" and it tries to go beyond the usual summary of conclusions of the chapters in the volume. However, in its original section, this chapter only outlines some hypotheses about the key factors of the (unexpected) subsequent economic success; however, these factors are not substantiated by in-depth analytical justification in the main body of the book. Obviously, the story of the "Hungarian miracle" is yet to be written.

On a more critical note, a number of studies in the volume could have omitted some unnecessary factual and time-specific details, whose irrelevance only increases with time. (One example is the rather lengthy discussion on the Hungarian pension system, viewed against the actual reform of the Hungarian pension system that followed; arguably, this part of the otherwise excellent paper on welfare reform by *I. Csaba and A. Semjén* might have been shortened in the editorial phase.) Also, some papers contain very detailed digressions with reference to the past. Such unnecessarily long accounts of pre-transition experience have little relevance to the main topics of the book (and which now only belong to economic history). Furthermore, as *Chapter 1* was obviously written last, it could have been kept more up-to-date (for example I did not understand why only some, and not all tables in this chapter were updated, given that the most recent data is available).

Notwithstanding these critical remarks, I would like to conclude that I consider the book as a big success and I think that it is essential for anyone who follows Hungary's most interesting road towards a market economy, as well as for those trying to understand some of the caveats and traps along this bumpy road.

R. DOBRINSKY

FERBER, K.: *A siker ára — Japán* (The price of success: Japan). Budapest: László és Társa. 1998. 132 p.

It was with keen anticipation that I picked up this book by Ferber. This was because I felt it was high time that someone—eventually a European woman—having spent several years in Japan, should reveal that the way of life in Japan is far from being a joyride and that the miracle does have its shadowy sides. My excitement grew even greater since I very well remember an excellent book I had read in the early 1980s (Jared Taylor: *Shadows of the rising Sun*, Morrow et Co., New York, 1983). The latter provided an insight into the darker sides of the so-called "Japanese miracle". Hence it seemed to me that it was a brave and praiseworthy venture for a new approach towards the topic, by a Hungarian. Moreover, the latest bad news on the Japanese economy, slightly overdramatized by a sensation-hungry press, has created a receptive atmosphere for a critical opinion for two reasons. However, the lasting and exemplary values of the Japanese model should be recognized and they can be followed by other nations and economies. As I see it, the model contained a lot of genuinely good values (like diligence, thrift, endurance, the priority given to group—e.g. family, company, country—as opposed to those of the individual, and also their long-term approach). Secondly, someone should have pointed out that, by modifying the mixed proportions of tradition and change, the Japanese were certain to be able to overcome their difficulties. By using the time-honoured trick of "let's break out from tight corners by making the best of it", the Japanese have been successful in such a way that they have gradually adopted the norms of the global community *and* preserved their own identity. At least, I myself regard this scenario as the most probable, and also the most desirable both for Japan and the world.

This book is quite a disappointment from a number of points of view. The title is vaguely worded and it does not live up to its promise—i.e. that it is going to account for the successes of the Japanese economy. The chapters of the first half of the book deal with Japan's "unfinished" past, its nation statehood, its relation to war and peace, its education system and the emergence of its bureaucratic administration. Having done this the author then indicates that "it is high time to find the answer to the question in the title; (sic!) what has been the price of success in the Japanese economy and society today?" (p. 73). She then states, (almost like some form of self-criticism perhaps?): "The answer can obviously not be found in this book only." Even after all this I still hoped that, at a later point, the book might say something about positive and negative experiences which could serve as lessons for Hungary. This hope was raised by the fact that Ferber poses a question with almost economic philosophical profundity: "Knowing the successful modernisation of Eastern Asian economies as well as the painful, socially irreversible damage and loss of the decade-long 'transition' of many a Central-European country, the question is unavoidable (sic); namely, what is the social price of market rationality and is there any guarantee for the players of the economy to act as market rationality actually dictates?" (p. 74). I must confess that, even later in the book, I did not find the answer to this question.

The other reason for my disappointment was that the text is full of vague wording, with linguistic and orthographic inaccuracies. The incorrect (and often unnecessary) use of semi-colons (see the above citation) and question marks at the end of indirect questions are frustrating. Furthermore, the unmatched sentence elements become annoying. [What did the editor do? Did the author reread the proof before printing? What shall we do with sentences like "Japan is an archipelago in Eastern Asia but (sic!) historically it is an Asian country" (p. 20), or "class-teacher relationships are arranged by the rules of sub- and superordination" (p. 45), "the technological operation of the company ...had been ensured by NTT's experts" (p. 66), or "parliamentary committee hearings of ministerial employees have no sanctioning consequences at all, this comes up with arrest by the police (?) only" (a footnote on page 92), and "except for the agrarian reform, all other economic organisations banned by the American occupation forces had been restored" (p. 107). How could the fol-

lowing two subsequent "stammering" sentences been put into print: "As for Asia, China was the first to introduce entrance exams for bureaucrats had been introduced by the Ming emperors in the 16th century. Japan, too, took over the basic principles of Japanese bureaucratic selection from China" (footnote No. 80 on p. 88). Has no one noticed that "social mobilisation" is not identical with social mobility (p. 89)?]

These inaccuracies are all the more conspicuous since (the author herself must have experienced it during her stay there) the topic she has chosen evokes *a priori* the notions of quality and preciseness. The multiple and mutual control of Japanese bureaucrats that results in faultless work, or the zero-defect production declared by quality leagues of Japanese processing industries, are all integrated components of the Japanese success; thus these features remain in the minds of foreigners who spend a longer period of time in the country. As for me, I will always remember how minutely my host—a Japanese professor standing much higher in the university hierarchy than me—worked on the Japanese translation of an English-language paper of mine, and how much care he took to ensure the exactness of the words he used.

The inconsequential use of Japanese and other foreign names and words is embarrassing. At one moment the transcription and order are Hungarian and then English in their form; then they are mixed in a unique manner. With regard to names, it is amazing how, categorically, Ferber pronounces the authors of certain sources as being the best in the field she has chosen for her research. At the same time, she has mentioned only one Hungarian name in the book: that of Papp István, a composer living in Sweden who also spent some time at a Japanese university (N. B. not at the Hitotsubashi as Ferber thinks but at the Chuo...).

Ferber, who spent four years in Japan, knowingly avoided the trap that awaits many. As she writes: "According to a Japanese proverb, after a week in Japan, one writes a book, after a month a study, and those who spend more than a year here, are unable to write anything on this very different world." (p. 19). She has undoubtedly contributed a few highly valuable analyses to Hungarian—Japanese research. One of them is the chapter with the title "State-owned or private" (pp. 65–74), where the author demonstrates "how profoundly the dimensions of private or non-private, i.e. state-run institutions (corporations) of the Japanese economy, differ from the concept prevailing in Europe and even more in Anglo-Saxon territories" and that "all state or authority-run companies in Japan are flexible with regard to their property relations, scope of activity and conditions (price, wages). Any private company may be transformed into an official one, just as well as state-run corporations may function as private ones". "These companies ...are not of a public nature since there is no kind of public control over them." "The whole of the sector which gives work to over one million employees is a highly important link functioning both economically and socially between the private sector and the bureaucratic state apparatus."

The March 1997 issue of *Külgazdaság* rightly published an abbreviated version of the chapter on "heavenly missionaries" from the state administration landing like parachutists in the private sector (pp. 79–101), given that it contains novel ideas. In it, Ferber makes an important statement: "Japan's political elite, including the economic one, has over the past half century preserved its elitist position on the basis of status, not property. As a matter of fact, the nouveau riche in Japan cannot become members of the elite even today." (Let me add that the egalitarian attitude of Japanese society is well reflected by recent surveys showing that over 90 percent of the population thinks of itself as a member of the middle class.)

Ferber deserves credit for drawing attention to Japan's Fiscal Investment and Loan Programme (FILP for short, or with a Japanese acronym ZTK). Traditionally, the FILP almost rounds off the central budget and I would liken it to a permanent supplementary budget (pp. 105–126). A discussion about the role of Marxism in Japan is a little bit out of place here, but the author borrows a thought from Brian McVeigh when she states that "... the efficiency of the Japanese state cannot be measured with its system of institutions or the number of people employed by them. The bureaucracy is small just because its rules and the in-

stitutional and traditional expectations they embody make the expectations in connection with the state clear and easy to oversee. The functioning of the Japanese state is efficient because it is not the visible institutions and rules that enforce the will of power groups. This is, however, nothing else in my view but a recognition of the fact that the principles of Confucianism still impregnate the society or, as the author remarks: "... the functioning of state institutions is efficient since, in the eye of individuals, it seems to be a 'natural endowment'." This is exactly why I cannot share the view which Ferber expounds in an earlier chapter, namely, "an image of Japan as 'harmonic' or 'conflict-avoiding' would be overly schematic. Another question concerns the sort of 'new' human features that might emerge in a Japan that is now in the process of the deepest transformation in its history, once creativity becomes more important and individual aspects are given priority over group interests. The explanation for the system of so-called 'indirect financing' in the context of the second budget is also useful for a better understanding of the mechanism of the Japanese economy. The chart on the last page of the book, though its source is not revealed, gives a vivid picture of the change in spending (and not resource-side, as it is indicated) priorities. It's a pity the book ends with the situation as it stood in Japan in 1981..."

It was not only the reviewer who felt that Ferber's book ended abruptly—she really should have given some sort of summary. The final note of the less than two-page long prologue—based on a vague citation without referring to its source—only adds to the reader's feeling of want. If anything, she could have mentioned the *pledge of* further *success*—i.e. that the much-heralded administrative reforms, such as deregulation or Big Bang, will have an effect only if introduced swiftly and not over a period of, say, five years.*

A. HERNÁDI

*This book review appeared incompletely for technical reasons in the previous issue of Acta Oeconomica. Now the complete text is published once more. (Editor's note)

WAGENER, H.–J. (ed.): *Economic thought in communist and post-communist Europe.* Routledge Studies in the History of Economics. London–New York: Routledge. 1998. 388 p.

A grand theme and an ambitious title. As we learn from the book's preface, the issues which prompted the research focus upon the role of economics as a science in post-war Central and Eastern Europe, recent changes of the respective economic systems of the countries of the region, and the reforms which took place between the two changes of the regime. In fact, the theme is narrower than the title would indicate. To cite just a few Hungarian examples: it has not been able to take into account János *Kornai*'s promising but discontinued anti-equilibrium initiatives, András *Nagy*'s equally disrupted survey of the international flow of products, the metrological studies of András *Bródy*, and Ferenc *Jánossy*'s schemes for reconstruction periods or of the origins of European capitalism. These economists did not have much to do with regime changes or reforms, but they were deeply involved with economic science and with economic thought. Another reference to a less broad perspective can be read in the author's introductory study, where he considers renowned economists of the region and their works in accordance with Mark *Blaug*'s history of theories. Blaug made a school by ranking economic theories and their creators according to the extent they are considered to have contributed to the emergence of the mainstream economics of our age (i.e. the '70s and the '80s). According to Blaug, the rest can be forgotten. It is easy to see that the method lets older ideas, or ones born on the periphery, seem as mere rivulets or dry river beds of intellectual landscapes avoided by the rain of Nobel prizes. Given such a point of view, the following conclusion seems only logical: "On the whole, it seems that the contribution of Soviet socialism to economics was, above all, negative in establishing the counter-example of more successful market capitalism" (p. 25). Comparativeness perhaps? No, because the author writes: "A similar fate has befallen the human capital of the Western specialists in comparative economics." (p. 25) In other words: its

repositories learned to read between the lines, and this is no longer needed. Of course, it was necessary at one time, and may still be needed—not merely for reading between the lines, but also to find out what economists, sociologists and other social scientists in Novosibirsk or Budapest discovered with painstaking research about the functioning of their respective economies (some of them are still exploring). Yet this collection of material has not covered the efforts of such researchers. Nevertheless, we will see that some of the authors have been unable to tell their part of the story without mentioning them.

The research which underpinned the book was organized and guided by the European University Viadrina, Frankfurt/Oder, Brandenburg, Germany, with generous funding from the federal government and the state's ministry of education. Teams were formed to compile material for chapters on ex-Soviet (i.e. Russian), Polish, Hungarian, Czechoslovak (Czech) and East-German economics, and (at the last moment) on the Yugoslavian experience. The first conference was held in 1994 and the preface of the book is dated March 1997. Hence research was conducted within a relatively short period. The authors were asked to write about the "cognitive pre-history of transformation" and to describe the latest theoretical trends. In his preliminary study, Wagener presents the relevant periodization, themes and theses; the latter focus on the question which considers why the socialist system could not be reformed. The authors of the subsequent chapters were, however, unable to follow these guidelines all the way; the material they worked with had seemingly resisted the attempt (and so did their extremely diverse approaches). As a result, the book is not boring: it is readable.

In the following, I will not deal with every chapter but the reader's attention will be drawn to less known, or completely unknown episodes and interrelations and wherever it applies, to conspicuous deficiencies.

Russians (Pekka *Sutela* and Vladimir *Mau*)

The first country study is quite a disappointment. The authors have failed to formulate the essence of the theories under survey, and they have also been unable to throw light on the political, economic and management situation that launched the theoretical work (or which caused it to be launched by higher ranking institutions and individuals). After Stalin's death—as a response to scholars dealing with theory—the situation was managed in a mainly voluntaristic way. It is, for instance, a nonsense to dispose of Viktor *Novozhilov* and Vasili *Nemchinov* so quickly, when in the '60s the former (together with *Kantorovich*) opened the way for the elimination of plan instructions by suggesting interest rates and allowances based on the shadow price of resources; the latter wanted to achieve a utopian unity of plan, statistics and management using a single system of multilevel computerized programmes. A similar misconception (shared by many a Kremlinologist) is the legend of Kosygin's reform in 1965. This was in fact a counter-reform, preceded by press debates, activities on the respective regional and company levels and high-sounding policy speeches. Yet, over a period of ten years the "reform" strictly divided the economy (i.e. branches and companies) into segments under federal, provincial and local control; it reorganized existing units of the economy with giant mergers and it created agrarian-industrial complexes (often doing away with the independent accounting departments of the former); finally, by winding up wholesale companies (bases) it created a uniform system of material and technical supplies and forbade companies (i.e. merged companies) to have direct (contractual) commercial contacts. No doubt this resulted in a significant drop in the number of central plan indexes and instructions. One does not know whether to laugh or cry when, at the same time, the authors call to account economists, of all people, for the absence of arbitrage and a capital market.

Weaknesses aside, the chapter has strengths as well. From subtle details and references there is a picture of Abalkin—perhaps the only clear-headed economist and economic politician of the '80s. He had a quite fixed concept of how the monster described in the aforesaid could, in ten or fifteen years, be turned into a more or less normally functioning market of goods and services (and in a restricted manner, of capital); this would have been some-

thing like the situation in Hungary in the early and mid-1980. Another important part of the chapter is where Sergei *Glaziev* and Pyotr *Aven*, two highly knowledgeable actors, reveal what the purpose of the Gaidar programme had been. The sterile programme, that had hardly anything to do with local realities, was conceived in the autumn of 1991 by a team of Russian and foreign experts working in isolation: "...since the governability of the economy had already been lost, the task at hand was the destruction of as much of existing institutions as possible, thus both securing irreversibility and clearing the road for a new institutional revolution." (p. 69). We do not learn from the authors if there was (or is) such a programme. The last part of the chapter deals with the renewal of economic science in education.

The chapter on Russia was at the front of the book presumably because the Soviet Union was not simply a world power of the postwar era but also the absolute leading force of the CMEA; the latter, in its heyday, united as many as ten countries. It was an example followed by most of the 25 to 30 countries that called themselves "socialist" and the Soviet Union was their economic ally. It is strange that this situation, and the relevant theoretical problems, are not referred to in the chapter; they are not even listed, although it was a highly important domain of Soviet economic thinking. What could have been considered by the authors are: the theory of communism (its scholars were pulled down to the earth by Stalin's 1952 study but it reemerged later as the transition to communism); the (economic) competition of the two global systems and, within it, the theory of two world markets; in connection with the CMEA, first the so-called international socialist division of labour (i.e. specialization and co-operation within branches, coordination of plans), and later socialist integration and its phases (i.e. long-term co-operation programmes and target programmes, joint planning).

Poles (Krzysztof *Porwit*)

We know from the preface that the Polish team was the biggest. The choice of Porwit to write the chapter was an excellent one: he is a contemporary of all protagonists from the prewar period to our days and also he is an author who is able to handle his material correctly. It is a pity that the chapter is rather long, (almost twice as long as the one about the Russian). It is true that, by Eastern European standards, Polish economic science had all along been producing "big names". Think of *Kalecki*, *Lange*, *Drewnowski*, *Bobrowski*, or Edward *Lipiński*—who, from the very beginnings of their long careers addressed the problems of socialism's possible economic system (many of them held the planned economy to be the most viable one). Moreover, they had been able to word their original constructions in the scholarly language of their age. Those who had emigrated and later returned with an international reputation, combined forces with their colleagues who had remained at home. They then irritated Communist governments which made the mistake of allowing them to head reform committees (as happened to Oskar Lange and Michal Kalecki in 1956–57) or to teach and carry out research. This resulted in two things. There appeared a young and restless generation (e.g. *Brus*, *Laski*) who were still left-wing and socialist but who relentlessly demonstrated the faults of the economy and the way in which existing socialism functioned. This often ended in conflicts and emigration. Then there was a next generation that elegantly, and with specific—very Polish—terminology, dealt with insignificant little reforms by taking them most seriously (like realistic raw material prices, and pseudo-reforms like border rates and other "parameters", which were mainly for the purpose of incentives and efficiency estimates). However, waves of crises in the economy and in society prompted some economists and sociologists to look deeper into the micro-environment of social conflicts and economic decay. Porwit deserves credit for introducing the reader to this fact-finding literature which, until now, had been unknown to the world but is certainly of scientific value.

In the light of the above it is no wonder that the 1981 reform proposals of Polish mainstream economists (e.g. *Pajestka*, *Mujżel*) hardly differed from the ones which had been made in 1956. The most important counter-

proposal came from a young team led by *Bałcerowicz*; it called for the liberation of prices, the control of the state's regulating function and for other democratic (parliamentary) procedures and guarantees. The government (Porwit does not mention Jaruzelski by name) introduced the first phase of the reform during the state of emergency; the second phase was to be implemented in 1987 and, according to Porwit, it would have been not far from the Bałcerowicz proposal with regard to support for private initiative, company independence and the development of banking institutions. The author of the chapter goes into (too many) details when dwelling on the debates during the system's last years, or on why there was a crisis and who was to blame. Yet, in years to come, researchers may be grateful for his thoroughness.

A sub-chapter is devoted to the literature and debates of the 1990–1996 period. This may be justified by the fact that the Bałcerowicz programme adopted in late 1989 by the Sejm, was quite ambiguous with regard to the nature of the economic system it was meant to create. In the beginning, however, debates-centred on the causes of the economic slump which was accompanied by a steep inflation rate, and also on the sequence and speed of reform steps; Polish economists living abroad, understandably, took an active part in the discussion. The chapter ends with a review of the "Strategy for Poland" (theses) attributed to Kołodko and with some excellent economic and sociological surveys of companies.

Hungarians (László *Szamuely*, László *Csaba*)

Of all the studies, this seems to be the most balanced and the best to read. This praise is considerable given that the authors had relatively few sources on the subject at hand; the majority of the few sources that are available cover short periods and even these have gaps. (As a matter of fact, this chapter has been expanded and published by the Közgazdasági Szemle Foundation in book form under the title *Rendszerváltozás a közgazdaságtanban — közgazdaságtan a rendszerváltozásban* (Transformation in economics—economics in transformation).

Szamuely's short retrospection at the head of the chapter on the position of Hungarian economic science before and during World War II deserves praise (even if it is inevitably limited in its scope). He also mentions some outstanding statisticians who were involved in the so-called "academic" science. He describes for whom and for what was the absolute caesura in the study of economic science—unprecedented even in the Eastern European region—which began as early as 1945/46 and took hold after 1948. Of possible causes, he mentions in the first place the role Hungary played in the war and the possible collaboration of leading economists, but this can hardly be believed.

A Hungarian reader is obviously more sensitive to the wording of a chapter on Hungary, which is not always fortunate. For instance, the "biggest civic party, the Smallholders' Party, which won the absolute majority of seats in Parliament at the general election of November 1945". (p. 24 in the Hungarian version) translates into "the biggest bourgeois party" (p. 162). This and some other adjectives throw a somewhat misleading light on the figures of István *Varga* and Jenő *Rácz*. Otherwise, this chapter which deals with the 1945–1978 period is concise and well-written. There are only two protagonists of the period missing: the influential István *Friss* who, in the debate 'reform of mechanism versus a proper economic policy', stood out for the latter; and Sándor *Ausch*, who attempted to draft outlines for a CMEA which could accommodate economic units (companies) of member countries experimenting with market reforms.

Both authors of the chapter are consistent in the sense that, in describing the background of economic debates, reform proposals and theory-making from 1968 onwards, they do not try to present some sort of "marketless" economy. Moreover, they have managed to provide a clear and focused picture of the various forms of "neither-plan-nor-market" in full awareness of the actual institutional backdrop (and its movements). This particular approach which they have adopted is especially handy in the sub-chapters "From the market under socialism to market or socialism" (pp. 181–191) and "Reforms beyond socialism" (pp. 191–200) written by László Csaba. At the

same time both authors, referring to the dominance of bureaucratic co-ordination, still regard the post-1968 Hungarian system as one of the versions of a "third model" of central planning, or in other words, of a command economy.

It is worth mentioning that the chapter, apart from dealing with the period before 1948, also gives a fair treatment to the most original Hungarian research—i.e. microeconomic (company) surveys which include sociological aspects of the theme; it also praises János Kornai's *oeuvre*. The enjoyment of the pages devoted to recent years is several times disturbed by unexpected, and sometimes vague assertion of a political hue; furthermore, the classification of contemporary researchers according to particular economic schools (is there at all a living neo-liberal economic theory?) is something which could have been left out of the study. The list of references and literature at the end of the chapter is excellent but it needs pointing out that the book by Tamás *Sárközy* published by *Közgazdasági és Jogi Könyvkiadó* and the one published in German by *Akadémiai Kiadó* are *not* the same.

Czechs and Czechoslovaks
(Jiři *Havel*, Jan *Klacek*, Jiři *Kosta*, Zdislav *Šulc*)

The chapter covers the years from 1945 to 1992. First we learn that here, just like in several other countries, the Communist party produced workers versed in Stalinist science through "crash courses", while long-time left-wingers or scholars who wanted to study planning theory, like Josef *Goldmann*, were simply imprisoned or, in some cases, executed. The profession began to recover in 1956, but not for long: the turning point was the 1964/65 crisis when works by Josef Goldmann and Karel *Kouba* on planning, growth cycles and on the rewording of Kalecki's growth theory were published. It was in 1968 that young Václav *Klaus*, as the *enfant terrible* of the Czech economic science, appeared on the scene. He avoided any contact with Marxist theory in his very first study. In 1964 the Communist rulers appointed Ota Šik as head of their reform committee.

The authors try to mention all the trends and debates of any significance and still place the Czechoslovakian reform programme among the reform tendencies of the period. The result is that distinctive characteristics of the original programme—like wages calculated on the basis of the residue principle, unemployment as an important instrument of market control, accumulation centralized by the state as a factor to be increased from above—all get somewhat lost in the process. The chapter does not mention that the very first company experiment had been preceded by an extensive concentration, and the implementation of the system had been accompanied by strikes and demonstrations; thus, early in 1968, significant changes had to be introduced. All these facts are somehow compressed, or hidden, in one sentence; yet, following the coming into power of the democratic-minded Dubček government "a growing number of economists were now searching for a solution that would take into account both the demand for democratization in decision-making at the enterprise level on the one hand and the requirement for efficiency on the other." (p. 227). At this point it is worth mentioning that in his Sankt Gallen exile, Ota Šik worked out a third way for Socialist countries.

As a matter of fact, the chapter on the Czechs gives a detailed account of economists who emigrated after 1968 and it duly describes foreign—Eastern and Western—influences as well.

The authors are of the opinion that, despite the repression following 1968 and the restitution of party bigotry, economic science survived in Czechoslovakia because there was still some room left for research: one could write studies for a closed—institutional—circle; others were confined to write "for their shelves" only, although their works were here and there discussed by professional bodies; again, others could take refuge in harmless professional jobs. This is the only chapter that mentions the contacts maintained with Western (American) colleagues and study trips abroad. Therefore the vague reform attempts, albeit weak as they seemed (there is a list of them in the chapter), and the upcoming generation were not totally unprepared for the turn; we have seen many a proof of these facts ever since.

East-Germans (Gunther *Krause*)

This story runs from 1945 till 1990. The approach of the chapter differs radically from the guideline for the whole book, as devised by the organizers; this is because Krause sets out from the premise that "interpreting the phenomena in the GDR exclusively as a prelude to its collapse not only leads too easily to one-sidedness, but also ≪introduces the danger of grossly ignoring the question of possible alternative courses within the historical constellation≫." (p. 264). A few pages later, however, we are told that GDR-economists "increasingly became convinced that economics in the GDR had no major impact on economic policy or the development of the economic system." (p. 266). Given these two theses, the author necessarily finds himself on a road where he gathers together considerable amounts of data to explain events that were less and less interesting, even for those who were protagonists in the overall process. It was their way of life. What was actually going on in their heads, if anything particular at all, we are not informed about. The lengthy story told by Krause implies that the scholars of socialist political economics in East Germany occasionally might or might not say or write something; these desultory efforts were then followed invariably by harsh reproach and, of course, self-criticism.

However, we know from the results—that is, from the time of the implementation of the *Neues Ökonomisches System* in 1962/63—that these economists had to scrutinize and dissemble the Soviet plan instruction system, along with its dual subordination and *hozrastschot*, in order to create a simpler and more clear-cut one. The "charm" in this was that the statistical data for the "revised" system's production associations (VVBs) corresponded without a hitch to the lines and columns of the national economy's input-output tables. Nevertheless, we are not told anything of this, nor do we learn how, around about 1970, the reorganization of the same associations into giant combines (that functioned along largely different coordination principles) was carried out. Given that none of these achievements could be attributed to this or that member of the Communist Party's politburo, it would have been interesting to have been enlightened on the subject of policy implementation.

While showering us with lots of data and bits of facts, the author keeps quiet about something which occurred in the 1980s: namely, policy-makers in the GDR suddenly found that under the latest development trends of the CMEA, their processing and machine industrial combines—as possible integrators of the joint development programmes—might help their country acquire extra benefits. Also, they thought that their own planning methods and control system could, after a little rewriting and simplification, become *the* practice of plan coordination (joint planning).

Since Gunther Krause does not have anything to say about the above, there is not much left for him to write about other than Helmut *Koziolek et alia* who published, and ruled, under the name *Autorenkollektiv*; he mentions Gunther *Kohlmey*, who started out as a sort of hero from the Freiburg school and who, by GDR standards, stumbled from one revisionism to the other. Nevertheless, the long list of literature may one day be useful for historians of science or ideology.

Yugoslavs (Vladimir *Gligorov*)

This last chapter should enable the reader to become acquainted with the development of economic thought in Yugoslavia. Alas, the author declares in the very first note that this is not his intention. In fact, there is not a word on the following pages on the biggest achievement of this country's social scientists: that is, the system of self-management ("organizations of associated labour"), along with market contacts (which were a specific form of dominant collective ownership). We never learn who developed it nor how it operated. As for the "father of denationalization", Edvard *Kardelj*, the first of his works referred to dates from as late as 1978. Where the short study begins—that is, "the second model of socialism"—suggests that an earlier system had long been in existence since the first sentence states: "The main subject of Yugoslav economics after World War II was systemic reform." (p. 329). It is true that the system was being reformed practically all the time, but scholars never actually questioned the foun-

dations of the system. The ones who attempted to do this became famous abroad. Those who stayed at home became hapless onlookers of economic processes right up until both the federation and system fell apart. This is where Gligorov's study starts to become informative (but not before he lists a full page of reforms from 1952 till 1988, and on a few more pages he reviews the main issues concerning the debates around them). The author finally arrives, in the second half of the chapter, at the key issue: i.e. the intellectual tendencies of the protracted period of decay, beginning with the so-called humanist Marxists rallying around the one-time Praxis in Zagreb, and continued with the expanding nationalist and leftist (or rather centrist) Socialist group. We learn that, over a period of time, trade had become more professional and practical, mainly under Western influence. Nevertheless, the liberal approach which prevails today did not emerge until the collapse of the federation. In this part we are presented with interesting details about how some economists worked together in order to justify the desintegration (eventually, every part of the country felt that it was them and only them who was being exploited by the rest). Thus, following the collapse, not untalented individuals set out to implement the tasks of the day; former major figures like Branko Horvat, tried to carry on with business as usual. The chapter is closed by an excellent list of literature; those interested can find the titles of the very works on the development of theory, the subject of which they might have missed in the study itself.

At the end of the book there are short biographies of nineteen outstanding economists who have been referred to. The most exciting of these is Miroslav *Toms* of Prague; at the time of his premature death at the age of 44 in 1988, he had created a school without having made a name abroad. Of the Hungarians, the biographies of János Kornai, György *Péter* and István *Varga* are included.

K. LÁNYI

Corrigendum

In the previous issue of Acta Oeconomica (Vol. 49, Nos 3–4) on p. 380 in the study by I. J. Tóth entitled "Inter-enterprise ownership links in Hungary" instead of *Table 3* a wrong table has appeared. Here is the correct table.

Table 3

Distribution of firms according to the number of their own enterprise (percent)[a]

Number of enterprises	Distribution of medium-size and large enterprises (FIRM96) with given amount shares			Distribution of the largest manufacturing companies (EXPORT96) with given amount of shares		
	They have ownership shares	Their share is over 25 percent	Their share is over 50 percent	They have ownership shares	Their share is over 25 percent	Their share is over 50 percent
None	–	27.0	43.0	–	28.4	40.0
One	36.6	34.0	25.0	42.1	30.2	35.1
Two	21.8	13.0	13.0	16.6	15.6	12.4
Three	13.9	6.0	4.0	13.7	11.3	6.1
Four	4.0	6.0	5.0	6.2	5.7	0.9
Five	6.9	3.0	2.0	5.8	0.8	0.0
Six of more	13.9	11.0	8.0	15.7	8.0	5.5
Total	100.0	100.0	100.0	100.0	100.0	100.0
N	101.0	100.0	100.0	102.0	95.0	96.0
Average number of firms	3.38	2.1	1.6	3.62	2.1	1.2
Standard deviation	3.71	2.7	2.2	4.52	3.3	1.6

[a] Among firms which had investments in other companies and answered the questions regarding their ownership shares.

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