ACTA OECONOMICA

PERIODICAL OF THE HUNGARIAN ACADEMY OF SCIENCES

AKADÉMIAI KIADÓ, BUDAPEST

VOLUME 49
NUMBERS 3–4
1997–98

ACTA OECONOMICA

PERIODICAL OF THE
HUNGARIAN ACADEMY OF SCIENCES

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Orders can be placed with Akadémiai Kiadó (H-1519 Budapest, P.O.Box 245).
Subscription price for Volume 49 (1997–98) in 2 double issues US$ 148.00,
including normal postage, airmail delivery US$ 20.00.

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Acta Oeconomica, Vol. 49 (3-4), pp. 243-269 (1997-98)

VULNERABILITY OF CURRENCIES—FINANCIAL CRISES IN THE 1990S

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This study is a summary of recent experiences in connection with currency crises, with special reference to the case of Hungary. First, the theoretical literature is surveyed, then a critical appraisal of former empirical findings is presented. The main part consists of lessons drawn from 14 case studies (Mexico, Chile, Argentina, Colombia, Thailand, Hong Kong, Indonesia, South Korea, Malaysia, South Africa, Turkey, Poland, Slovakia, the Czech Republic). The case studies are not reported here—they can be found in a National Bank of Hungary working paper. The main conclusions include comments about the diversity of experience, and the need to merge macroeconomic and financial market considerations when judging a country's vulnerability. The picture that emerges suggests caution is needed on many fronts.*

Survey of the theoretical literature

Theory of currency crises: From Krugman to Krugman

In this section the most influential models of currency crises and speculative attacks will be reviewed. The theory of currency crises has a rather rich literature and it is not the aim here to give a full review; thus only the most influential and characteristic models are mentioned. There seems to be consensus in the literature about the existence of two major families of models: namely, first and second generation models. The family of second generation models includes distinctively different models which might justify the creation of new categories. However,—as we argue later—developments in the 1990s indicate that the group of models which tries to explain currency crises is joined by new models after virtually every major crisis; in other words, this categorisation is no longer important.

First generation models focus on balance of payment crises and the collapse of fixed exchange rate regimes. Their main assumption is that there is some kind of policy inconsistency in the economy which finally makes the existing exchange rate peg unsustainable. In first generation models speculative attacks and currency crises are based on the inconsistencies among fundamentals; furthermore, there is usually a unique equilibrium when the peg is abandoned.

One of the earliest contributions to the modelling of balance-of-payment crises was that of *Krugman* (1979) who examines and compares the dynamic behaviour

*The opinions expressed in this study are those of the authors and do not necessarily represent the official views of the National Bank of Hungary.

of economies with flexible and fixed exchange rate systems. In his model, there is inconsistency between fiscal and exchange rate policies. Krugman assumes that money creation finances the budget deficit, and the accumulation of foreign money equals the current account balance. The discussion of the fixed exchange rate system concerns the dynamic behaviour of the budget deficit and of foreign exchange reserves. The budget deficit can be financed by drawing on the government's reserves of foreign money or by issuing domestic money. Since exchange rate pegging implies zero inflation in this model, the public will absorb only part of the new domestic money and will trade some of it for foreign money. Thus, maintaining the fixed exchange rate eventually becomes impossible if there is a budget deficit, and the fixed rate collapses when the government runs out of foreign reserves. Krugman shows that the attack will precipitate an unavoidable crisis, and its timing can be related to fundamental variables of the model.

The relationship between foreign reserve holdings and the collapse of a fixed exchange rate system is further developed by *Flood and Garber* (1984). They consider only the money and foreign exchange markets and make no assumptions about the budget or the current account. Flood and Garber present two examples: a continuous-time, perfect foresight model, and a discrete time model, with stochastic market fundamentals. The authors define the shadow exchange rate as the nominal exchange rate that would prevail if the currency were to be floated. If this is weaker than the pegged currency speculators can obtain arbitrage profits, and thus an attack will occur. This model was quite popular in the 1980s and it served as a basis for the empirical testing of first generation balance-of-payment crises, since it gave a rather plausible characterisation of the crises which occurred in the 1970s and 1980s.

Obstfeld (1984) uses the above idea to see how the expectation of a subsequent devaluation affects the timing of balance of payment crises. He uses Flood and Garber's model to link the respective dates of occurrence of balance of payment crises to the size of the expected devaluation and the length of a transitional floating period between two exchange rate pegs.

Another area of research in the field of first generation models is the modelling of speculative attacks with different assumptions about the level of foreign exchange reserves. Most of the first generation models (Krugman 1979, Flood and Garber 1984, Obstfeld 1984, *Calvo* 1986) assume that there is some binding minimum threshold level of foreign reserves which is known by the public and which has to be maintained by the central bank; thus, if the reserves are depleted to the threshold level, the central bank either devalues the currency or lets it float. *Willman* (1989) considers the possibility that the central bank might change the foreign exchange target before the minimum level is reached. He also reasonably assumes that this minimum level is not known to the public. This model was a good characterisation of currency crises when the pressure on the currency lasted for a longer period—e.g. with respect to the series of attacks on the Finnish currency in 1991–92.

The currency crises of the 1990s induced substantial changes in the understanding of currency crises. It became obvious that first generation models are unable to describe the reasons and evolution of some major currency crises and speculative attacks, including the 1994 Mexico crisis, the 1992–93 ERM crisis and the 1997 Asian crisis. With regard to some of the currencies attacked in the 1990s there was no apparent deterioration in the given economy's fundamentals and the attacks were, unexpectedly, based on the logic of first generation models. So-called "*second generation models*" were developed to explain speculative attacks in cases in which the exchange rate seemed sustainable for a long period of time, but was still attacked. The magic expression for second generation models is "self-fulfilling prophecies". In these models the future behaviour of policymakers is not unique and there may exist a path of fundamentals that is consistent with the existing exchange rate regime and another one that is not. If expectations are such that the inconsistent path is considered more probable by market agents, this may prompt a speculative attack; this becomes self-fulfilling and the currency is devalued even if the peg could have been maintained. Second generation models focus on the panic nature of speculative attacks. The main idea here is very similar to the famous Diamond-Dybvig (1983) bank panic model with a "good" (no attack) and a "bad" (attack) equilibrium. The panic (attack) is self-fulfilling: if everybody believes that the others are going to flee, then the flight is rational independent of what one thinks about the fundamental reasons behind the panic (attack).

Second generation models date back to *Obstfeld* (1986), but they became popular in the 1990s after the ERM and Mexico crises. In his model, Obstfeld assumes that fundamentals are consistent with the exchange rate peg, and if market agents assume that a speculative attack would not generate any changes in monetary policy (which is here characterised by the path of domestic credit), then the probability of the crisis is zero. If, however, market agents assume that an attack would result in domestic credit expansion, then multiple equilibria exist which are functions of subjective expectations about the collapse of the peg.

Calvo (1996) analyses a series of models, starting from Krugman (1979). In his second model a country runs a current account deficit, since it wants to utilise some newly discovered productive resource. If financing of the new project is undertaken by the domestic banking system, and the central bank is lender of last resort to it, then a bank panic is translated into a currency attack. In the third model reserve losses are temporarily avoided by bond financing of budget deficits. However, this may backfire depending on investors' expectations. The crisis can set in earlier, and the ensuing inflation can be higher than otherwise, if nominal government liabilities increase. In the next model the budget is balanced, but there is an expectation that a cyclical deficit will occur later. In this case nonlinear budget adjustment costs may lead to a self-fulfilling expectation crisis. The last model studies the role of the international financial community. Calvo studies a situation where international investors are well-diversified, but certain markets

are missing. Diversification leads to reduced incentives to collect information, and to discrete jumps in the reallocation of funds.

Flood and Marion (1997) present a stochastic fundamental model which builds on Flood and Garber's (1984) first generation model, but it is modified by getting rid of the linearity assumption, and non-linearity is introduced into the model by assuming there is a time-varying risk premium. The future variance of the exchange rate influences the spot exchange rate through the time-varying risk premium, so the probability of a crisis is higher if this variance increases. The non-linear and stochastic nature of the model is crucial because it makes multiple equilibria possible.

Another group of models (within the family of second generation models, but it can also be considered as a distinct group) approaches the problem of speculative attacks and currency crises from a different angle. This branch of the literature claims that models assuming a passive behaviour on the part of the central bank do not give a realistic picture about what actually happens during crises. These models do not suppose that central banks just watch the depletion of foreign reserves and do nothing, for it is assumed that the banks have the means to *defend the exchange rate peg by raising interest rates*. Thus, the real question is not *when* the central bank runs out of foreign reserves but *at what price* it is willing to defend the peg. The right approach is to assume that the central bank analyses the costs and benefits of defending and abandoning the peg. In theory, there is always an interest rate level at which it is more profitable to invest in domestic assets as opposed to foreign assets. Dynamically, it is obvious, however, that high interest rates cannot be maintained forever, since their maintenance is costly. This cost can take the form of increasing interest expenditures on the existing debt of the budget (countries with high public debt are particularly sensitive to this); it can contribute to a slowdown in economic growth (which is particularly important in cases in which the economy is in a recession anyway, or there is political interest in high growth). The central bank is also hesitant to maintain high interest rates in those cases in which private sector indebtedness is significant, and this debt bears variable interest rates (e.g. mortgage loans in many countries). It is obvious that the outcome of the crisis depends on who is able and willing to bear the costs of high interest rates longer: the monetary authorities or speculators. *Obstfeld* (1994) and *Bensaid and Jeanne* (1997) among others present models which formalise the above idea. The interest rate defence models were inspired mainly by the 1992–93 ERM crisis, when different European countries faced different constraints to raise their interest rates—e.g. Italy was constrained by its high public debt, the UK by the large share of floating rate debt of households, and corporations in France were hindered by slow economic growth.

The 1997 Asian crisis provided incentives for a reconsideration of the theory of currency crises, since this crisis could not be explained by either of the existing models. *Krugman* (1998) relates currency crises to asset price bubbles. Asset

price bubbles can develop for many reasons, apparently without any good reason. In this case they are based on the optimism of investors who believe that they could, at least for some time, live in a panglossian world. What does this mean? Normally, investors consider things like expected yields and the variability of yields when pricing investments. However, in special circumstances they can behave as if only the best possible outcomes should be considered. This might happen if they feel insured against losses via implicit government guarantees. However, there is a serious problem with guarantees. They cannot be unlimited. Guarantees cannot be fulfilled if the whole economy suffers losses, for instance. If the insurance system is shaken, investors would like to flee as quickly as possible as the market sentiment turns into excessive pessimism. Whereas in the first stage asset prices were unreasonably high, later they fall precipitously. Capital tries to leave the country and everyone believes there must be a devaluation to make the asset price correction effective. This is the East Asian story, where financial intermediaries were considered to be guaranteed by the states; this charmed foreign investors into advancing ever larger amounts of loans to the private sector in these countries. With the occurrence of adverse systemic shocks the trust of investors, rightly, staggered, and a capital flight ensued.

Corsetti, Pesenti and Roubini (1998) give a detailed account of factors which they believe led to the Asian crisis, as well as an interpretation of the events. Building on Krugman's (1998) idea they develop a model which incorporates the moral hazard problem (taking into account the implicit bailout guarantees) which lies at the heart of the Asian financial and currency crisis.

One can observe that each model presented above focuses on specific crises or a type of crisis. The comparison of speculative attacks and currency crises in the 1990s shows that reasons behind, and the dynamics of attacks may differ substantially, and the different model types explain different crises. Although the literature on currency crises is getting more and more extensive, the new models usually lag behind events. As noted above, models emphasising self-fulfilling prophecies were developed[1] and became popular after the 1992–93 ERM crisis when some of the currencies attacked (e.g. the French franc) seemed to have no fundamental problems. The 1997–98 Asian events also indicate that speculative attack models are mostly *ex post* justifications rather than predictions (Krugman 1998).

There can be little doubt that currency crises are complex events, and it is difficult to put crises into "clean" model categories. Speculators are becoming increasingly sophisticated due to the integration of capital markets and to technological developments. Consequently, their potential to take advantage of profit opportunities by attacking vulnerable currencies is enhanced. It is also likely that the characteristics of foreign exchange and capital markets (the micro structure of

[1] With the notable exception of Obstfeld (1986).

the market) have a significant influence on the outcome of attacks (this also seems to be true for exchange rate behaviour in tranquil periods).

One may ask whether there is actually a "need" for a universal model (that is, one which is able to explain each type of speculative attack and currency crisis). Currency crises can be compared to other catastrophic changes—for example, death. There are numerous causes of death but there is no point in trying to construct a general model of death. This, however, does not mean that the systematic and general (theoretical) investigation of certain frequent, typical death cases is unnecessary or useless, because it helps recognise "danger" in concrete cases even if the circumstances are idiosyncratic.

The empirical literature

The empirical literature has sought answers for several questions concerning currency crises. One branch of the literature focuses on the credibility of pegged exchange rate systems and the problem of devaluation expectations. *Blanco and Garber* (1986) tested the model of Flood and Garber on Mexican data for the period 1973–82. They derived the probability that the peg would collapse in $t+1$, and they also obtained the expected value of the new exchange rate together with confidence intervals. Using quarterly data they proved that there was always a devaluation when the shadow exchange rate (see previous chapter) was higher than the fixed rate at the end of the previous period. One-month ahead devaluation probabilities were highest during the months of actual devaluations and thus the model performed quite well.

Frankel and Rose (1996) provides an example of a cross-country analysis. On a sample of more than 100 developing countries for the period 1970–1994 the authors estimated crisis probabilities. Real exchange rate overvaluation and recession were the real variables found to be mainly responsible for crises. Among financial indicators excessive domestic credit growth and a drop in FDI appeared to be most relevant. They emphasised the role of "northern" interest rates, while they pointed out that it was curious that the current account and budget deficits seemed to be unrelated to crises.

Eichengreen, Rose and Wyplosz (1997) conducted another cross-country regression analysis to study the phenomenon of contagion. They found that contagion was important, and could be attributed more to trade relations than to macroeconomic similarities.

Another group of researchers have applied non-parametric statistical methods to identify early warning indicators—i.e. variables that "emit signals" well before the occurrence of a crisis. The method roughly consists of the examination of a large number of variables to see whether they behave normally or exceptionally in a

period running up to a crisis. Exceptional behaviour is taken to be a warning signal. Then it can be calculated how many times some indicator is signalled correctly, and how many times falsely. Using this methodology *Kaminsky, Lizondo and Reinhart* (1997) examined 75 crisis episodes between 1970 and 1995. Their results defy easy evaluation. Nevertheless, the authors selected the following indicators as being the best: slowing of export growth, unusually large deviation from trend by the real exchange rate, high M2/reserves ratio, output growth slowing down or output falling, and declining share prices. Again it is interesting that neither the current account, nor the structure of foreign debt seem to be reliable signals. It is stressed that a good indicator system must contain a number of variables, rather than relying only on a few. *Kaminsky and Reinhart* (1997) combines this sort of analysis with the investigation of banking crises. They found that banking crises can help to forecast currency crises, but not vice versa. Banking crises are frequently preceded by financial liberalisation and large capital inflows. In his summary *Goldstein* (1997) underlines that interest rate premia usually do not forecast crises well; thus it seems that capital markets do not factor in devaluation expectations with regard to financial asset prices.

There exist many examples of less formal analyses, such as graphical analyses and case studies. Among more recent papers *Calvo and Mendoza* (1996) stated the idea according to which financial vulnerability can be measured by the ratio of M2 to international reserves. *Dornbusch, Goldfajn and Valdes* (1995) put real exchange rate overvaluation into the centre, as a crisis determinant. They emphasised that real exchange rates are policy variables in the short term and that, because of price rigidities, overvalued exchange rates can be corrected only via devaluation. *Bordo and Schwartz* (1996) overviewed many historical crisis episodes, and concluded that in each case there was some inconsistency between the fixed exchange rate and fundamentals.

Many empirical works have been based on graphical analyses and on case studies. By their nature their conclusions can better be regarded as guesses, rather than well-founded hypotheses. Cross-sectional regression estimates have been frequently criticised as being overparameterized, given that the efficiency of estimation hinges on improbable assumptions. As crises are inherently non-linear phenomena, good quality estimation requires a high-quality and large database; this is not the case with non-experimental macroeconomic series. The fundamental critique of the early warning signal methodology can be found in the work of the authors themselves. If there exists some indicator that predicts danger very well, then it is plausible that governments take preventive action, and in many cases crises would be avoided. Thus, the best indicators often fail to signal crises according to this methodology. The above remarks suggest that one should treat the results of empirical analyses of currency collapses with substantial caution.

However, one can derive some very robust, but not necessarily sharp lessons, from the set of empirical studies. Any system of crisis indicators should include a

wide variety of variables. This "conclusion" is a corollary of two premises: 1. Nobody has been able to find very clear-cut results concerning the best signals of crises, 2. Better safe than sorry. With regard to individual variables, most studies underline the importance of real exchange rate overvaluation. However, because of the uncertainties surrounding the measurement of the concept, this seems to be retrospective wisdom. The maturity structure of debt has not proved to be very significant, which is something which seems to contradict common sense. This is also the case with the surprising finding that large budget and current account deficits have little to do with currency collapses. Recession and weak export performance, however, appear to be good indicators. Yet these may only be signals that the real exchange rate is overvalued. Another potentially interesting finding has been that interest rate premia are not very good predictors of crises, and they frequently gave misleading signals. This can also be explained by the assumption that increasing premia signal trouble for governments, and this leads to preventive action.

There exist significant differences in opinion as to whether crises are always fundamental, or whether self-fulfilling prophesies have occurred. In verbal analyses it is not too difficult to find some fundamental reason, as no country is perfectly "healthy". On the other hand, statistical methods can easily lead to the conclusion that there is some kind of "non-fundamentalness"—the only trick is to misspecify the set of fundamentals. Another facet of this problem is that contagion seems to be very difficult to distinguish from common causes.

The above remarks point to the weakness of one-dimensional approaches, and the hopelessness of multi-dimensional methods. Thus, our opinion is that, despite its obvious shortcomings, the most reasonable empirical approach is still via analysing individual cases in comparison with other cases.

Lessons from case studies

1. Macroeconomic indicators and crises

Summarising theory, one can say that a currency crisis will occur whenever expectations are such that, without intervention, the exchange rate will depreciate sharply. This event could be the result of many scenarios, depending on government preferences, and on the behaviour of market participants. Every attack has the flavour of a vicious circle, and each seems to indicate that there are specific causes.

In the following we consider the behaviour of some macroeconomic indicators in our sample. We will see that one cannot rely (mechanically) even on the most plausible indicators. This should not be interpreted as proof that macroeconomic conditions are irrelevant for vulnerability. Rather, we believe that it is necessary

to evaluate the macroeconomic situation in a complex way, and in addition, certain microeconomic features (the foreign currency market, the banking system) must also be taken into account. On the other hand, we want to stress that forward looking expectations may be more and more germane to the origin of crises. Past indicators may not always be the best indicators for these, especially as expectations concerning the behaviour (reaction function) of the authorities are an absolutely inextricable part of the story.

Economic growth

Empirical investigations have usually indicated a very important role for recessions and weak export performance, respectively. The conjunction can be understood if we realise that poor growth is frequently correlated with a slowdown in exports in small open economies. At times of recession governments are likely to delaying painful adjustment, and weak exports are frequently a sign of an overvalued currency. On the other hand, large import growth and current account deficits can signal that there might be a dynamically growing economy which is in the process of catching up. Sustainable current account deficits must be higher in countries that have better growth prospects and/or attract a relatively larger amount of FDI. The same current account deficit might seem to be less of a burden in a country with high export growth, as it might indicate that the country's international competitiveness is good enough to enable it to service external debt in the future. A recession can result in a crisis even without a previous period of debt accumulation. In a sick economy domestic investors may contemplate capital flight. Of course, from the creditors' point of view, a deterioration in GDP growth prospects is more dangerous if there is a larger original level of indebtedness. Thus we can expect that countries with large debts and also in a recession are particularly vulnerable to attack. In a downturn the costs of defending the currency, via increased interest rates, are higher. Thus the probability that the central bank will be willing to oppose an attack is not so great.

However, looking at concrete stories, one can find that relationships involving growth can be quite complex. For instance, Mexico's growth rate was the highest in 1994—i.e. just before the crisis. However, this growth relied on fiscal expansion. According to growth indicators, Chile should have been more vulnerable than Mexico, and Argentina was less to be threatened by the Tequila effect than Chile. The economy of Hong Kong was less healthy in 1995 (when an attack on the Hong Kong dollar was easily repulsed) than it was in 1997, when the situation was more menacing. On the other hand, the recession which hit Finland was crucial for indicating the incredibility of the markka's peg, and the slowing down of growth in Thailand was a sign that the age of very high growth had come to an end. Similar

was the case with the Czech Republic, which suggested that, for the markets, the peg of the crown would in fact entail real losses.

Savings and debt

Classical attacks affecting developing countries were usually debt crises, where expectations implied that debt would not be honoured without a major devaluation. Among the more recent crises Mexico, Turkey, and—somewhat surprisingly—South Korea and Indonesia, belong to this group. In the case of Mexico default risk was perceived by the markets to be very high at the apex of the crisis, whereas with the case of Turkey in 1994 the enormous deficit could not be financed except alongside very high inflation, implying devaluation. The Turkish road to crisis is clear whereas, in the case of Mexico, "appropriate" policy reactions must have played a very important role, as the response to the initial capital outflow seemed to indicate excessive confidence. In the more recent cases of Indonesia and South Korea, the respective governments were effective in creating a crisis in several ways. First of all, implicit government guarantees, and the illusory assurance of exchange rate stability, led to an enormous increase in private foreign debt. Secondly, the governments tried to conceal the problems and this led to a collapse of trust at the moment of truth. Thirdly, after they turned to the IMF they again attempted to soften agreed-upon reforms, resulting in an absolute evaporation of faith.

On the other hand, many (or most) crises do not appear to have been unavoidable. Rather, they represented a manageable way of resolving certain problems. For instance, in the case of the Czech Republic micro and macro reforms may have prevented the eruption of the crisis; however, these were lacking, possibly due to political events. In fact, the attack on the currency prompted the reform process. A very similar interpretation can be given to many of the 1992 ERM crisis episodes. Many currency crises can be regarded as being the results of cost-benefit analysis by governments: i.e. whether it is more costly to defend the currency, or to leave exchange rate determination to the care of the market.

The diversity of the character of crises can explain some of the strange conclusions of the empirical literature. These studies have not usually been able to find a place for indicators related to macroeconomic sustainability (internal or external debt, current account and budget deficits). Likewise, the maturity structure of foreign debt has not proved to be significant. There were several examples among our cases when debt definitely had an important role (e.g. Turkey, Mexico, Thailand, South Korea, Indonesia). At the same time, these cases suggest that crises are not just caused by past accumulated debts—it may be sufficient if agents recognise that, without adjustment, past events would necessarily result in a debt problem. Putting off adjustment is not necessarily unproductive, but open capital markets

waiting in vain for "good news" eventually have one outcome: an attack on the currency.

Before 1997 there was a widespread notion that high domestic savings rates could stabilise a country even if large inflows and increasing indebtedness were the case. Practically all East Asian countries exhibited very high domestic savings rates but, on account of even more astronomical investment rates, there was also substantial borrowing. Therefore, one possible lesson from 1997 is that high domestic savings rates are simply not enough to stem the problem.

It is a widespread view that if a country has a large short-term foreign debt, then it is more vulnerable to speculative attacks. Indeed, this factor has been very important in some crises (such as in Mexico in 1994). Before these attacks, the short-term foreign debt-GDP ratio significantly increased in Turkey and in the Czech Republic. *Ex post*, it turned out that it was very significant in the respective Indonesian and South Korean crises. However, the size of short-term foreign debt was not at the time publicly known in these countries. One may guess that the increase in short term debt did not result in a panic by lenders, but rather it led to a fear of devaluation, which urged borrowers to hedge their foreign currency exposure; this consequently exerted pressure on their domestic currency. In other words, the issue was not simply large short-term debt, but large, short-term, uncovered foreign exchange denominated debt. There was an increase in short-term foreign indebtedness after the Mexico crisis in Chile and in Colombia, countries relatively untouched by the Tequila effect. On the other hand, in Argentina and Malaysia, which were exposed to serious attacks, a reduction occurred in such indebtedness. (Note: both countries were rather successful in defending themselves, at least in relative terms.)

Here again we find a case in which interpretation is difficult. In most cases the increase in short-term foreign debt is an epiphenomenon, rather than a cause of crisis. Firms which start to have financial difficulties have to borrow to make up for lost profits; furthermore, creditors are less and less willing to advance funds for longer maturities because of the increasing default risk. Our assumption, concerning the role of short-term foreign debt, is the following: Relatively high short-term foreign debt can be compatible with otherwise bad and good fundamentals. However, if there is an attack, and fundamentals are bad, then a higher level of short-term foreign debt would probably lead to a more serious attack, and a more hopeless defence.

The above means that treatment aimed at short-term debt would be ill-advised. The increase of shorter term debt can be, however, a good warning signal that an increasing number of enterprises and banks are not able to refinance themselves with longer term borrowing. Nowadays, it is fashionable to invoke the Chilean experience that capital controls, making short-term flows more costly, can be a very efficient way of reducing vulnerability in a preventive fashion. However, it seems that this focus may be misleading. Capital controls appear to be more

effective against weaker market participants, and those investors that have access to substantial credit lines and have a lot of established business relationships in the country in question circumvent them more easily. Thus capital controls may serve as nothing other than an obstruction to the way of escape, or they make risk-management by those agents (that are, in any case, more prone to be unreliable and this can be fully justified. Of course, a wider set of capital controls may make it more effective, but then we are back to the basic problem: is it worthwhile to prevent capital flowing freely across borders or not? If we believe in efficiency arguments in favour of free capital flows, then we have to search for other ways to reduce vulnerability.

2. Contagion

Fast international transmission plays an outstanding role in recent crises. An important aspect of this is the similarity between the structure of exports, that has been very influential in the East Asian crises, since those economies competed on the same markets to a large extent. Policy similarities were also a characteristic of these economies. Practically all of these countries managed the exchange rate of their currencies and the pegs were more or less to the US dollar. According to estimates, the unpublished baskets contained the USD to the extent of at least 75 percent in each respective country. These similarities predestined them to undergo the same types of shock. In such circumstances one devaluation might make necessary the devaluation of related currencies in order not to lose competitiveness. (Eichengreen, Rose and Wyplosz 1997). To reduce vulnerability a well-diversified export structure appears to be imperative.

Contagion might occur through the financial markets as well. It might happen that speculators get rich through successful attacks on some currency, and want to use part of the profit for further attacks. In such circumstances a country with somewhat vague fundamentals might become a victim, though otherwise it would be left unattacked. (A good example is that of Argentina in 1995.) Another instance of financial contagion is proxy hedging. If an attacked currency's market has no liquidity, investors may hedge in a correlated currency, causing by this an attack on a country whose fundamentals did not justify this.

Thus, during global turmoil one has to be careful even with fundamentals that in normal times would not give reason for any concern. This is one additional reason why it is risky to delay macroeconomic adjustment (for instance letting a high current account deficit develop, or the real exchange rate appreciate for a long period) since globalisation has increased the chance of crises spreading over to many countries. The 1990s were characterised by regional rather than isolated crises (ERM, Latin-America, East Asia). However, there have been cases of positive

contagion—that is, there have been countries whose currencies have served as safe havens, like Chile and Colombia at the time of the Mexican crisis.

3. Market microstructure

Apparently currency markets exhibit such positive feedback mechanisms that lead to excessive swings in exchange rates. Thus, it is essential to examine the participants in these markets. In developed countries and in some of the emerging markets the number of transactions towers over the reserves of all but a few central banks.

Most important market participants:

Banks and securities firms, usually in the role of market makers. They possess a lot of information, and their open position at the end of the day is normally small. Their goal is not speculation; rather, they increase liquidity and advise other participants.

Non-financial corporations, that buy and sell currency usually to support their international operations. The treasury of larger companies can be very sophisticated and can transfer substantial sums.

"Global hedge funds", that are very highly levered and whose main activity is speculation. Their actions guide the actions of other participants and there is a sense that these are the first movers in the event of an attack.

Investment and pension funds, that for diversification reasons hold some of their assets in foreign currency-denominated securities. In the case of a weakening of the currency they may react rather quickly and can move huge sums.

Central banks, that intervene in order to manage the exchange rate, but can carry out active portfolio management as well.

Among the above participants hedge funds are regarded as those that can initiate an attack, but larger banks can do that as well. Other participants are either defensive, in the sense that they try to cover their open position if they fear a devaluation, or they can join an attack if they hope there is a chance to get profits. Central banks defending their currency essentially make it possible to have transactions even in the case of one-way expectations, i.e. when everybody expects a change in the same direction. There also exist finance- or liquidity-constrained agents that are forced to do certain transactions even if their expectations do not justify this. These include mostly non-financial corporations and households.

It might be worthwhile to talk about the specialities of derivatives markets, as currency derivatives belong to the most liquid ones. The deeper the market the more instruments agents have access to launching an attack. In addition liquidity and depth may make a currency prone to be used for proxy hedging (see above). Many central banks have intervened on the forward market, which is quite dan-

gerous in that this generates contingent liabilities, and in the case of failure this leads to enormous losses. Forward intervention reduces transparency, too, since official reserves do not reflect the correct reserve position of a country. Mexico is an outstanding example of regular forward intervention. Since August 1996 currency derivatives in Mexico have been the main vehicles for managing the exchange rate of the peso. Mexico wanted to replenish reserves without interfering with the spot exchange rate. Thus, the *Banco de Mexico* auctions dollar put options every month (in increasing amounts) for commercial banks, who practice the option, obviously, when the peso appreciates unexpectedly.

So far the Mexican experiment has been regarded to be as successful, but generally it is advisable to intervene in the forward market only if the central bank is confident that the forward market is liquid enough, since at the time of a crisis they can be squeezed and this results in a deterioration of the situation. Some Asian central banks have used, with deplorable effects, the forward intervention for crisis-aversion purposes. Great attention has been drawn to the case of the Bank of Thailand. The latter sold forward almost all of its foreign currency reserves, holding it in secret. At the time of the June attack it transpired that the actual amount of reserves was sufficient only to cover two days of imports, and the fate of the baht was sealed.

The unfortunate outcome of the Thai forward intervention received high publicity. The lack of transparency problem has emerged in other cases, namely during the Mexican crisis of 1994. At that time the *Banco de Mexico* was unwilling to publish certain data (e.g. the amount of foreign reserves), at prespecified dates. Holding back data had very negative consequences. Markets draw the conclusion, rightly, that the figures spelt danger, and acted accordingly. The fear of hiding or falsifying data might have had an influence on the Indonesian and South Korean crises in 1997, when the reported rate of increase in foreign debt was astonishing.

Another development of derivative markets is that non-delivery future currency contracts have recently gained ground. Central banks do not like these, as they make intervention more difficult, and serve as independent judges for the future of currencies. Currency options raise the problem of dynamic hedging. In developed markets hedging is frequently done via the creation of a so-called "synthetic put". If a weakening currency is defended by increasing interest rates, the dynamic hedging formula orders the automatic selling of the currency. This means further pressure on the currency. The effectiveness of interest rate defence depends eventually on which effect is the stronger: the losses of those squeezed by the interest rate increase (they have to close their position and cannot speculate against the currency), or the effect on dynamic hedgers. In the ERM crisis the dynamic hedging problem was important in Italy—it seemed that the defence of the lira suffered a lot because of this.

It remains a problem as to how we have to evaluate the role of derivative markets in currency attacks. Without doubt levered speculation is made easier

with the help of derivatives. However, every deal has two sides. In the case of speculation the partner must be either a speculator with opposite beliefs, or an arbitrageur. In the first case it is not really an attack. In the second case there must be someone else with whom the arbitrageur can make another deal in order to hedge his position. Short of an infinite chain, we have to stop at some place. This place must be the central bank, eager to manage the value of the currency. Thus derivative markets coupled with central bank intervention are more dangerous than they appear.

On the other hand, forbidding constraints on derivative trading can be circumvented and there exist other channels of speculation (see the case of the Czech Republic). Also, there are participants in derivatives markets other than currency speculators, for whom these markets serve as insurance against exchange rate risk. To forbid such actions might result in two outcomes for them: they do not take on open foreign exchange positions, (which is constraint on the efficient allocation of resources) or, if they do, then they may react very nervously to "bad" news concerning the exchange rate. Making organised derivative markets costly might pose a problem for those who are usually not active attackers during a crisis. It is not impossible that the relatively immature financial markets might have prevented the hedging of currency risk for Korean enterprises, and deteriorated the situation when expectations turned for the worse.

4. The banking sector

Many currency crises have been preceded by large capital inflows. This happens usually, though not always, through the intermediation of the banking sector. The whole process might entail threats for the banks for various reasons: asset price bubble, large open positions, excessive credit expansion, extreme liquidity transformation.

When asset price bubbles burst, bank profitability can suffer considerably because of sharply increasing defaults. Looking at stock price indexes one can see that in many countries there occurred a substantial fall in prices in 1994–95. However, crises set in only in 1997. Thus bursting a bubble would not necessarily lead to a banking and currency crisis. In the very significant case of Thailand the bursting of the bubble was followed by a period when banks could get away without cutting their losses. When it was not possible anymore, the banking and then the currency crises ensued. Thus, it was not the bubble itself, that led to the crisis, but the bubble coupled with a regulatory stance that allowed for (temporary) survival of financial institutions in trouble.

Banking sectors can be endangered if many enterprises have significant open foreign currency positions. For these a sudden devaluation means a large loss, thus

the risk of default increases. Using interest rate defence can also be dangerous for a not too strong banking sector because of the existence of the liquidity transformation. It is pretty obvious that the quality of regulation is very important. A well-regulated, prudently managed banking sector can weather large shocks accompanying a crisis or an attack, thus making the probability of the attack itself smaller.

However, recent decades have proved that even well-regulated banking sectors are not exempt from taking on substantial systemic risk—i.e. they can invest in highly positively correlated risks. Real estate and, in general, asset price bubbles generate such situations frequently, and apparently financial liberalisation can result in the same. In several countries where some crisis occurred later, the ratio of domestic credit to GDP increased significantly (e.g. Mexico, Thailand, the Czech Republic, Indonesia, Malaysia). These countries characteristically differ from Chile, where this ratio actually decreased during the nineties. It is also true that fast credit expansion turned the maturity mismatch in a more dangerous direction. Again with the exception of Chile, the ratio of M2 to international reserves increased substantially in many Latin-American countries. This characterised Malaysia as well.

We can see that the threat of a banking crisis is very instrumental in currency crises since it greatly increases the costs of defence. In many banking crises the government's implicit guarantee for the banking sector is also influential. This guarantee is *ceteris paribus* higher when the banking sector is not privatised or owned mostly domestically. This and the lender of last resort function of the central bank was a major source of problems in the Mexican, Thai, Czech and South Korean crises. It might be worth considering whether the lender of last resort function is consistent with the globalized banking markets, especially in relatively small countries.

5. The exchange rate regime

From the side of the exchange rate regime it seems that the factor mostly responsible for vulnerability is excessive trust followed by excessive mistrust. Defending a currency via intervention (i.e. losing reserves) makes participation in an attack practically costless, whereas "non-panicking" can be very harmful individually.

A remarkable trend has been observed a remarkable trend in the past two decades. Developing countries clearly moved towards more flexible exchange rate regimes (see *World Economic Outlook*, 1997, October.) However, official categorisation may not be a true reflection of practice; some countries may manage their currency more heavily than like to confess. Still it can be said that managed floating has become rather popular recently. However, Frankel and Rose (1996), who

identified a crisis as a sharp large depreciation, found that about 50 percent of cases fell to floating currencies. Among our cases the Turkish lira is a floated currency, but the risk of crisis has been continuous. The regime in Malaysia has been less rigid than in Thailand—the attack was there, and it did not stop after full floating. The South African rand was basically flexible, and the Czech crown before the crisis was presumably little managed. In Mexico floating did not halt the fall of the peso given that in 1995 a new mini-crisis developed. It is remarkable that in the more stabilised atmosphere of 1996 Mexico moved towards a more managed regime.

Thus, it seems that though fixed regimes increase the probability of an attack, *ceteris paribus*, making exchange rates still more flexible is not a sure way to prevent crises. The problem is partly that it is equally impossible to commit in the case of non-intervention, as it is for maintaining the value of a currency. A reasonable mixture of floating and managing seems to be the only long term viable method of exchange rate policy for developing countries.

6. Defence: Capital control and interest rates

The most viable way to counter an attack is through the raising of interest rates. However, in many cases when things go as far as that, even this is hopeless. On the other hand, for the sake of prevention it seems imperative that a country should not be exposed to short-term hikes in interest rates, as a sudden increase in rates can make a banking system with large maturity mismatch unprofitable. To manage this problem the *Banque de France* tried to segment money markets during the ERM crisis. It separated *bona fide* banks from speculators, and while the former could get central bank credit at normal rates, the latter could get loans only at penal rates. General interest rates increased, but the effect was not so damaging. Obviously, such an approach requires substantial confidence, and is difficult to implement. Also the central bank can easily become a target of accusations of partiality.

Another segmentation can occur between domestic and offshore markets. There are several ways to do that. 1. The central bank may practice moral suasion to prevent domestic banks lending to foreigners (e.g. the Czech National Bank in 1997), 2. It can increase reserve requirements depending on foreign lending (the Bank of Spain 1992), 3. It can explicitly forbid lending to foreigners (Bank of Thailand 1997). Segmentation can lead to further outflows if it is taken to be a signal of further restrictions. Also segmentation can only be a short-term expediency, as circumvention will eventually happen.

Maintaining strict capital controls (like in Slovakia), or retarding the development of financial markets can create a situation where speculative capital has no place to flow in. In this case the country can avoid a crisis for some time even

with unsustainable macro indicators. The costs of capital controls are manifold, including directly determinable costs as well as hard to define welfare losses. Poorly developed financial markets are thought to hinder the efficient working of monetary policy, resulting in prohibitively large transaction costs for many agents, and they can also narrow the range of available investment opportunities. By and large risk management will suffer. A concomitant problem with capital market restrictions can be related to international competition. If countries in the same region liberalise, those countries that do not may suffer by losing business, and by having less access to international sources of investments. Domestic banks may be at very serious disadvantages *vis à vis* foreign banks working in a more liberalised environment. It is also important that rating agencies take liberalisation as a positive indicator, thus restrictions can directly increase the funding costs of the whole country.

Hungary

Hungary endured the Czech crisis of May 1997 relatively well, though the forint's exchange rate temporarily moved towards the middle of the band, from a previously stable and strong position. Slovakia was the scene of an attack a few days after the Czech crisis, but as Slovak capital markets are much less open, regulation is more strict, the banking system is more closely attached to the government, and the National Bank of Slovakia was also well-prepared for the attack—consequently, the attack was repelled without difficulties. Poland's situation was similar to that of Hungary. This lack of contagion must be explained, as we know that both the Mexican crisis and the Thai crisis were followed by similar events intraregionally.

1. Fundamentals and contagion

Looking at macroeconomic indicators the path of the Czech economy seems to have been rather different from that of the Hungarian. At the time of the crisis Hungarian growth accelerated, whereas Czech growth seemed to come to a halt. The forint's real exchange rate appeared to be stable after 1995, whereas there was continuous appreciation of the Czech crown. Current account and FDI developments were rather favourable in Hungary, while these by and large deteriorated in the Czech Republic. Slovak macroindicators were rather similar to Czech figures, whereas the interpretation of Polish data is not easy. The differentiated "treatment" by the markets indicates that investors did not pool automatically Central and Eastern European countries. This seems to be in contrast with what happened in South-East-Asia, but there contagion may be explained by the more similar export structure, and the fact that the profits that could be achieved by speculation

were much higher than in Central Europe. From the case of Latin America we can learn that positive contagion is also possible, and relatively stronger countries can even profit from the woes of others.

The above observations raise the question of what kind of connections international investors see between Hungary and the other countries of the region. Macroindicators in 1993–94 were just the opposite from those described above in relation to Hungary and to the Czech Republic respectively. Thus, investors may see a negative correlation between these two countries. A risk-averse investor would conclude that assets which originated in both countries should be held in the portfolio. A speculator believing to be smarter than others can react with discrete jumps, and can reallocate his assets suddenly when he thinks the wind is turning. Hence, though it is good that positive correlation is apparently not there, negative correlation may also entail some dangers. Thus it is important to know to what extent Hungary competes with its neighbours, both on export markets, and in the market for investments.

Concerning fundamentals the budget deficit can be the most dangerous thing from the Hungarian point of view. The structural reform of the budget could be essential as we have emphasised bad fundamentals are punished increasingly in a forward looking way; thus the expectation of a deterioration in the budget might bring forth its unfavourable effects.

2. Banking and financial sectors

Possible asset price bubbles must be looked out for in Hungary, too. Real estate prices might become extremely high, and banks—even if aware of the risks—could take on excessive risks in order to maintain profitability and market share. It is an advantage that listed companies in Hungary are not concentrated in the real estate and financial intermediation sectors of the economy as they are in Southeast Asia; consequently, bubbles are less likely to emerge.

As we have seen, the enterprise sector can cause banking problems in the case of a large depreciation, if it becames a significant currency risk. The typical way to handle this is to borrow in foreign currency, and produce for the domestic market. Exporting firms are natural hedgers, but cross exchange rate changes can be harmful to them if they do not hedge explicitly on financial markets.

The natural way to defend a currency in the case of an attack is to raise interest rates. A large maturity mismatch can lead to large losses, but this does not seem to be the case in Hungary. In general, we can say that after the decrease in lending in the 1990s reduced enterprise and household leverage made the banking sector less vulnerable to interest rate hikes. For instance, the same sort of problems that were influential in Britain at the time of the ERM crisis just do not exist in

Hungary, since mortgages are insignificant in bank portfolios. Recently, however, the growth in domestic borrowing could have led to changes in this, which is hard to appreciate at the moment, but one can guess that in the future vulnerability may increase.

On the other hand, it is an important countervailing force, that in Hungary the banking sector is mostly privatised, and in addition owned by foreign banks. Thus, there is much less need to exercise the implicit option provided by the NBH as lender of last resort and therefore the inherent moral hazard problem is less serious. Of course, it is unrealistic to ask for this potential role to be given up but the credibility of using it only at a serious systemic crisis is enhanced. As prevention, the strengthening of banking supervision, together with a broader definition of the concept of risk seems to be advisable (according to international experience).

Summary evaluation

Prudent macroeconomic policy and stable fundamentals are necessary but not sufficient conditions for a country in order for it to avoid speculative attacks. There are no universal rules or signals for forecasting currency crises. Therefore, it does not seem sensible to determine "mechanical" rules for certain indicators or for a composite index of vulnerability. Since currency crises are costly events, a *"conservative" attitude* is advisable and this should take any quantitative or qualitative sign of vulnerability seriously. Part of the reason for this is that expectations are very important and they cannot easily be derived from past data or events.

Contagion has played an important role in the currency crises of the nineties and it may take several forms. For example, the similarity of export structure may be an important factor, and it is supposed to have had a great importance in the recent crisis of Southeast Asia, where countries compete to a large extent in the same markets. Thus, a country with well-diversified international trade is less vulnerable to demand, price and exchange rate shocks. Theory suggests that if an economy is significantly exposed to international shocks, it should choose a less rigid exchange rate regime.

During regional or transcontinental turbulence a country with more or less healthy fundamentals can more easily fall victim to a speculative attack than in tranquil times when the same fundamentals would not induce an attack. Therefore, it might be dangerous to postpone obvious adjustments (e.g. responding to high current account deficit, high budget deficit or an overvalued currency) upto a point when policymakers judge the situation unsustainable (based on the knowledge that similar fundamentals have resulted in currency crises in the past). An attack may come before this realisation. The experiences of the nineties indicate that regional currency crises (ERM, Latin America, Southeast Asia) were more frequent than

individual ones; thus the danger of contagion should be taken seriously by those countries whose economic fundamentals would not yet justify an attack. It can also be observed, however, that during regional or global crises there are countries which may experience *"positive contagion"*—that is, capital fleeing countries which have been attacked flows to "safe havens". Chile may serve as an example in the follow-up of the 1994 Mexican crisis. On the other hand, during tranquil periods, unsustainable fundamentals are tolerated for a longer period because foreign capital needs a trigger in order for an attack to begin (another similar country's crisis is an obvious trigger) and domestic monetary authorities should be willing to make larger sacrifices to defend the currency. The May attack on the Czech crown is an obvious example: the high current account deficit and the overvalued currency were tolerated for quite a long time.

In most cases when a currency crisis has been coupled with a banking crisis, the implicit commitment of monetary authorities to bailout troubled banks has been an important element. This implicit commitment is stronger if the banking system is not privatised. This "lender of last resort function" of central banks seems to have had an important role in the Mexican and Thai crises, because it was a source of moral hazard. It is worth considering whether central banks should serve as the lender of last resort in a liberalised global financial system. National banking systems (like the Asian ones) are more exposed to the problem of moral hazard than those in which the share of foreign capital is high.

The main sources of currency crises are still the budget deficit and public debt. The increase in debt raises the chance of a crisis if the financing is monetary or if it is financed by bond issues, either domestically or abroad. It is not only existing debt which matters, but also the prospect of its growth. For instance, the probability of an increase in public debt grows if monetary authorities implicitly commit themselves to bailout the financial intermediary system when trouble occurs. Modern financial markets increase the vulnerability of countries with substantial debt for several reasons. Firstly, a potential attack may result in a large profit for those who can afford to take speculative positions. Secondly, the costs of belated flight of other financial market participants may be huge, whereas the flight itself is cheap. Thirdly, there are several types of speculative (uncovered, risky) positions in the economy to which regulatory authorities have no access, and the closing of these positions can launch catastrophic changes.

Sudden and large falls in asset prices may be dangerous if there are weak (too risky) balance sheets in the economy. The most serious form of this is if the banking system takes excessive risks. The prudential regulation of the banking system in itself does not seem to be enough to prevent the formation of bubbles. A "too easy life" (e.g. continuous increase of stock or real estate prices, no volatility in the exchange rate) may contribute to taking excessively risky positions. The interest rate sensitivity of an economy is an important determinant of the probability of an attack on the currency and of the prospects of its defence. Interest rate sensitivity

may take several forms, but the significant indebtedness of some agents always plays a part (e.g. high interest payments on public debt or substantial indebtedness of households in the form of mortgage contracts).

The substantial appreciation of the real exchange rate as well as a large and persistent current account deficit are dangerous in a fixed exchange rate regime, not necessarily because they are unsustainable but because they increase the chance for an attack to be profitable if there is an unexpected shock (that is, the after-attack nominal exchange rate will almost certainly be weaker than the previous fixed rate). In the currency crises of the nineties, expansionary fiscal policy was not the only cause of these crises (as an influential branch of theory suggests); if fiscal policy was loose, however, a crisis became almost unavoidable.

Financial liberalisation also contributed to the increased probability of speculative attacks. Liberalisation and the growth as well as the deepening (e.g. new forms of derivatives) of financial markets make speculation easier. The unsustainability of public debt and exchange rate misalignments are penalised not only ex post (as in the past) but also ex ante. It must be emphasised that the faster and more dramatic reaction of financial markets is not due to their perfection or efficiency. On the contrary, changes in perfect and fully efficient markets would be much less drastic and catastrophic changes would occur less frequently. The real problem is that liberalisation itself does not eliminate every problem, but at the same time the consequences of problems stemming from market imperfections are less and less borne by sophisticated market agents. If we believe that financial liberalisation is a good thing and that it contributes to the long-run higher level growth of the world's economy, then its unpleasant side effects must be accepted and dealt with.

The fact that open capital markets reduce the independence of domestic economic policies is not necessarily troublesome. On the one hand, open capital markets also make it possible for less sophisticated investors to protect themselves from unexpected devaluations and from the inflation tax. On the other hand, it is observable that less liberalised countries are able to maintain not only risky, but explicitly unsustainable policies for quite a long time (e.g. the Slovak Republic).

As far as fiscal policy is concerned, if a country wants to avoid a speculative attack without restricting capital flows, then public debt should decline and not even in unfavourable circumstances should the upsurge of debt be allowed. As far as monetary and exchange rate policies are concerned, rigid exchange rate regimes increase the vulnerability of economies. Since exchange rate stability plays an important role in small, indebted countries, a managed float may be a temporary solution.

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Appendix

T indicates the year of the currency crisis (attack) or the year of the closest statistical observation. Countries marked with an asterisk did not experience any crisis (attack); here T indicates the year in which countries geographically close to them were attacked.

Table 1

Real GDP growth (percent)	T−3	T−2	T−1	T	T=
Argentina	8.9	8.6	6.0	7.4	1994
Chile*	7.2	11.0	6.2	4.2	1994
Columbia*	1.8	4.2	5.2	5.8	1994
Czech Republic	−0.9	2.6	5.0	4.4	1996
South Korea	5.8	8.6	9.0	7.1	1996
Hong Kong	6.1	5.4	4.6	4.9	1996
Hungary*	−0.6	2.9	1.5	1.3	1996
Indonesia	7.2	7.5	8.1	7.8	1996
Malaysia	8.4	9.4	9.4	8.2	1996
Mexico	3.6	2.9	0.7	3.6	1994
Poland*	3.7	4.6	6.6	6.0	1996
Slovak Republic	−2.9	4.3	7.7	7.0	1996
Thailand	8.3	8.8	8.7	6.7	1996

Table 2

Budget deficit (percent of GDP)	T−3	T−2	T−1	T	T=
Argentina	–	–	–	–	1994
Chile*	1.5	2.2	1.9	1.6	1994
Columbia*	2.5	−1.9	−0.5	–	1994
Czech Republic	2.7	0.9	0.5	−1.6	1996
South Korea	0.3	0.5	0.4	0.3	1996
Hong Kong	–	–	−0.3	1.3	1996
Hungary*	–	−8.2	−6.5	−3.9	1996
Indonesia	0.6	–	0.5	0.6	1996
Malaysia	1.7	3.9	0.8	−3.3	1996
Mexico	–	–	–	–	1994
Poland*	–	−2.3	−3.4	−3.5	1996
Slovak Republic	–	−1.0	−0.5	−1.3	1996
Thailand	2.1	1.8	2.7	2.2	1996

Table 3

Current account deficit (percent of GDP)	T–3	T–2	T–1	T	T=
Argentina	–1.5	–3.7	–2.9	–3.7	1994
Chile*	0.3	–1.6	–4.5	–1.2	1994
Columbia*	5.6	1.8	–3.8	–4.8	1994
Czech Republic	2.2	–0.2	–3.1	–8.6	1996
South Korea	0.1	–1.2	–2.0	–5.2	1996
Hong Kong	–	–	–	–	1996
Hungary*	–11.0	–9.8	–5.8	–3.9	1996
Indonesia	–1.3	–1.6	–3.5	–3.6	1996
Malaysia	–4.5	–5.9	–	–4.9	1996
Mexico	–5.1	–7.3	–6.4	–7.8	1994
Poland*	–6.7	–2.8	–3.6	–1.0	1996
Slovak Republic	–4.8	–5.2	3.7	–8.0	1996
Thailand	–5.1	–5.7	–8.1	–7.9	1996

Table 4

Current account deficit +FDI (percent of GDP)	T–3	T–2	T–1	T	T=
Argentina	–0.2	–2.5	–1.5	–3.5	1994
Chile*	1.8	–0.0	–2.8	2.2	1994
Columbia*	6.7	3.3	–2.1	–2.3	1994
Czech Republic	4.3	2.2	2.7	–	1996
Hong Kong	–	–	–	–	1996
Hungary*	–5.0	–7.0	4.5	0.6	1996
Indonesia	–0.1	–0.4	–1.4	–	1996
Malaysia	3.5	0.3	–	–	1996
Mexico	–3.5	–6.0	–5.2	–4.9	1994
Poland*	–4.7	–0.8	–0.5	–	1996
Slovak Republic	–3.2	–6.7	4.8	–	1996
Thailand	–3.6	–4.7	–6.9	–	1996

Table 5

Short-term foreign debt (percent of GDP)	T−3	T−2	T−1	T	T=
Argentina	8.4	8.1	4.7	4.0	1994
Chile*	9.2	9.2	10.1	12.9	1994
Columbia*	4.2	5.8	5.8	7.1	1994
Czech Republic	9.9	8.0	11.3	–	1996
South Korea	7.5	6.8	7.3	23.0	1996
Hong Kong	–	–	–	–	1996
Hungary*	8.4	8.5	8.2	8.0	1996
Indonesia	11.4	9.7	11.3	–	1996
Malaysia	11.1	8.7	8.5	–	1996
Mexico	9.9	9.1	11.2	11.4	1994
Poland*	3.9	2.4	0.2	–	1996
Slovak Republic	10.6	13.6	12.5	–	1996
Thailand	10.7	9.8	11.0	–	1996

Table 6

Foreign exchange reserves/M2	T−3	T−2	T−1	T	T=
Argentina	0.37	0.37	0.34	0.30	1994
Chile*	0.57	0.61	0.58	0.72	1994
Columbia*	0.85	0.84	0.71	0.53	1994
Czech Republic	0.19	0.24	0.36	–	1996
South Korea	0.20	0.22	0.24	0.23	1996
Hong Kong	–	–	–	–	1996
Hungary*	0.31	0.32	0.55	0.44	1996
Indonesia	–	–	–	–	1996
Malaysia	0.50	0.42	0.31	–	1996
Mexico	0.22	0.20	0.23	0.05	1994
Poland*	0.14	0.18	0.35	–	1996
Slovak Republic	0.11	0.23	0.33	–	1996
Thailand	0.26	0.27	0.28	–	1996

Table 7

Foreign exchange reserves (import cover in month)	T−3	T−2	T−1	T	T=
Argentina	5.10	6.07	7.37	6.17	1994
Chile*	7.82	8.38	8.44	10.39	1994
Columbia*	8.60	8.61	6.69	5.61	1994
Czech Republic	3.09	4.18	6.48	–	1996
South Korea	2.50	2.60	2.50	2.50	1996
Hong Kong	–	–	–	–	1996
Hungary*	4.98	5.01	6.74	5.60	1996
Indonesia	3.38	3.23	2.96	5.40	1996
Malaysia	5.99	4.51	3.21	3.50	1996
Mexico	2.98	2.67	3.33	0.72	1994
Poland*	2.06	2.79	4.86	6.60	1996
Slovak Republic	1.34	3.08	4.36	–	1996
Thailand	5.38	5.35	5.03	5.30	1996

Acta Oeconomica, Vol. 49 (3–4), pp. 271–283 (1997–98)

INVESTING ATTITUDE OF VENTURE CAPITAL FUNDS AND COMPANIES IN HUNGARY

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The venture capital industry in Hungary is one of the most developed in Central-Eastern Europe. According to assessments, available venture capital had reached half a billion US dollars in 1996. As a result of the proliferation of the market economy's infrastructure as well as the uninterrupted growth of economic production, it can be predicted that companies fed by venture capital will be even more widespread in the future. Besides the improvement in terms of economic conditions, appropriate knowledge on the nature and mode of operation of venture capital have to be learned in order for venture capitalists to find their way to target companies. Having insight into this industry, companies may consider whether they are attractive enough to be financed by venture capital. In addition, in order to compare their own strategies, it might also be interesting for venture capitalists to learn about the investment policies of other investors.

Undertaken by the Research Institute of Industrial Economics of the Hungarian Academy of Sciences during the spring of 1996, a questionnaire method was used to analyse investor behaviour among venture capitalists in Hungary. The primary objective was to reveal the conditions and techniques employed by the venture capitalist in selecting potential targets for investment. Another important objective was to investigate the requirements of companies with regard to the investor's portfolio. What are the ways to supervise their operation? Furthermore, as a co-owner in the target company, what functions are to be filled in by the investors in the target companies?

However, it was not the objective of the research to evaluate the results which have been achieved by venture capitalists up until now; rather, the purpose has been to introduce the components of investors' portfolios, to report exits that have been completed or to explain the future plans of investors. Even so, further research has to be undertaken in these respects.

Nine venture capitalists out of twelve agreed to communicate data. (The questionnaires did not focus upon commercial banks holding investments other than venture capital or only partly venture capital, since different types of investments are not easy to distinguish from those that are venture capital investment in character. Moreover, regional funds investing throughout Central-Eastern Europe were ignored, too.) Three out of the nine funds considered are incorporated abroad; however, they invest their assets exclusively in Hungary. Two of these three are the largest among domestic venture capital investors.[1] Two state-established com-

[1] The venture capitalists dealt with in this survey together hold 70 percent of the investments originating from members of the Hungarian Venture Capital Association.

0001–6373/95/$5.00

panies, originally focused on innovation-finance, are also involved as well as two investment companies, launched by the Hungarian Development Bank Ltd. They have regional coverage. With regard to the rest, two other private-based companies deal with venture capital investment as a mere ancillary activity. Due to the fact that information gathered in the questionnaires was qualified as constituting business secrets by the investors, no investors are indicated by name.

Investor behaviour in the UK—examined by the Centre for Management Buy-Out Research, University of Nottingham—was a great help in elaborating questionnaires for this research. Apart from the methodological help given by the British questionnaire,[2] it also became feasible to compare domestic results with the same information in the UK. Based on the volume of investment, these results, after the United States, illustrate the second best achievement in terms of the development of the venture capital industry.

Selection of investment offers

Venture capital investors usually, quite intensively, filter out potential target companies. This happens before a thorough examination on emerging investment opportunities takes place. The filtering process requires a lot of effort and consumes much time. During this selection process, most investors simultaneously take into account several factors in order to select those offers which they consider to be valuable for further assessment. The first question is aimed at those factors which are relevant for investors when, later, they evaluate and select investment offers. (Factors on the questionnaire are classified from 1 to 5, according to the importance of the factor—1 means the least, and 5 is the most important factor. Nevertheless, respondents were able to indicate more than one factor with the same weight.)

After the summing up of all the answers, a surprising end-result was discovered (at least, for those who are not so familiar with the characteristics of the venture capital business). Instead of a required level of return on the invested asset (evaluated as 4.4), investors highly appreciated when the exit time and method could be forecast quite accurately (4.6). Moreover, compared with the former factor, even the knowledge and experience of the management of the target company was shown to be more significant (4.6). The percentage assigning importance to the ownership in the target company reached the same level of importance as the financial ratio benchmark (4.4). Furthermore, it is understandable that among the factors, investors saw significance in the size of the funding injected into the target company (4.1); the establishment of a legal structure representing the mutual interests of the entrepreneurs and also the investors (4.0) was rated quite highly.

[2] As a base for comparing, the investigation covered 66 investors in the UK in 1997 (*Wright and Robbie* 1997).

On the other end of the scale, investors attributed less importance to the fact of whether the investment proposal falls in a given industry or not (1.6). More value was given to (apart from the capital) the target company's experience (2.9) or to the stage on which the investment would take place (3.2).

The numerous factors with importance ratings higher than 4 refer to a multi-preference apparatus on the part of the investors. The ranking, set up among the different factors, clearly indicates that, even though the venture capital investment is, in its classical form, a long term investment, nowadays it only finances for a transitional period of time. Investors are eager to exit (the most important factor) with the highest return possible. However, it is significant for the managers of the undertaking to see that investors appreciate their knowledge and expertise in order to reach success through a joint effort.

Sources of information

The survey paid distinct attention to finding out the main sources of information on which investors rely. (A similar approach was followed as that with "Selection of investment offers", inasmuch 1 is the least and 5 is the most important factor on a scale from 1 to 5.)

It is not easy for venture capitalists to receive reliable data about the company they are considering for investment, especially with regard to the prospects inherent in the target company. As is well-known, there is no nationwide computer database in Hungary at the disposal of the investors—neither for seeking projects nor for checking the information available. The Companies Act obliges companies to make public balance sheet information—even so a nationwide computer database has not yet been established. However, the Act on Statistics does not permit public bodies to provide data about firms. Organisations that provide information on companies rather focus on rendering information for references and they do not follow the purpose mentioned above. However, it is not surprising that investors' personal information, encapsulated in an evaluation report, had a primary role for respondents (5.0), without any exceptions. Far behind the due diligence report, based on personal information (and perhaps, on a contact network) was information emanating from auditors and consultancy firms (4.0). Investors, primarily relying on their own information, ranked sales and marketing information in the second place (4.78). Market data thus took preference over the balance sheet, income statements, and also planned data expressed by the business plans of the target companies (4.33).

In the UK, investors' reactions were quite the opposite as far as the last two sources of information are concerned. Apart from the less reliable nature of the information communicated by the target companies in Hungary, the reason

behind the Hungarian tendency, perhaps, indicates that investors are more inclined to reaffirm their positions with respect to domestic undertakings. (Cf. *Karsai, Wright and Filatochev* 1996) This presumption was confirmed by the fact that product information was ranked in the fourth place (4.27). As it could be foreseen, similar to the experience in the UK, instead of publicly available statistics having a minor importance in shaping business decisions (2.33), statistics, drawn up by the industry itself for a specific purpose, are more favoured by investors (3.22). Information coming from other venture capitalists received a 3.3 average, albeit with great diversity among investors. It seems that, even though some of the venture capitalists have a good relationship with one other, the rest do not exploit information received from other investors.

Investment proposals which, according to the information collected from the aforementioned sources, appear to be attractive, have to go through further detailed examination. It must be emphasised that this thorough examination is rather a control to see whether company-based information is true. In this phase, a pivotal role is taken by diligence reports produced by the potential investors (4.7), and also personal references about the target company as well as about its management (4.2). In the third place came reports made by independent experts with respect to the market segment (3.9). Reports drawn up by independent auditors were qualified as an information source having average importance (3.0). In the UK this information source has more significance than in Hungary. This might be explained by the relatively low expertise on the part of Hungarian auditing firms with respect to venture capital business.

The required rate of return on venture capital investment

Obviously, the acceptance or the refusal of investment opportunities, examined thoroughly according to several aspects, mostly depends on what expectations are nurtured by the investor in terms of the required rate of return (IRR); in other words, how risky is it to attempt to realise the investment proposal in question?

Up to this point, the British survey creates some difficulties with regard to comparison with the examination of the Hungarian market. Direct comparison is problematic, mainly due to the difference in the time when the two surveys were prepared, in the number of investors involved, and in terms of the maturity of the capital markets in the respective countries.

Nevertheless, it can be deduced from the information gained that investors in the UK are more flexible than their Hungarian counterparts. They do not anchor themselves to a required rate of return which has been defined in a normative manner. (Cf. Wright and Robbie 1996) On the other hand, although companies on the Hungarian market employ different methods to determine what rate of return is de-

sirable, in Hungary, investors are more reluctant to shape their expectations (with respect of rate of return) in accordance with the characteristics of their portfolio-companies. To justify this statement, it is enough to refer to the highly-ranked position of the standard required rate of return (4.0). Some differentiation is indicated if the required rate of return is adjusted to the risk band of the investment (3.4), and whether the rate of return yields a total cash return commensurate with the amount invested (3.3)—these points slightly exceeded the average. Similar weight was given to the characteristics of each investment (3.1).

It is not surprising that British investors, with greater expertise and a more developed infrastructure than venture capitalists in Hungary, classified the aforementioned factors in a completely opposite order. In other words, in the case of a concrete project, the required rate of return was associated with the specific circumstances of the investment opportunity rather than being reflected in a standard requirement about the rate of return.

The survey also had the intention of showing how often investors ponder over some factors which are significant for calculating the required rate of return. (Investors gave a ranking of 5 for indicating the factor which is always taken into consideration, and gave 1 if the factor has never been used.) Logically, the factor regarded as the most important was the expected length of investment in a particular proposal (4.7). It was followed both by the market conditions related to the particular proposal (4.4) and the investment demand of the target company (4.4). In the frequency of the factors, the size of the ownership in the target company acquired third place (4.3). Similarly, the type of sector in which the investment takes place is usually considered (4.0). Other factors, such as the general economic conditions, the geographical position of the investment and changes in the return of alternative capital-saving options, seem to have little influence on considerations about the size of the required rate of return.

Looking at the attitude of investors in the UK there is, however, one striking difference. In Hungary, investors pay more attention to the acquisition of majority ownership in the target company than do investors in the UK. (Cf. Karsai, Wright and Filatochev 1996) In the light of this tendency, it would be important to make provisions—in the draft proposal on regulating venture capital investment—for venture capital investors to be able to acquire a majority stake in the target company.

According to UK practice, the required rate of return—based on after-tax income and related to own capital—is growing; it is departing from the investment being made in a later stage towards early stage investment, thus counterbalancing the higher risk-level inherent in the latter type. (Wright and Robbie 1996) Expectations, however, might be revamped depending upon the size of the target company, as well as there being a necessity to restructure the target company. The former is mainly caused by the disproportionate changing of control costs. The same impact can be traced with respect to the high cost of restructuring the company.

Questions aimed at the size of the rate of return resulted in incomplete answers, coupled with difficulties which arose out of the different currencies as a base for comparison. Although expectations are quite different, to set forth the required rate of return, investors usually consider the stage at which the target company stands when the need for financing by venture capital arises.

A private venture capital firm which invests its capital in companies which are in a later stage of development, aims at the highest rate of return when it desires a rate of over 55 percent (in case of liquidation), and between 46–55 percent if the investment serves as a replacement of the previous ownership or where the acquisition takes place during privatisation. Another investor indicated a 21–25 percent rate of return if the target company is in an early stage development, whereas companies having a sound track record are expected to render a rate of return over 55 percent. Again, in the early stage approximately 31–35 percent was expected by a third investor, while 26–30 percent was desired in a later stage. This investor expects the same rate of return when the target company is being financed during privatisation. The fourth venture capitalist did not see any difference between a company in its early stage or in a phase of expansion, he expected the same 21–25 percent rate of return. Finally, the last investor, involved in this research, anticipates 36–45 percent when the deal involves privatisation, and expects 46–55 percent if the target company is either in a later stage or under liquidation. Obviously, investors did not make it public if there was a difference between the required rate of return and the actual return which was finally achieved. Due to the very few cases in which target companies had been admitted on the stock exchange, available information is limited.

Even the rosiest picture about the return can be blurred if the investor has to take a high risk. Consequently, the survey purported to investigate the main points for evaluating the risk-level of an investment proposal. According to domestic venture capitalists, like their British counterparts, first place in the ranking was taken by the managerial skills and expertise (4.89). Second and the third place were taken, respectively, by the nature of the market of the portfolio-company (4.33) and by the expected time period when the investor may exit (4.22). Only after all these factors was the financial contribution of the management of the target company considered to be important, along with the legal deficiences and the maturity of the capital market. Although the English investors follow a similar way of thinking, they pushed the financial contribution of the management forward by one place.

Apart from the expected rate of return and the risk-level, the investment is also deeply influenced by the method chosen to evaluate the selected investment proposals. (Since numerous techniques can be applied for the evaluation, investors were asked to indicate from 1 to 5 how often they favour one or another method in such a way that a method labelled 5 is almost always employed for evaluation, while 1 reflects a situation in which a method has never been fashioned.)

Methods for assessing investment proposals can be divided into three categories, such as asset-based methods, income models and stock exchange transactions models. The last one relies on the price/earning multiple (P/E). Due to the relatively high level of uncertainty in evaluating companies, it seems to be advisable to assess the value of the target company by way of different methods supplementing these with evaluations from different sources.[3]

According to the information which appeared on the questionnaire, venture capitalists apply different methods for assessment in Hungary. As a general experience, out of the income-models, discounted future cash flows (*DCF*) has gained the highest respect, followed by the capitalised maintainable earnings (*EBIT*). Compared with these two methods, investors gave less preference to *P/E* methods. Average preference was shown towards capitalised maintainable earnings on prospective as well as historic grounds (3.67 and 3.44, respectively). Analogous to this application is how often investors use the dividend yield basis (3.44). Contrary to this, in Hungary, it is very rare to take advantage of asset-based models, such as the historic cost book value, replacement cost asset value and the liquidation value of assets (2.11, 2.0, 2.33). It is also quite unusual to employ solicited bids for the potential investee (2.22), recent transaction prices for acquisition in the sector (2.44), and recent transaction prices on the stock exchange (3.0).

Obviously, the maturity of the domestic capital market, especially the size of the turnover of shares and the organisation of the share-section on the market, is crucial in determining the potential tools for assessment. The development of the capital market and of both the supply and demand sides of the companies' market—either via the stock market or outside the stock exchange—will offer more and more ways of assessment. Therefore, besides the currently popular income-models—especially the *DCF*-models—*P/E*-models showing characteristics of similarly quoted companies will certainly be widespread in Hungary, following the British example. In this way, the models which will be in a leading position are

[3]Out of the asset-based methods, techniques such as the ones based on the historic cost book value, on the replacement cost book value and on liquidation value of assets are the most widespread. While the first has its roots in the balance sheet when it evaluates the value of the own capital of the target company, the second mirrors the amount which is necessary for the investor to acquire identical means. The third method focuses on the amount which the investor could earn if the target company were to be wound-up immediately and its assets sold simultaneously. The application of income-models is based on the presumption that the value of a property depends on what kind of benefits come from the ownership of this particular property object. These models are characterised by a time-based calculation of future cash flow performance, where the achieved results are discounted by the company's cost asset. The simplest, as well as the most often applied, method is the discounted cash flow (*DCF*) model. In order to adopt price/earnings (*P/E*) multiple methods, it is expected that the company subjected to the assessment is commensurate with another company which is listed on the stock exchange. With this model, the calculation requires multiplication of the pre-tax earning of the company with the *P/E* ratio of a similar listed company. Listed companies are expected to be commensurate, by and large, with assessable companies in terms of dynamics, risk-level, profit, etc.

the ones which reflect more efficiently those political and market changes bringing about stability in making assessments.

The role of venture capitalists

Acceptance of the investment proposal on the part of the investor results in co-ownership with the original proprietors of the target company. In this respect, the survey searched for the key functions that are deemed to be significant for venture capitalists. (In the answers, functions regarded as being most important were marked with 5, while 1 was used when no importance whatsoever was given to the function in question.)

Information deduced from the answers, of course, represents a wide range of diversity. Consequently, these data can only present a vague picture. The reason behind this statement is partly due to the diversity in the attitudes of the investors and partly due to the fact that different stages in the lifespan of the target company require different functions to be catered for. As a consequence of this the question as to how managerial tasks are to be shared with the venture capitalists has to be interpreted in the light of the aforementioned remarks.

To set up a ranking, it can be seen that the way to ensure a successful target company is mainly guaranteed by the venture capitalists via their controlling activities (4.89). Furthermore, investors consider it crucial to be able to have a say in shaping the key organs of the target company and also to be able to contribute to the development of new strategies for meet changing circumstances (both evaluated as 4.56). In addition, control of the management of the company (4.33), the monitoring of investments undertaken by the portfolio company (4.22) as well as participation in problem-solving or management crises (4.22) were also given preference. Finally, it is also essential to be able to assist management in working out strategic plans (4.11) and formulating a marketing strategy (4.11).

In comparing the aforementioned functions less attention was given to monitoring operational performance (3.89). Similarly, contribution in terms of inventing new ideas (3.89) or increasing the number of consumers, have less relevance (3.89). Tasks related to the daily operation of the company also fell outside the mainstream—for example, taking decisions about the remuneration of the management (3.78), the recruitment of new managers (3.44) and motivating employees (3.44). It is striking, however, that investors did not attribute much importance to taking part in raising loans or other forms of fund-raising (3.0). Investors felt even less inclination to get involved in the planning and elaboration of production (2.67).

By far the most essential role of the venture capitalists can be identified as the control function. Consequently, it is interesting to point out the major instruments

needed for bringing about this goal in order for the investors to oversee the current situation of the investees and, what is even more significant, to deal with unexpected problems as rapidly as possible. Since there is no guarantee with respect to the investment of venture capitalist in the same way as with bank loans, it is essential to get instant and precise information about all the relevant facts and changes which might affect the investment.

Control can occur in two ways. Firstly, through the owners' agreement, which is concluded together with the investment contract. Here, management's decision-making competence is divided in several instances. For example, without the involvement of the investors no decision can be made on certain essential topics. The other instrument for overseeing the company's operation is a continuous information supply on the part of the management. Besides the declared obligation of the management to provide information, the same objective should be satisfied by less formalistic, personal conversations. (To ensure control power over the company's affairs, tools were classified from 1 to 5 where 5 signified the most, while 1 indicated the least important tool.)

Investors pay distinct attention to having a presence on the management/supervisory boards of the target company, from a watchdog viewpoint (4.67). Moreover, venture capitalists considered it essential that they receive decision-making power in the disposal of the assets of the company (4.56). They excluded the sole competence of the managers in questions such as mergers with, and acquisition of other firms (4.44), and their approval was also necessary when raising additional loans (4.33). As a consequence of the numerous deficiencies within a company's control mechanism, and the necessity of monitoring actual economic conditions, it is understandable that monthly financial reports are the most frequently applied among the different type of reports, (4.33), apart from the evaluation of monthly performance (4.22). Having up-to-date information at their disposal, investors consider that annual reports about audits have a lower value (3.78), even though investors have access to the latter form.

Venture capitalists, being part of the control mechanism, take into account their right to assemble the board of directors (management committee), their right to appoint new board members, and their direct access to the target company's accounting system. (All of these tools were evaluated with an average of 4.22.)

Up to this point, venture capitalists thought that restriction on directors' remuneration had only a moderate impact (3.78), as is the case with the selection of accounting policies and the choice of one accountancy firm or the other (both scored 3.67). Least importance was given to the participation of industrial experts on the management board (2.44).

Given the rapidly changing domestic economic conditions, it is essential for investors to be informed, as soon as possible, about the performance of the portfolio-company. Direct communication with the management is the most frequently used channel for giving notice about problems or irregularities (4.22). It is quite ex-

ceptional when a venture capitalist learns about the inadequate operation of its portfolio-company solely by way of a frozen dividend. In second place, investors ranked monthly management reports (4.0). More than half of all the answers mirrored the fact analysis of management reports led them to the conclusion that some sort of intervention that the investors' own had to be available (3.89). However, phone calls (3.78) as well as written observations (3.67) are also considered to be helpful methods. As a general experience, other channels, such as audited, annual accounts (2.33), information communicated by the relevant credit institutions (1.67) and the freezing of dividends (1.78) are deemed to be inappropriate for anticipating problems in time.

Venture capitalists are informed about unexpected events at the portfolio-company either immediately, or at least within one week (3.67). It is not typical that investors suspect troublesome situations in advance (2.22). On the other hand, learning about a particular event later than one month after its occurrence is also unusual (2.22). These numbers reflect a broad latitude as far as the ability to perceive problems is concerned. Relying on the investors' answers, mainly private, especially foreign-based funds have the shortest time period with regard to learning about facts indicating irregular events.

It is not surprising that in the case of irregularities, investors want to acquire the clearest picture possible. It seems to be logical that they primarily prefer to receive information from the management (4.89); they keep their eyes on the company in question (4.78) and attempt to work out a "rescue-plan" (4.78). Changes in the membership of the management are quite usual (4.22)—all the more, since investors are deeply concerned that ineffective management is one of the reasons behind a poor performance. Obviously, at first investors focus mainly on solving the problems and only if this fails do they contemplate removing their investment; the latter represents a solution which is an average for all the replies (3.78). Even more rare is a renegotiation either of how to finance the company (2.56), or modification of the size of their interest in the investee (2.44). It is especially not practice to proceed with liquidation against the company in question (1.56).

Regarding the relevance of all the posts filled at the portfolio-companies, the experience is commensurate, from numerous aspects, with that in the UK. In both countries it is a striking feature that, on the part of the investors, the inclination to gain information about a company's matters is far above the level of what is generally experienced with the "average" shareholder. The slight difference between the British and the Hungarian behaviour perhaps has its roots in a different approach, since investors in the UK consider management contracts to be a part of the control mechanism which serves their interests. These contracts may suffer some modifications, depending on the company's performance. In this way managers at the portfolio-company are motivated to achieve better earnings. In the UK, a firm's related bonus—which nowadays has a bitter aftertaste in Hungary—immanently belong to the contracts concluded with venture capitalists.

Elements of the automatic control mechanism have a similar impact in Hungary as they do in the UK. Both in the UK and in Hungary it is general practice that investors require a detailed, in-depth information supply in line with legal standards. Information, which is gained in this way, is always compared with plan-numbers. Therefore, in the case of a divergence, investors intervene immediately in the management of the company. Consequently, the control mechanism has its role as an "early-warning system" in the process of monitoring.

The survey in the UK placed a considerable amount of attention on examining which posts are preferred by the investors when the portfolio-company has a poor performance. (Wright and Robbie 1996) In this case the nature of these posts depends upon the classification of the portfolio-company—namely, how the investor has ranked the investee on his preference list. When the portfolio-company is qualified as irrecoverable, investors aim at investing the least possible amount of capital, or avoid making further efforts in order either to dispose of their stake at a nominal value, or to write it off completely. Investees, however, which have a chance of improving their performance take further steps in association with the co-owners.

With regard to the survey carried out in the UK, it can be concluded that the formalisation as well as the "closeness" of the operation of the monitoring system is dependent on the stage the company has reached in its development, how large it is and, also, what kind of approach is inherent in the investors' attitudes. Departing from real-life experience, in the case of investees at an early stage of development, working in the high-tech sector and relatively smaller in size, investors are more inclined to neglect the "traditional" ways of monitoring. Besides, the "closeness" of the monitoring system behaves differently in cases in which the company's performance is being altered. Therefore, the obligation to report could be reshuffled continuously. (If the company can maintain those requirements that are laid down in plans, investors' control becomes "looser", whereas a fall in results leads to a more rigorous monitoring.)

Correlation can be observed between the risk-level of the investment and the "closeness" of the control mechanism as well. The English survey plainly expressed the desire to have a closer look in terms of rendering information and curtailing the decision-making power of the management of the investee if their business is regarded as being more risky than average. More frequent and elaborate information disclosure is required; for instance, more details are required if the capital-structure of the portfolio-company is to be revamped for an unexpected purpose—*i.e.* additional capital needs to be injected into the company. The same impact can be traced when the investment comes from a less experienced investor.

Concluding remarks

In order to outline venture capitalist's behaviour it is necessary to grasp clearly those features which characterise those professional investors who are ready to take a higher risk-level. They expect a higher return and thus they invest their assets into a target company for a certain period of time. Therefore it is not an accident, that investors, whenever they filter out investment proposals, are keen on assessing their chances for transforming their assets into liquid capital again.

Obviously, compared with other returns available on the market, a higher return on the venture capitalist's investment is appropriate for the higher risk-level. The intention to abate the risk-level is mirrored in several patterns and these are easily detectable in the attitudes of the venture capitalists. Therefore, in the second phase of the selection of investment proposals, a thorough and strict examination of the quality of the management of the target company takes place. This aspect has even more relevance than an assessment of the future success of the goods or services offered by the company in question. There is a similar need for an objective evaluation which governs investors when they undertake more and more sophisticated examinations in order to determine what can reasonably be expected with regard to the future value of the company. Similarly, guarantees on the investment contracts attempt to enhance the security of the investors by restricting the decision-making power of the investee's management. Fast moving information disclosure, as a part of the monitoring regime, is also a motive for ensuring immediate intervention in achieving the same goal.

The methods for approaching problems did not reveal any significant differences between the behaviour of the British and the Hungarian venture capitalists. When differences arose it was not because of the unexperienced investors on the Hungarian market (even though it is undeniable that sometimes a quite striking divergence exists between one investor and the other). The harshest diversity can be detected in Hungary between the respective attitudes of domestic or foreign private venture capitalists and that of, directly or indirectly, state-owned investors. The difference between British and Hungarian investors emanates from the difference between the advanced level of the market economy in the UK and its early stage in Hungary.

Venture capitalists in Hungary have no opportunity whatsoever to rely on a company-based databank or on auditing firms which have sufficient experience. As an alternative, to step on the stock exchange is not necessarily a wise solution for domestic investors; however, it can partly help to provide public information related to companies and it can later serve as a way of exit for venture capitalists. Moreover, a foreign investor in Hungary lacks the same sort of legal security with which he is familiar in his home country.

Learning about the behaviour of investors operating in the UK venture capital industry—which is the second most advanced worldwide in terms of investors'

approach as well as how they handle their investments—offers a good opportunity to have a base for comparison in order to assess all the characteristics of Hungarian investors. Furthermore, analysing the attitude of investors in the UK, after the investment decision and the investment contract have been made, it is possible to anticipate some modifications with regard to how investors will possibly react in the Hungarian venture capital business later on. An improvement for the future could be the shaping of the required rate of return on a permanent base in line with the particularities of a concrete investment. Stock exchange-based assessments will probably take a pivotal role among the evaluation methods as well as management agreements. This will make the growth of managerial interests in the company dependent on the company's results and it will certainly motivate managers more effectively. Finally, it also seems to be feasible that monitoring systems be set on a more flexible basis with regard to the life-span, size and other characteristics of the investees.

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THE RELOCATION PHENOMENON: "MOVEMENT OF JOBS" FROM WEST TO EAST EUROPE*

L. NEUMANN

On the basis of Western professional literature this study analyzes the undoubtedly strong process of deindustrialization taking place in Western Europe and its connection with the opening up of Eastern Europe. Very interesting studies have been made about a number of countries (mainly Belgium, Germany and Austria) concerning the social conflicts, great publicity and debates which have occurred due to enterprise closures and downsizing related to relocation. These studies show convincingly that, after the cold war, the more open trade of Europe can be regarded as an unambiguous success for Western Europe. Examples of rather dubious relocations to the East show that the companies and national economies of a Western Europe in economic transition have made profits due to structural changes.

> "Workers at a French factory have taken their directors as hostages; workers are afraid that the establishment will be closed down. They said that one of the production lines had already been relocated to Hungary. This case happened in the Panasonic plant in Longwy, where the Japanese firm manufactures video recorders..." (*Népszabadság*, April 26, 1997)

> "In fact, Electrolux relocated their production units, less profitable in other regions of the world, to Hungary. Four years ago deep freezers from Canada, in 1994–95 absorption refrigerators from Luxembourg and England, last year bottle coolers from Germany and deep freezers from Denmark, this year vacuum cleaners from Italy have been the new products at Lehel, the Hungarian affiliate company." (*Világgazdaság*, May 17, 1997)

According to the articles quoted above, foreign capital investment—often declared a success story in Hungary—is far from being straightforward for the parent country and West European multinational companies. The issue of labour market competition is raised most often by employees, trade unions and politicians. In addition to the phenomenon of the migration of eastern labour commuting to the West, the problem of the relocation (or *délocalisation*) of economic activities to countries offering lower wages occurs frequently.

Here, it is assumed that complex interest reconciliation and lobbying activity has been at work beyond European Union level and the national regulations allowing individual countries to implement some kind of protection (contrary to the declared EU principles of the free movement of goods and capital). The aim of the protection is itself a means of defending markets enjoying success from undesirable external competition. Nevertheless, despite the relatively frequent occurrence

*This study has been prepared within the framework of the 10th project of the working group for Integration Strategies.

0001–6373/95/$5.00

of such political action provoked by factory close-downs and relocation, to which we shall return later on, one cannot speak of even partial success with respect to the protection of national labour markets. As leading politicians know very well, such action would also be entirely senseless from the point of view of the respective national economies concerned.

Relocation in the economics literature

The classical theory describing capital movement and multinational companies starts out from the standard interpretation of external trade—i.e. Ricardo's theory of comparative advantages. A more advanced theoretical framework is provided by the factor endowment model that has, for a long time, provided satisfactory explanation for trade between the developing and the developed countries. Contemporary European trade, however, can hardly be understood in terms of the scarcity of production factors and differences in prices; this would leave unexplained, for example, intensive capital movement between developed market economies offering by-and-large identical labour costs and constituting, for that matter, the decisive majority of western relocation cases. Theories focusing on concepts such as technological gap, product cycle and economies of scale have also made significant contributions to the explanation of the international division of labour. Contemporary company strategies and the underlying economic policies, however, cannot be understood without the context of globalisation, regionalisation and structural problems. Single-factor orthodox economics theories tend to give way to increasingly "eclectic" pragmatic views (*Dunning* 1993; *Hamar* 1993; *van Liemt* 1992; *Halpern* 1997). In what follows, instead of emphasising theoretical subtleties and their political implications, we shall focus on the relocation phenomenon itself and on related political practice.

Geographical relocation of jobs may be due to one, or more that one out of three kinds of respective economic processes. In the simplest case, cheap goods imported in the framework of classical *foreign trade* squeeze out domestic ones produced at a higher cost, making the domestic producer stop production and liquidate jobs. The second process (involving no transfer of materials in most cases) is the *outward processing* initiated by either the producer or the distributor, intending to transfer labour-intensive phases of production to lower-wage countries. The global procurement policy (i.e. outsourcing or global sourcing) of big West European and American retail chains and brand owners plays a major part in today's process of globalisation. Finally, the third possibility is *foreign direct investment* (FDI); there can be little doubt that this is playing an increasing role in job migration today. Multinational companies are involved in every form, but their position is especially favourable when it comes to profiting from the advantages of direct investment;

this is due to the fact that they are able to coordinate development, production and sales phases via their internal hierarchy, whereas in the other two cases coordination inevitably involves external, contractual, relationships. Relocation pure and simple (i.e. the physical liquidation of well-defined jobs in one country and their re-appearance in another, and involving the dismantling and transfer to a new work site with new equipment) is a relatively rare phenomenon. This is because of the fast changes (driven by incessant production mix, technology and organisational development) taking place, even with units performing the same functions. This is the reason why the relevant literature prefers to treat the relocation phenomenon in its wider, functional, sense to investigating the narrower, physical, one.

It is easy to understand that simple trade relations with the East Central European countries represent no direct threat to jobs in West Europe. Although the volume of trade has expanded significantly since 1989, commodities originating from East Europe replace those coming from suppliers from outside the European Union—from Latin America, for example, in the first place. It is worth noting the fact that the European Union has a considerable industrial finished goods trade surplus relative to the East European countries. (Asia, a more important trade partner, has nearly attained a break-even trade balance in this relation.) East European countries export labour-intensive products and import production equipment, research results, (i.e. knowledge), and technology-intensive products. The imbalance of the trade turnover and the nature of the international division of labour, are highly reminiscent of those found in the developing countries. In the final analysis, Western European countries enjoy the advantages of access to new markets thanks to their expanding exports, and labour-intensive imports from the East force them to implement structural changes. So far the member states of the European Union have clearly been the winners of the liberalisation of trade, even in the area of the so-called "sensitive" goods. Export expansion feeding on trade liberalisation in turn clearly plays a positive employment role on the side of the European Union—that is, relocation is not a uni-directional process resulting in job losses in the West. (*European Parliament* 1996a)

In the first two cases of relocation, the importing country, or the one that relocates production, obviously loses jobs, but foreign direct investment does not necessarily imply physical relocation. A considerable part of the relevant western literature is still busy identifying the drives of the process, and demonstrates quite convincingly, especially for Eastern Europe, that the most frequent goal is market access and the most important prerequisite political stability. Low labour costs rank seventh, preceded even by the skill level of the workforce (*Gabrish* 1996). Geographical proximity and wage costs are even less important in capital flow among Western European countries, the main attractions here being technical innovation, advanced infrastructure and services, and highly qualified labour and management. If inward FDI in East Europe is actually motivated first and foremost by the wish to gain a foothold on the local markets instead of the competitive edge provided by

lower wage costs, it does not necessarily affect production and jobs in the parent country.

However, even if the labour-intensive phases of production were finally relocated to countries offering cheap labour, this would not be entirely detrimental to the economy and labour market of the country of outward investment. From the point of view of outward foreign direct investment, the following initial hypotheses are usually taken into account.

— Relocation of the labour-intensive phases of production to countries offering lower wage costs increases both the export and import competitiveness of the remaining part. Hence relocation is an important element of *structural change*, whether at branch level (development of services outpacing that of manufacturing) or within the company (gradual predominance of phases producing a higher value added at units located in the developed countries).

— Although the outward investment is advantageous to the economy overall, certain employee groups, companies or regions may lose by the transition, especially in the less competitive branches and areas, where employees are less educated and mobile.

— Different forms of relocation have different impacts. Hierarchical relations within multinational companies allow for a more gradual transition and the internalisation of transaction costs; thus, in general, these are considered more favourable than simple trade contracts or subcontracting.

Relocation in the narrow sense is thus part of the more general phenomenon discussed by contemporary literature under the general heading of "globalisation". The labour market impacts are to be examined from the points of view of both outward and inward foreign direct investment, and a more comprehensive analysis must cover the quantitative, qualitative and regional aspects of job movement. The direct and indirect impacts to be taken into account are reviewed in *Table 1*.[1]

Empirical research and country studies at the European Union level

Research studies usually start out from the more general phenomenon of globalisation. This includes everything from the opening up of Eastern Europe after the cold war, through the development of the communications and transport infrastructures, to the establishment of the legal and financial systems required for doing business. Whether or not it is possible for mass production to be relocated to another region is, in some sense, determined by branch-specific features.

[1] Although this study assesses the phenomenon primarily from the point of view of outward investment, the criteria in the table relating to inward investment could be conceived of with a view to an analysis of the domestic impacts of multinational companies; thus they can be seen as a set of hypotheses for a prospective empirical research project.

Table 1

The range of potential effects of foreign direct investment on the quantity, quality and location of employment

Area of impact	Inward foreign direct investment			
	Direct		Indirect	
	Positive	Negative	Positive	Negative
Quantity	Adds to net capital and creates jobs in expanding industries	Foreign direct investment through acquisition may result in rationalisation and job losses	Creates jobs through forward and backward linkages and multiplier effects in local economy	Reliance on imports or displacements of existing firms results in job losses
Quality	Pays higher wages and has higher productivity	Introduces practices in, for example, hiring and promotion that are considered undesirable	Spill-over of "best practice" work organisation to domestic firms	Erodes wage levels as domestic firms try to compete
Location	Adds new and perhaps better jobs to areas with high unemployment	Crowds already congested urban areas and worsens regional imbalances	Encourages migration of supplier firms to areas with available labour supply	Displaces local producers thus adding to regional unemployment (i.e. if foreign affiliates substitute for local production or rely on imports)

Table 1 *(continued)*

The range of potential effects of foreign direct investment on the quantity, quality and location of employment

Area of impact	Outward foreign direct investment			
	Direct		Indirect	
	Positive	Negative	Positive	Negative
Quantity	Creates or preserves job in home location —e.g. those serving the needs of affiliates abroad	Relocation or "job export" if foreign affiliates substitute for production at home	Creates or preserves jobs in supplier/service industries at home that cater to foreign affiliates	Loss of jobs in firms/industries linked to production/ activities that are relocated
Quality	Skills are upgraded with higher value production as industry restructures	"Give backs" or lower wages to keep jobs at home	Boosts sophisticated industries	Downward pressure on wages and standards flows on to suppliers
Location	Some jobs may depart from the community, but may be replaced by higher skilled positions, in this way upgrading local labour market conditions	The "export" of jobs can aggravate regional/local labour market conditions	The loss of "blue collar" jobs can be offset by greater demand in labour markets for high-value added jobs relating to exports or international production	Demand spiral in local labour market (triggered by layoffs) can lead to employment reduction in home-country plant locations

Source: *UNCTAD* 1994

In motorcar production, for instance, research and development and production may be separated geographically, while in the aerospace industry they are kept in the same place. Globalisation implemented by multinational companies is considered essential; its extent is the ratio of foreign trade within the same company. In the OECD countries the overall total is estimated to be around one-third of the total turnover.

An examination of relocation by the target country yields unexpected results: the decisive majority of the cases are the results of inter-OECD capital movements. Approximately two-thirds of the jobs relocated from Belgium, for example, were directed to the developed countries, especially neighbouring Germany, France and the Netherlands. The countries in question are Belgium's major trading partners anyway, and relocation is obviously governed by the complex strategies of multinational companies. Wage costs hardly figure among the motives. From the point of view of corporate strategy, finer analysis may make a distinction between cases involving relocation in the physical sense, factory shut-down/downsizing, expansion or diversification. In Belgium, for example, relocation in the broad sense was responsible for 24 percent of the mass redundancies only, the rest being due to other causes (technological development, market change or rationalisation). A mere 10 percent of the relocation cases originating in Belgium consisted of factory close-downs due to the launching of a production unit abroad, while 27.5 percent of the cases definitely served the purpose of expansion. Typical examples of the latter type are Belgian food industrial, food distribution and pharmaceuticals investments to Hungary (*Bernhard et al.* 1994).[2]

As far as relocation within the European Union are concerned, we may assume that those targeted at countries in a peripheral position, having joined the Union at a later date (i.e. Spain, Portugal, Greece, Ireland), will be of relevance for Hungary. Spain has, for years, attracted 15 to 20 percent of the European capital investments and Ireland has also scored successes on a similar scale lately, while the respective performances of less developed Greece and Portugal have lagged behind in this field. Production tends to be relocated to the relatively less developed countries, with R&D and coordination and control functions concentrated in the developed ones. This distribution may lead to the consolidation of the semi-peripheral status of entire regions/countries: i.e. an uneven, hierarchical, system of the distribution of power and income-generating capacities is emerging throughout the European Union (*European Parliament* 1996b). Numerous under-developed regions in Europe have tried to attract significant capital investments, but it remains to be seen whether individual companies will actually be capable of guaranteeing all

[2]The 1994 survey makes explicit reference to the cases of the Interbrew-Borsod Brewery, to Douwe-Egberts-Compack and Alyum and, in passing, a few production units affecting the Belgian companies of Ontex, Philips and Samsonite.

the factors required for their integration into the local economy. Relocating companies are often accused of robbing other enterprises of qualified labour (i.e. of "skill poaching"). That is, in addition to direct job creation, losses due to the "ousting effect" must also be taken into account. In the final analysis, the market-driven process of relocation stabilises or rather intensifies inter-regional structural disparities and uneven development (European Parliament 1996b). Although structural and cohesion funds allocated to the peripheral regions of the European Union are, in theory, meant to compensate for these effects, aid originating from the funds are lower by several orders of magnitude than foreign direct investment to—the more developed regions of—the same countries (*European Commission* 1994).

It is worth comparing the growing role of East Europe (as a migration target for Western European jobs) to global trade and capital investments to the East European countries.[3] Although the "Visegrád countries" no doubt are a fashionable investment target today, one must not disregard the fact that the weight of Eastern Europe (i.e. the former Soviet territories included) in world trade and capital flow does not exceed 3 percent. The corresponding share of the fast-growing South-eastern Asian region is 5 to 10 times that, and even Central America and the Caribbean attract four times the amount of capital in question.

The volume of outward processing trade, on the other hand, is less well known. From the point of view of the developed market economies, this, too, is an efficient means of structural change. This is because it leaves the human-capital-intensive an high-profitability phases of production behind in the parent country. Note that the "exported" low-wage jobs do not necessarily imply activities requiring a low skill level. Typical areas of outward processing include the textile industry (with special regard to clothing and footwear), and certain branches of engineering and the transport vehicle industry. Contrary to capital investment, the strategy of outward processing implies high flexibility: the activity may be relocated again at a minor transaction cost, without capital loss, should the circumstances change. It is an essential economic condition of outward processing relations between the European Union and East Europe that import deliveries consisting of spare parts originating from countries of the European Union are accorded preferential customs treatment by the countries of the Union (European Parliament 1996a). From 1989 to 1994, outward processing deliveries from the Visegrád Countries, Romania and Bulgaria expanded by 24 percent on average annually, as opposed to an average annual growth of 18 percent for other non-European-Union countries. Hungary and Romania were already important partners in 1988, while the others joined outward processing trade later on. Today, 70 to 80 percent of the Romanian and Polish textile industries depend on outward processing, while the Czech Republic, for instance, performs more diversified outward processing activities—for example, in the motor-

[3] Western studies analyse East European investment data by country and branch, and in detail. This is well-known in Hungary but it will not be considered here.

car industry. Nevertheless, the bulk of outward processing taking place in the region as a whole takes place in the textiles and clothing industry, whose role has grown, even during the period under scrutiny, from 64 to 75 percent. East Europeans have taken away markets from such traditional suppliers as Morocco and Tunisia. The same, however, is not true for the production of other industrial goods, where the developing Asian countries have achieved a definite prominence. The most important outward processing users are Germany, the Netherlands, France and recently Italy. German clothing companies procure approximately half of their domestic sales from outward processing sources, so that in this sector sub-contracting is actually the decisive form (European Parliament 1996a). Data on outward processing are similar in Hungary, where the share of this form within the overall export rose from 24 to 27 percent from 1995 to 1996, accompanied by the slow decline of the corresponding proportions of value added. Growth was most pronounced in light industry (65 percent), followed by engineering (33 percent) and the chemical industry (10 percent) (*Napi gazdaság*, December 14, 1996).

Although outward processing-related job relocation may imply job losses to workers of western companies in the short run, the resulting specialisation may enhance their job security. In the textiles/clothing industry, for example, the sewing phase is relocated, but basic materials and accessories production is not. Owing to the low costs of labour, and to geographical proximity and cheap delivery, the proportion of primary materials and accessories in finished goods may be higher for outward processing located in East Europe than in the Far East. Job loss in the parent country is more than adequately compensated for in previous phases of production and other high-value-added phases such as design once production has been boosted. In Germany, for example, the proportion of jobs lost and created has been changing historically as well: in the seventies, at the time of the first wave of outward processing in Asia, more jobs were lost than created in other work phases. In the eighties, the trend reversed, and more jobs were created in secondary phases than lost in primary production. The trade balance showed even more spectacular changes related to differences in the volume of value added by individual work activity. This tendency, dating from the eighties, has persisted since 1989 when the East European countries joined the process (Gabrisch 1994).

From a Hungarian point of view, the most important of the numerous country studies devoted to this issue are those dealing with *Austria* and *Germany*, owing to the role of these countries in Hungarian trade and capital import. (The most important, but not necessarily the most interesting seems to be Belgium; in the latter relocation provoked ardent debates and the phenomenon was examined most thoroughly.)

The East European sites of *Austrian* companies were already employing 60 thousand in 1992. According to estimates based on the assumed five-to-ten-fold difference in labour productivity between the two countries, this is equivalent to the relocation of 6 to 16 thousand Austrian jobs (*Neudorfer and Bach* 1995); this

represents less than one percent of employment in the Austrian private sector. The figures, however, are to be queried (to say the least) if we take into account the nature of eastern investments. The decisive majority of direct investment was targeted at the services sector (e.g. trade, finances etc.) and the production of investment goods and construction. On the other hand, in the domain of traditional consumer goods outward processing has obviously been organised to exploit the advantages of cheap labour, and it has showed much faster development. According to the relevant surveys, the main motive for capital investment has been to conquer local markets; one study indicates that three-quarters of the investors wanted market access above all, with low labour costs playing a part in ten percent of the cases only (European Parliament 1996a).

Hard evidence concerning links with Austria are to be sought, as usual, in trade statistics. All in all, in 1993, only 6 percent of the country's external trade with East Europe took place in the framework of international companies, and re-export was of relevance only for Slovenia and Hungary. More importantly, exports to the East European countries were equal to twice the imports originating from the same. As in Germany, cheap imports threaten low-wage/low-skill branches in Austria, but this effect is counter-balanced at the level of the national economy by export growth. Not even the frontier zone between Austria and Hungary has reason to complain of recession due to imports. On the contrary: economic growth in the eastern provinces was already exceeding the national average before the country's accession to the European Union. Eastern outward processing enhanced the competitiveness of the companies concerned. This process first took place in the textiles industry and then moved in the direction of the machine and transport vehicle industries. (Migration is likely to have played a part in growth in the eastern provinces, but no specific data are available about this. Studies only make references to wage competition due to the presence of "guest workers". In activities requiring low skill, East European workers beat down wages and contribute to domestic unemployment. This process is considered disadvantageous from a strictly economic point of view as well, hindering as it does the—necessary—structural adaptation of Austrian companies, given that growing and decaying firms both have recourse to cheap alien labour.)

According to a survey, every second Austrian company has profited from the opening of East Europe and, according to their answers, they considered the ensuing opportunities more important than the risks involved. Austrian authors estimate that the country has gained some 20 thousand jobs thanks to the opening; moreover, these jobs have been in profitable areas requiring high qualifications. On the other hand, its losses have been concentrated in industries characterised by low skill labour (e.g. saw-mills, metallurgy, ceramics, textiles and clothing). The emerging dual labour market phenomena point to the fact that despite the advantages of the process to the national economy, fast transformation has losers who should be protected by structural and social policy instruments.

Job exports triggered considerable trade union resistance and many professional debates in *Germany* as well (*Wortmann and Dörrenbächer* 1997). Understandably, this is a sensitive issue for westerners having fresh experiences of job exports to the east after the unification—for instance, consider when *Länder* of the former German Democratic Republic became priority targets for production and services investments. Recently, the negative balance of the FDI flow has caused particular concern. A record amount of DEM 50 billion flew out of the country in 1995, and only one quarter of that amount entered it. The ratio of foreign investments corresponds to 12 percent of the GDP, and it somewhat exceeds the average of industrialised countries. In 1980, some 10 percent of the total German working population was employed by German companies abroad; by 1995, this proportion had risen to 15 percent. Growth was even faster in industry (from 11 to 29 percent), while services preserved their basically domestic orientation. This phenomenon, however, can by no means be attributed to capital flight: French and British companies are even more inclined to relocate production to sites abroad. The process, resulting in German companies abroad contributing 8 percent of the domestic product, is to be considered a normal one. In other words, it is part of the accommodation process of the companies in question, especially in problem-ridden sectors such as the textiles and clothing and footwear industries. At the same time, several authors are of the opinion that investments in 1994 to what used to be the GDR were driven by the intention to acquire new markets and not because of the attraction of lower wages. Production investments, on the other hand, especially those by major investors, have essentially been channelled to the motorcar industry and the local and third-country markets. Consequently, they do not compete with German producers but, on the contrary, promote the latters' exports.

The proportion of German outward processing relations is quite remarkable: in 1993, this form contributed 16 percent of the goods imported from East Europe. There are significant differences by industry: the respective proportions for clothing and electrical engineering, for example, being 60 and 20 percent. Capital investment, on the other hand, shows an inverse tendency: 1.9 percent only of the eastern capital outflow was directed to the clothing industry, and 25 percent to motorcar production. This shows that capital investment and outward processing are not alternatives, but distinct branch-specific corporate strategies.

Theoretically, one may nevertheless measure the relative long-term advantages of outward processing versus capital investment to the eastern partner countries. The first obviously has the "historical merit" of having survived after 1990 (East Central European companies having lost their markets and run out of state subsidies). However, in the long run, the same companies would have to face competition from even cheaper outward processing partners—first of all from the successor states of the former Soviet republics, i.e. countries that have little chance to acquire the technology and know-how required for entering the world market on their own. Consequently, such countries represent no threat to member states of

the European Union with respect to dumping cheap goods on the West European markets. (This is probably one reason why the deregulation of the trade in textile products was put on the EU agenda for 1997–1998.) The advantages of outward processing—i.e. low costs and flexibility—thus occur on the side of the Western countries. Foreign direct investment, on the other hand, may contribute to a larger extent to the diversification of the economy of the host country and the realisation of major capital investments that would otherwise hardly be feasible in the countries of the region. Investment is advantageous to both parties, increasing as it does the exports of the members of the European Union, integrating the host country more tightly into the global production networks and giving the latter's companies a better chance for technology and know-how development. Capital investment hence distributes advantages more evenly and consequently represents a more favourable solution to both parties (Gabrisch 1996).

Of course, western jobs tend to be lost in the low-wage/low-skill sectors, but the most important cause here is the Far Eastern region and not the countries of East Central Europe. Restructuring, on the other hand, may exert a more beneficial influence on domestic industry, as witnessed by the example of the German furniture industry. Relocation in this case was accompanied by market expansion, resulting in a German foreign trade surplus in this branch, even relative to the Far Eastern and East Central European supplier countries. That is, relocation exerts a positive influence on those labour market positions requiring higher skills and offering higher wages. The extra labour demand for managers and experts working for companies abroad in cases of direct capital investments, especially in the initial period, should also be taken into account, theoretically, on the positive side of the labour market balance.

Country studies are extremely cautious when they come to employment policy conclusions and political recommendations. In their opinion, the root of the problem is the low competitiveness of obsolescent, problem-ridden industries in the countries of the European Union where rationalisation should be put on the agenda anyway, irrespective of relocation. That is to say that those blaming relocation exchange cause and effect, and prescribe the same employment policy therapy for job losses due to rationalisation and relocation: i.e. the enforcement of the accommodation capacity of companies and, as far as the unemployed are concerned, new enterprise promotion and training schemes for the unqualified. In the area of human capital investments, they would prefer non-specific forms of training. This would make it easier for the unemployed to re-enter the labour market and it would bring about a more flexible utilisation of the workforce by companies (European Parliament 1996a).

Western experts are cautious in wording the possibilities for imposing limits and implementing restrictive trade policy measures as well. Given the fact that job losses due to relocation (suffered by those having lower skills) are not always replaced, even in quantitative terms, by expanding opportunities for those with

better skills and qualifications; they acknowledge that, in principle, European Union level intervention would be justified. At the same time, it is impossible to impose general constraints on capital investment and outward processing, as this would deprive the Union of cheap procurement sources and export opportunities in the trade of goods and services producing a higher volume of value added. At the most, a special policy package to counter negative impacts in case of "too keen or unfair competition" could be discussed. In this case, however, politicians would have to solve the insoluble—i.e. to make a distinction between "good" and "bad" relocation. Action against unfair competition, on the other hand, seems a feasible alternative if the competitive edge is due to "excessively low" labour standards. It is well known, at the same time, that the social clauses of international trade agreements have not been very successful so far (European Parliament 1996b).

Reference to labour standards is a well known option that has been used by the USA, for example, for decades in connection with granting or refuting most favoured treatment to applicants. Similar tendencies also recur from to time in the legislation and social dialogue of the European Union. Doubts are partly based on theoretical grounds: social clauses may have an effect that is opposite to their original goal—e.g. commercial constraints aiming at helping countries with lower wages in order to achieve higher standards of living may deprive them of the means thereof. (According to the well-known analogy, in the Third World only 5 percent of child labour is involved in the export sector, but suppressing that would deprive masses of families of their means of living.) Other problems are practical in nature: "minimum" labour standards should be defined and, an even bigger problem, implementation control be deployed. Labour standards do not play an important part in decisions concerning foreign direct investment and, consequently, they cannot be expected to exert an influence of any merit on capital movement.

According to the final conclusion of the study of the European Parliament, the problem of labour standards could be resolved by tightening the integration of the supplier countries (i.e. the target countries of relocation), instead of their isolation. Companies suffering losses should be allocated trade policy assistance by their own country or by Brussels. At the same time, this would be limited to resolving temporary adjustment problems, since long-term assistance generates rent-seeking behaviour. According to the study, the solution, and the area where potential contribution by the European Union would be most welcome, lies in training. The latter could contribute to the development of flexibly adaptable human capital as well as enterprise promotion (European Parliament 1996a).

Leaving Europe for a moment, one comes to the conclusion that relocation, a concomitant of both globalisation, is *not a major matter* for the developed countries. The most expressive analogy is perhaps the labour market impact of NAFTA, the North American Free Trade Agreement. According to a survey by the US Ministry of Labour, as a result of the agreement signed in 1993 by the USA, Canada and Mexico, some 100 thousand jobs were lost in the United States, an infinitesimal

amount as compared to the 140 million strong labour market of the country; thus the losses were of a magnitude not identical to the gains involved for the developed national economies (personal communication by *Duncan Campbell*, ILO). NAFTA's example may be more interesting for us than the Asian analogies, since the proportion of wage costs between the USA and Mexico is similar to that between the European Union and Hungary. Furthermore, the quality of foreign investments to Hungary and of jobs created there show many similarities with the former NAFTA duty-free zone—the export processing zone called Maquiladora—established on the frontier between the US and Mexico. (I do not want to imply that companies in Hungary in foreign ownership perform exclusively mass production which requires no special skill. Such a company strategy would not be rational either—investors could easily find lower wages than the Hungarian ones elsewhere in the region—but the labour demand and labour practice of many electronics plants and motorcar plants producing components is very similar to that of the export processing zones in the Third World. However, in order to obtain a reliable overview of the situation, thorough empirical research findings would be required.) Another analogy is the strong anti-NAFTA campaign waged by the trade unions prior to its signing: AFL-CIO used all its influence and called mass demonstrations to prevent the conclusion of the Agreement. (Trade union estimates at that time feared that as many as 600 thousand jobs could be lost.) When President Clinton finally signed the free trade agreement, it became obvious that for politicians the economic interests of businessmen and consumers overrode the short-term interests of employees which were clearly contrary to those of the former.

Trade union action against job losses in relocating industries

In Western Europe, a major factory closure or the exodus of a multinational company usually leads to trade union action and occasionally political crises, especially in the French-speaking territories. Memorable cases include the shut-down of a Belgian chemical-industrial Michelin plant in the mid-eighties (by the way, the company has withdrawn from Belgium completely since then), the relocation of a Hoover unit in 1993 from France to Scotland, and most recently the shut-down of Renault's Belgian factory. We shall review the last two cases in more detail in what follows.

Hoover, the partly American-owned vacuum-cleaner company, announced in 1993 that it would relocate its plant near Dijon to Scotland because the island site offered lower indirect wage costs. 600 jobs were liquidated at the 700-strong factory in France, and production was relocated to an already existing plant of the multinational company near Glasgow. This Scottish plant employed a staff of 975 at that time. Direct wage costs were also lower in Great Britain (costs per

industrial work hour amounted to ECU 15.27 in France and ECU 12.20 in Great Britain at the very beginning of the nineties). However, the main motive was the combination of flexible regulations on non-wage costs and work organisation *and* much lower wages in Scotland. The direct motive, on the other hand, was the newly-concluded Scottish collective contract giving company management a highly favourable position. The Scottish trade union agreed to freeze wages for 11 months, to introduce a flexible work organisation system and a moratorium on strikes; also, the union made considerable concessions with respect to the rules governing the management of company pension funds. Newly hired employees actually acquired an entitlement to join the pension fund after a period of two years. The new collective contract, moreover, allowed the allocation of part of the accumulated capital of the fund for the purpose of company investments. This "deregulation" introduced by negotiations and the above-mentioned Scottish working conditions were not exceptional in Ms Thatcher's Great Britain, which was characterised by weak trade unions: for example, similar rules applied to nearly one third of the company pension funds. Company-level collective contracts, moreover, also allowed fixed-term employment contracts to be agreed upon with newly hired staff; the re-allocation of staff from one position to another and teamwork were also accepted. Although Scottish trade union leaders were attacked by the French for their lenience, under the given circumstances the accusation was probably unjust. Prior to the signing of the collective contract, there were strikes and picketing in Scotland when the company wanted to take a unilateral decision concerning the allocation of the pension fund (*European Industrial Relations Review* 1993; *European Industrial Relations Review* 1995; *IDS European Report* 1993).

Such "deregulated labour relations would have been practically unimaginable in contemporary, Socialist-led, France. The political significance of the case was enhanced by the fact that Conservative Great Britain refused to sign the Social Chapter of the Maastricht Treaty, and the leading concept of Thatcherite industrial policy gave high priority to foreign capital investment. This policy wanted to boost the latter by low labour costs and a deregulated labour market and labour regulations. The French side—represented first by the trade union, then the government and finally Prime Minister Beregovoy himself—accused the other party of "social dumping". The state labour inspectorate investigated compliance with the dismissal regulations. The French trade unions elevated the conflict to the political level, convincing their government that it should initiate a European Community-level investigation to find out whether the Scottish plant had observed the freedom of trade union organisation, whether the company had received a state subsidy (more specifically, regional development assistance). In other words, they tried to have the verdict of unfair competition pronounced on the British emphasising their own competitiveness, as it was claimed that the activities in question could be qualified as violations of the European Community Treaty. The fora of the OECD were also used to investigate compliance with the 1976 guidelines which apply to

multinational companies. Later on, international trade union confederations, and even Jacques Delors, President of the European Community Committee, joined the campaign against Hoover.

Although one could keep on listing similar such political initiatives, the essential thing is that the management of the Hoover factory was actually able to go through with the relocation. Simultaneously with the Hoover case, the French factory of Grundig was also closed down, with assembly relocated to Vienna and spare parts production to Hungary. Yet, given that a chocolate factory was relocated from Scotland to France at about the same time, one could hardly attribute relocation exclusively to differences in labour competitiveness.

The shut-down of Renault's factory at Vilvoordei, near Brussels, was announced in February 1997, without previous trade union consultations. The case does not qualify as relocation in the narrow sense: given the general shrinking of the European market, the Reanult empire was forced to downsize all over Europe. Even if they had relocated the production of the Mégane and Clio models to France and to Spain, finally jobs in France and elsewhere in Europe would also had to have been liquidated. (According to the strategy of the company, the key to the future is to boost sales and production outside Europe.) The interesting aspect of the case is its political relevance and the fact that it constituted the first major challenge to the institution of the European Works Council; it had been expected by the trade unions that the latter would provide considerable support for the assertion of interests against multinational companies (*ETUC* 1997a; *ETUC* 1997b).

The events themselves followed the Hoover factory scenario: strikes, demonstrations, and efforts on the part of the national and European trade union associations to make the Belgian and French governments and the institutions of the European Union intervene. (The details of the events can be traced in the February/March 1997 issues of the press as well.) The novelty of the trade union treatment of the case was the euro-strike and the mass demonstration in Brussels against unemployment. The issue was brought to the European Parliament, and even the King of Belgium issued a statement. The Belgian and French Prime Ministers called upon the Managing Director to observe the Belgian and European regulations on informing interest representation organisations in time. At the same time, it was quite evident to all concerned, that, at best, a few weeks' delay could be won to negotiate the terms of fair dismissal with the company. None could seriously expect the revocation or alteration of the decision itself. European trade union consultants and leaders were fully aware of what had been said about the economic aspect of relocation in the previous section (I experienced the same myself on the occasion of my May 1997 Brussels visit and interviews). The most they could hope for was a response to the alternative solutions they had drawn up—the rationale of the market and the economy exceeding their competence in the final analysis.

From a political point of view, one interesting aspect of the affair is that although Reanult was privatised, the French state still owned a 46 percent share in the company; the managing director had, right up until that time, occupied a high government position. On the other hand, it is not difficult to see the case in the light of a traditional Belgian/French cock-fight: the Belgian plant was Renault's most up-to-date unit and the decision could hardly have been motivated by rational productivity and cost/benefit considerations. (My first-hand experience is that Belgian public opinion considered the entire issue a French political decision having little to do with either business rationale or trade unions.) However, the case did have a certain impact on business, as share prices started to rise right after the announcement—this is exactly what the trade unions and the left found unacceptable: that the capital market should reward an irrational production decision.

Most intensive European-level trade union activity is partly justified by the spectacular failure of the new "accomplishment", the European Works Council, and partly by the more general political implications of the issue—i.e. essentially everything that is usually referred to as the "social dimension" of Europe. As far as European-level interest reconciliation and social rights are concerned, will the German/Scandinavian model included in the Social Chapter of the Maastricht Treaty gain the upper hand? Will the Union be "socially sensitive", or will business/employer positions supported by the Thatcherite opposition prove stronger? Will labour relations become "Americanised", or will labour regulation, the regulated participation of interest representations in company transformation typical of continental Europe, persist? (ETUC 1997a; ETUC 1997b).

The weakness of the European Works Council is partly due to the inevitable downward levelling due to the harmonisation of national legislation. There are two factory council models in Europe: the German one issuing stronger licences, and the French weaker licences, with the latter prevailing at the European level. What is more, Para 13 of the 1994 European Works Council Directive acknowledged as European Works Councils European-level "voluntary" participation institutions established earlier as well; the presence of the latter led to a further "dilution" of the licences involved. What happened in Renault's case was that European trade union leaders accustomed to the German factory council system tried to assert the German interpretation of the law. Consultation and information provision prescribed under the contract was considered a preparatory phase of the negotiations aimed, essentially, at making it possible to negotiate, dismissal terms and alternative solutions in time—on the basis of the information received—and to conclude an agreement binding to all parties. (The problem, I presume, is not unknown to experts familiar with Hungarian participation practice.) Let us note, however, that the German example—were in the given industry Volkswagen plays the model role—is rather contradictory itself. Two years ago Volkswagen managed to resolve similar problems by introducing shorter working hours and more flexible work organisation and the employer committed itself, according to a contract, to stop

lay-offs. While this solution would be the positive alternative proclaimed so loudly by the trade unions in the Renault case, one can read about the German-majority European Works Council of Volkswagen. This was established, in concert with the management, so that a system of labour division among European factories would allow for the more valuable phases of production to be kept in Germany: research and development, strategic models and the production of special and more demanding models will continue in the parent country, while cheaper (and hence of necessity lower profit-content) models will be produced by factories of the company empire located in countries occupying a peripheral position (European Parliament 1996b). The principle of product life cycle is a time-tested explanation for labour division by country within international companies—and one could hardly find a better example for that than Volkswagen.

European-level legislation did not deal with relocation according to merit, and neither did trade unions lobby in order to it, but attention was paid to the other component of labour market competition—i.e. the position of "posted workers" working for their company in another member state. Since this latter regulation essentially pertains to the assertion of vested entitlement (e.g. social insurance, pension) in another country of the European Union, from our point of view the German experiment, which was aimed at excluding the possibility of wage competition and trying to adjust the wages of *all* alien workers to the German rates is more important. Originally, an attempt was made to have a directive in line with that approved by the December 1994 session of the Council of Social and Employment Ministers, but it failed owing to the veto of Greece, Portugal, Ireland and Great Britain. After that, a bill was drawn up in Germany concerning the extension of certain working conditions ensured on a mandatory basis by German employers to alien workers in the construction industry. The provision would have applied to the minimum wage (the wage item in the lowest bracket) prescribed under the collective contract as well, and also to paid leave and supplementary leave. Employers' organisations were basically opposed to the bill, while trade unions objected to its being limited to one branch. The trade union would have agreed to impose a lower wage rate for foreigners by way of compromise if, in exchange, the provision had been extended to all workmen's activities. In their opinion, in the latter the dumping effect of foreign workers represented more of a threat to the position of German workers (*Freytag* 1997). It should be noted that trade unions are capable of achieving (irrespective of the relevant government order) on the basis of their own bargaining position such that foreigners should also be paid the wage rates specified under the German collective contract. (The same applies to Hungarian workers: those employed in motorcar production for example, as reported in *Szőke*'s article (1997) among others. Apart from the details, this case is also a fine example of the fact that, in the final analysis, the personal wages of Hungarian workers did not increase at all as a result of German trade union action.)

What then, is the position of western European trade unions with respect to East European relocation? Since relocation implies job losses to trade union members employed in sectors characterised by low competitiveness, low wages and low skills, at the level of slogans, the competent local trade unions or European-level representations always oppose job exports. At the same time, they describe the fact that an East European worker receives but a fraction of the payment for the same work as "unacceptable social dumping" (*ETUC* 1997c).

To understand the argument, one should be aware of the background and usage of the expression "social dumping". Dumping in the classical sense is the assertion on the given market of prices kept low by unfair means; in a wider sense, monetary, ecological, environmental, fiscal and social dumping are also mentioned (*IWERF* 1994). The real meaning of the term is that an agent can and does bypass general regulations applying to other competitors in the given area, whether by exploiting currency devaluation or more lenient environmental protection practices or state subsidies. Social dumping partly means that wages are kept exceptionally low, and partly labour violating the relevant standards accepted under the relevant international conventions (e.g. child-labour, forced labour, violation of labour safety regulations, evasion of social insurance obligations etc.). Social dumping was a serious topic of discussion in the European Community at the time of the accession of the South European countries, and the issue could only be resolved finally by the adoption of health protection and labour directives and standards. (Given the fact that differences in labour standards within the Community can easily become a temptation for job relocation, the fact that Great Britain did not join the system understandably gave causes for concern. The Hoover case reviewed above was actually about this fight, the same as numerous cases brought to the national courts and the European Court, of major significance in precedent law.)

The interesting aspect of the argument concerning East Europe quoted above is that it makes reference to wage disparities, while according to public consensus, social dumping within the Union—on the agenda owing to the accession of the South European countries and Great Britain's refusal to join the Social Chapter—may refer to any condition of labour *except* wages: it is impossible to order member states to set wage levels that do not match their economic development level and would diminish their competitive edge.

Trade union attitudes to eastward enlargement are characterised by a certain ambiguity. At the level of statements, the image of the loud supporter prevails: many leaders consider the integration of East European countries something of a moral obligation. At the same time, there exists a "quasi-intestinal" fear of rivals, whether the issue at hand is migrant labour or job relocation to the east (this situation exists despite the awareness, confirmed by numerous economic studies, that both phenomena are advantageous to the economy in the long run). Trade union documents occasionally show surprisingly thorough background knowledge and problem sensitivity: they are aware, for example, of the fact that a common

agricultural policy and the system of structural and cohesion funds are untenable, the same as current limits on the trade of "sensitive" goods or the differences in the economic and development levels of the South European countries having joined the Union earlier and the East European ones awaiting accession. They give a qualified answer to this contradictory situation: yes, we do support accession, but compliance with the social standards must come first as a prerequisite of accession negotiations. (*Langewieshe and Antilla* 1997). My personal experience, however, is that the contents of the social standards is open as of now: we do not know whether it will be limited to the freedom of organisation, labour safety regulations and legal harmonisation, or be extended to wages guaranteeing a living and the level and quality of social provisions in the welfare state.

The decision of the European Trade Union Confederation (ETUC) accepted in June 1997 also reflects the ambiguity of trade union concepts concerning the accession of East European countries (*ETUC* 1997d). The document which considers enlargement to be the most important task at hand calls on the Union to clarify the conditions of accession and promises active political support to East European countries for the time of the accession negotiations. The status analysis section of the document lists the economic problems of accession with great perspicacity, discusses the enormous GNP gap between the Union and the countries awaiting accession, the dependence of economic growth in the countries concerned on economic processes within the European Union, the enormous agrarian population of the eastern countries, and the low share of export-oriented investments within FDI in general. According to the document, marked wage differences between the European Union and the countries hoping to join the EU are conductive to the relocation of production. Under-qualified labour—i.e. those subject to competition represented by migrant or commuting eastern labour—are threatened most by the ongoing processes. All these circumstances may lead to net job losses in the countries of the European Union unless a West European economic boom takes place and an employment-oriented economic policy is developed. Extra burdens may be imposed on the labour markets of the European Union by migration due to wage differences that are likely to prevail in the long run and will, in the final analysis, increase the costs of accession. Despite grave statements concerning the impacts of migration, the document proposes no restrictive measures, although as is well-known, trade unions in some of the countries will only accept the accession of the east Europeans on condition of the phased implementation of the freedom of movement of persons. It is worth noting the fact, however, that according to the authors of the document, it is not a true alternative for the would-be accessing countries themselves either to join Europe in the long run as something of an "assembly subcontractor unit" or a low-wage zone. Therefore the proposal of the western trade unions objects to the systematic devaluation of Eastern European countries and to productivity growth falling short of wage growth.

The ETUC document specifies certain requirements in the "social dimension". In addition to the usual fundamental ILO standards (such as the freedom of organisation), it insists on European-level interest reconciliation, the presence of autonomous social partners, and also social consensus with respect to accession topics. The requirements of the White Paper which discusses harmonisation requirements exclusively from the point of view of economic competition must be supplemented so that compliance with the requirements of European social and employment policy should also be called to account. The goal of the trade union confederation is, in the final analysis, to have prospective accessing countries adopt the entire European "social dimension". From the point of view of the social standards of the European Union, the "liberal" reform of the East European social welfare systems in progress now is also a contradictory process. This is because, in the final analyses, it will increase the number of those falling behind—i.e. the poor—by relegating the principle of solidarity into the background. Yet the main goal of European Union social policy today is precisely to fight mechanisms and institutions promoting social exclusion.

East European perspectives: do they imply that inward investment has no problems?

As we have seen, today East Central European relocation is usually assessed in the context of globalisation—that is, in comparison with the role of other regions, pre-eminently the cheaper Far Eastern and former Soviet alternatives. Practically every study states that the main attraction of our region does not lie in its cheapness. More precisely, it *is* cheap, considering the fact that the western investor has access to labour approximating to the skill level of that in West Europe, political stability and a relatively advanced infrastructure in a region not very far from the parent country. What they mention by way of criticism is the absence of a money market and the low level of services. It is difficult to make comparisons with the developing countries, but this much is clear: the region is more industrialised and diversified than Korea used to be in the seventies, and the GDP is also higher than that of an average developing supplier country. The crucial difference, however, lies in the area of human capital: the level of schooling in these countries approximates to the Western European standards. This "late re-industrialisation phase" (Gabrisch 1996) raises the question of whether available human capital, together with higher-level technological investment, would make it possible to utilise this "learning potential", and whether the export structure of the countries in question could shift in favour of the more valuable activities. Western analysts, although they mention this possibility, do not examine it from the point of view of relocation. In principle, it is equally possible that this would be seen as a threat to more

valuable jobs in the West and therefore qualify as less desirable, or that relatively higher-value activities could also be integrated into the activities of the Western countries and the multinational companies without serious conflicts.

What is a hypothetical image of the future for western analysts is an urgent economic policy task for the country concerned about inward investment. Hungary is over the period when the main task was to ease massive unemployment by creating new jobs, whatever their quality. Economic growth and catching up, however, are both obviously inconceivable with low-skill industries producing little added value, because this brings back the possibility of the gradual deterioration of the exchange ratios and could thus lead at best to stagnation. It is beyond the scope of the present study to discuss what instruments are available to the government for excluding activities requiring low skills in a market economy environment surrounded by multinational agents, and then replacing them by industries requiring higher skills and offering a higher volume of value added; also, vulnerable outward processing relations should be replaced by more promising capital investment. The vanguard of the Asian "small tigers", Singapore among others, made this changeover in the seventies and eighties. The question now concerns the extent to which their instruments can be copied by a country in an entirely different economic situation.

To return to the phenomenon of relocation: in summary, it can be said that in contrast to western public thinking, the arguments of certain politicians and some trade union statements, liberalisation has so far been more advantageous than disadvantageous to the Western European countries. This is perhaps one reason why Western European governments seem to be more concerned about intensifying the migration of low-skill labour after the accession of the eastern European countries (rather than with the relocation issue). It is, moreover, to be assumed that the higher strata on the labour markets of the Western European countries may be affected more sensitively by present-day migration—that is, more than they were by the massive low-skill guest worker inflow at the time of the boom in the fifties and sixties. The argument that relocation is profitable for Western Europe can only be used at the accession negotiations—for example, it should be pointed out that, so long as Hungary is not capable of changing and upgrading the quality of relocated jobs there should be no problems for the member states of the European Union.

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Acta Oeconomica, Vol. 49 (3–4), pp. 309–333 (1997–98)

TWENTY-FIVE YEARS OF JAPANESE TRADE WITH EUROPE*

A. NAGY

This study analyses the development of trade between Japan and three European regions in eight commodity groups for the period 1970–1995.[1] It investigates the structural changes of the trade flows, the trade balances and their commodity breakdown between the regions and their development during this long period. The present study is in fact a by-product of a larger project which has as its overall aim the analysis of emerging new tendencies in international trade, especially the structural changes. (Nagy 1972; 1979; 1983; 1985; 1995) The research project has been in progress for several years.

Introduction

Analysis of international trade flows is an approach by which, instead of dealing with the foreign-trade relations of a single country, or surveying bilateral trade between pairs of countries, world commodity trade as a complex system is examined in order to demonstrate its structural changes in a consistent framework.

The trade flow model used in our analysis is based on the data published regularly in the *Monthly Bulletin of Statistics* (MBS) of the UN[2] and aggregated into 11 regions and 6 commodity groups.[3] Summing up the trade flows by regions, or by commodity groups, we get the total world trade (TW). When we talk about trade flows, it has to be taken into account that this term differs from the usual export and import values, where exports are usually measured in FOB and imports in CIF parity. In international trade flow models the value of exports of country A to country B has to be equal to the value of imports of country B from country A, even if the import expenditures of country B are higher than the export income of country A (because of transportation, insurance and other costs). The trade flow data published in the MBS use exports statistics (whenever possible) measured in FOB parity. This means that, in most cases, they exclude transportation and other

*Paper presented to the European Network on the Japanese Economy, a CEPR/ISEAO Conference in Milan, 16–17 January 1998.

[1]This study is a follow-up of a presentation to the International Research Seminar on East Asian Economies: "Economic Relations between Europe and East Asia", Nimes, in June 1997 (Nagy 1997). The research project on which this study is based was supported by the Hungarian National Scientific Research Foundation, No. T 018311.

[2]Published in February and May of each year, tables D. World trade data in this consistent framework are published with two years' delay.

[3]For a list of regions and commodity groups see *Appendix 1*.

costs; as a consequence import values are less than they are in reality, and in the trade balances surpluses are higher and deficits lower than in financial statistics. The difference becomes greater as the share of transportation costs increases in the total costs of the transaction—i.e. the bulkier the traded commodity. The trade flow data published in the MBS are given in current US dollars and, as a consequence, the price and exchange rate changes have a strong influence on the tendencies which can be observed.

This study analyses the development of trade relations between Japan and three European regions: namely, the Soviet Union/European CIS countries, Eastern Europe and Western Europe. As we intend to study the long-term development of structural changes in international trade relations, not many alterations to the regional breakdown of our model have been introduced. However, the changes of national borders following the political changes after 1989 have obviously had to be taken into account.

Thus, after 1992, the region designated as SU means the European part of the Commonwealth of Independent States (CIS), and this refers to the European countries of the former Soviet Union except the Baltic states.[4] The trade data of the Central and East European countries (EE) include—from 1992—the data of the Baltic States, Yugoslavia, Croatia and Slovenia.[5]

In the first section the growth of Japanese-European trade will be presented. This shows how differently Japanese trade developed with the Western and with the Eastern parts of Europe, respectively. Changes in the commodity structure of Japanese trade with the European regions are dealt with in the next section. This is followed by a discussion of methods which can be used to measure the influence of trade policies and, after defining the trade intensity indicators, the results of their analysis are presented. The final concluding remarks deal with issue of what can be expected of the future development of Japanese-European trade, and to what extent changes in trade policy might affect future commodity flows.

[4] The intra-trade among these countries has not yet been reported. Starting in 1991, the trade data of the former Soviet states are reported in commercial exchange rates and are not exactly comparable to the previous trade values.

[5] Yugoslav trade data were previously included in Western Europe (WE). Up until 1991 the Socialist Asia/China (SA) region included Vietnam, Mongolia and North Korea, but their intra-regional trade was not reported. The export data of this region between 1990 and 1995 contains only the exports of the People's Republic of China and the import data are missing. From 1992 the imports of China, the reported trade of the other three SA countries, and those of the previously Asian Soviet Republics are all included in the East Asian (AS) trade.

Table 1

Japanese foreign trade (million USD)

	Japanese exports, importing regions													
Years	SU	EE	SA	WE	NA	OD	LA	AF	WA	AS	TS	TD	TG	TW
70	341	107	744	2910	6578	1054	1112	1073	541	4855	1192	10542	7581	19315
75	1625	574	2519	8081	12411	3083	4663	4590	5536	12668	4718	23575	27457	55750
80	2778	807	5570	21463	34086	5981	8542	5958	13114	31242	9155	61530	58856	129541
85	2751	564	12878	24934	70566	7476	7763	3484	11326	33917	16193	102976	56490	175659
86	3150	682	10232	36927	86781	7689	8698	2903	9275	42464	14064	131397	63340	208801
87	2563	717	8644	45155	89868	8145	8086	3704	8336	53569	11924	143168	73695	228787
88	3130	776	9913	55736	96684	9802	8672	3684	8222	67754	13819	162222	88332	264373
89	3082	673	8684	56283	100523	10940	8855	3383	7775	74544	12439	167746	94557	274742
90	2563	996	0	62412	97619	10133	9712	3835	9570	90108	3559	170164	113225	286948
91	2115	922	0	68325	99342	9981	12243	3973	11583	106041	3037	177648	133840	314525
92	1128	762	0	71584	103579	10917	15053	4648	14201	117779	1890	186080	151681	339651
93	1581	660	0	64117	112681	11997	15914	5263	12569	136129	2241	188795	169875	360911
94	1298	598	0	65134	124619	13157	17650	4815	9821	158507	1896	202910	190793	395599
95	1215	794	0	73874	127844	13205	18522	4912	8892	193679	2009	214923	226005	442937

Table 1 *(continued)*
Japanese foreign trade (million USD)

	Japanese imports, exporting regions													
Years	SU	EE	SA	WE	NA	OD	LA	AF	WA	AS	TS	TD	TG	TW
70	379	88	283	1679	5373	1646	942	482	2062	2466	750	8698	5952	15400
75	927	187	1576	3546	11505	4512	1886	1136	15566	9657	2690	19563	28245	50498
80	1464	289	4288	8215	24181	7796	4367	1891	42498	28969	6041	40192	77725	123958
85	928	349	6327	9972	25656	7987	4707	945	24342	27339	7604	43615	57333	108552
86	1396	383	5560	13777	27036	8158	4551	988	15745	28939	7339	48971	50223	106533
87	1540	467	6808	19068	32030	7472	4965	1176	15796	38620	8815	58570	60557	127942
88	1951	644	8270	24058	43208	10455	6301	1634	16587	47311	10865	77721	71833	160419
89	2134	739	8394	27733	49914	10733	6697	1608	18659	54006	11267	88380	80970	180617
90	0	3661	9011	34453	53168	14616	7182	1401	12954	56120	12672	102237	77657	192566
91	0	1872	10217	32719	52354	15400	7432	1288	21377	60136	12089	100473	90233	202795
92	1784	364	11679	31630	52034	13688	6527	1494	21305	60018	13827	97352	89344	200523
93	2090	362	15776	31523	52588	13952	6292	1729	21575	63307	18228	98063	92903	209194
94	3203	339	21578	37707	58211	15515	7347	1426	5169	73615	25120	111433	87557	224110
95	3986	422	28467	46541	69177	17807	8969	1613	5323	91639	32875	133525	107544	273944

The growth of Japanese–European trade

Japanese trade, especially with respect to exports, has increased rapidly over the last twenty-five years: the value of total Japanese exports in current dollars has jumped from USD 19 billion in 1970 to USD 443 billion in 1995—i.e. it has increased by 2293 percent (*Tables 1* and *2*). Total imports grew at a somewhat slower speed: the increase was 1779 percent over the same period. The result of this process has been a rapidly expanding trade surplus which, by 1995, had reached USD 169 billion (*Table 3*).

Table 2

The growth of Japanese trade (percentages, 1970=100)

	Exports					Imports				
Years	SU	EE	WE	NA	TW	SU	EE	WE	NA	TW
70	100	100	100	100	100	100	100	100	100	100
75	477	536	278	189	289	245	213	211	214	328
80	815	754	738	518	671	386	328	489	450	805
85	807	527	857	1073	909	245	397	594	477	705
86	924	637	1269	1319	1081	368	435	821	503	692
87	752	670	1552	1366	1185	406	531	1136	596	831
88	918	725	1915	1470	1369	515	732	1433	804	1042
89	904	629	1934	1528	1422	563	840	1652	929	1173
90	752	931	2145	1484	1486	0	4160	2052	990	1250
91	620	862	2348	1510	1628	0	2127	1949	974	1317
92	331	712	2460	1575	1758	471	414	1884	968	1302
93	464	617	2203	1713	1869	551	411	1877	979	1358
94	381	559	2238	1894	2048	845	385	2246	1083	1455
95	356	742	2539	1944	2293	1052	480	2772	1287	1779

Japanese–East European trade developed in a very different way to Japanese trade with Western Europe. Both Japanese exports and imports to and from Western Europe grew faster than total Japanese trade (the increase of exports to Europe was 2539 percent, and of imports 2772 percent between 1970 and 1995); however, trade with the socialist and former socialist part of Europe increased much less. The high point of Japanese exports to the Soviet Union was reached in 1988 and to Eastern Europe in 1990 with USD 3.1 billion and USD 1 billion, respectively. However, since then it has declined substantially, as can be seen in *Table 1*. The value of exports to the SU/European CIS region was 3.5 times higher in 1995 than it was in 1970, 7.4 higher to the East European markets, while it was 25 times greater to Western Europe. This shows that the growth of West European imports from Japan was faster than North American imports, which increased 19 times in the same period.

Table 3

Japanese trade balances with the respective regions (million USD)

	Trade balances by regions													
Years	SU	EE	SA	WE	NA	OD	LA	AF	WA	AS	TS	TD	TG	TW
70	−38	19	461	1231	1205	−592	170	591	−1521	2389	442	1844	1629	3915
75	698	387	943	4535	906	−1429	2777	3454	−10030	3011	2028	4012	−788	5252
80	1314	518	1282	13248	9905	−1815	4175	4067	−29384	2273	3114	21338	−18869	5583
85	1823	215	6551	14962	44910	−511	3056	2539	−13016	6578	8589	59361	−843	67107
86	1754	299	4672	23150	59745	−469	4147	1915	−6470	13525	6725	82426	13117	102268
87	1023	250	1836	26087	57838	673	3121	2528	−7460	14949	3109	84598	13138	100845
88	1179	132	1643	31678	53476	−653	2371	2050	−8365	20443	2954	84501	16499	103954
89	948	−66	290	28550	50609	207	2158	1775	−10884	20538	1172	79366	13587	94125
90	2563	−2665	−9011	27959	44451	−4483	2530	2434	−3384	33988	−9113	67927	35568	94382
91	2115	−950	−10217	35606	46988	−5419	4811	2685	−9794	45905	−9052	77175	43607	111730
92	−656	398	−11679	39954	51545	−2771	8526	3154	−7104	57761	−11937	88728	62337	139128
93	−509	298	−15776	32594	60093	−1955	9622	3534	−9006	72822	−15987	90732	76972	151717
94	−1905	259	−21578	27427	66408	−2358	10303	3389	4652	84892	−23224	91477	103236	171489
95	−2771	372	−28467	27333	58667	−4602	9553	3299	3569	102040	−30866	81398	118461	168993

Table 3 *(continued)*

Japanese trade balances with the respective regions (million USD)

	Trade balances by commodity groups								
Years	AGRO-PROD	MIN-MET	FUELS	CHEM	OTHMAN	MACH	PRIM	MANUF	TW
70	−4034	−75	−3147	406	4737	6028	−7256	11171	3915
75	−11052	5962	−23803	2128	7513	24504	−28893	34145	5252
80	−21205	5656	−63887	880	20276	63863	−79436	85019	5583
85	−19407	5902	−48064	979	19232	108465	−61569	128676	67107
86	−23498	5607	−31721	1238	18587	132055	−49612	151880	102268
87	−29104	3139	−33031	1851	13417	144573	−58996	159841	100845
88	−37476	−9	−34520	2079	10748	163132	−72005	175959	103954
89	−39518	2468	−33700	1930	4382	158563	−70750	164875	94125
90	−39265	−5304	−35188	2545	4882	166712	−79757	174139	94382
91	−40152	−4575	−41643	3103	8447	186550	−86370	198100	111730
92	−42226	−320	−39715	4455	9296	207638	−82261	221389	139128
93	−44383	2149	−37721	5024	4901	221747	−79955	231672	151717
94	−51017	803	−21764	6627	−409	237249	−71978	243467	171489
95	−56536	−655	−23051	10212	−4909	243932	−80242	249235	168993

Japanese trade with the two post-socialist regions developed very differently: while imports from the SU region grew about three times faster than exports between 1970 and 1995 (causing a deficit for Japan of USD 2.8 billion in 1995), at the same time Japanese exports to Eastern Europe increased 50 percent faster than imports from there, thus producing a substantial Japanese export surplus.

It is interesting to compare differences in the size and dynamics of Japanese exports to Western Europe and to North America: in 1975 the value of exports to North America was 1.5 greater than those to WE, but as Japanese–American trade increased much faster, the difference had become 2.8 by 1985. In the next decade exports to Western Europe showed more development and as a consequence the difference in 1995 was 1.7.

Japanese export surpluses started to increase substantially in the eighties, reaching more than USD 100 billion by 1986 (*Table 3*). Over the next nine years it grew further, to reach USD 169 billion. The three main regions where Japan has the greatest surpluses are North America, Western Europe and Eastern Asia.[6] Looking at the trade balances by commodity groups, it can be seen that the total trade balance of USD 169 billion in 1995 was the result of a USD 249 billion surplus of manufactures and USD 80 billion deficit of primary goods. Nearly all of the trade

[6] The data in the trade balances with the AS region from 1992 is somewhat misleading, because of the way Chinese trade data were reported—see footnote 5.

surplus in manufactures comes from machinery exports; since 1994 Japan has had a deficit even in light industry products.

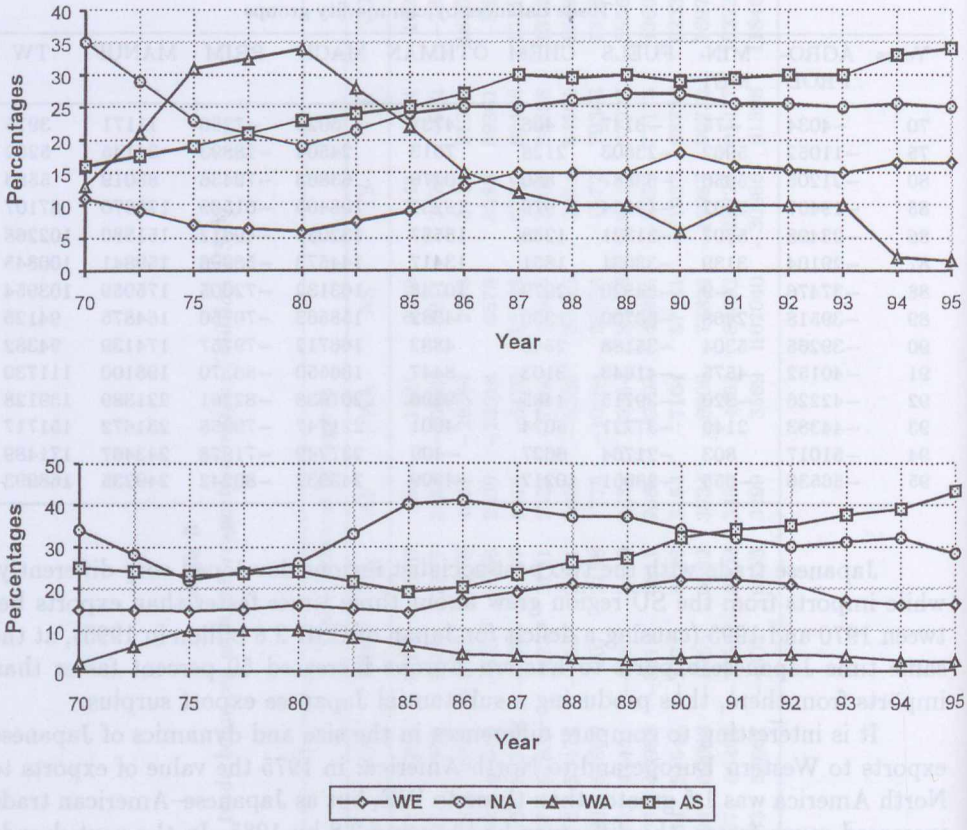

Fig. 1 Main providers of Japanese import/export

The changing regional orientation of Japanese trade can be seen in *Figure 1*.[7] West European exports to Japan increased from below 10 percent in the late seventies to around 17 percent, and remained stable. The share of North American

[7]There are five-year jumps on *Figures 1* and *3* for the period 1970–85, followed by annual data between 1986–95. The respective shares of the SU and EE regions are so small that they cannot be represented in the figure: imports from SU were around 1–2 percent and imports from EE less than half a percent in total Japanese imports. The development of West European–Japanese trade is compared to other major markets.

exports on the Japanese markets has always been significantly higher, representing about 25–27 percent of total Japanese imports. The share of the two Asian regions in Japanese imports behaved very differently: while the share of Western Asia (i.e. mainly the oil-exporting Arabian states) increased rapidly up to 34 percent after the two oil price shocks, it declined to 10 percent between 1985–93 and then—following successful Japanese energy saving efforts and reorientation of their oil purchases—dropped to 2 percent in 1994–95. In contrast to this, the share of East Asian exports on the Japanese markets demonstrated a rising trend: growing from 16 percent in 1970 to 33 percent in 1995.

The lower diagram shows the share of the same regions in total Japanese exports. Western Europe retained a nearly constant share of 15–17 percent in Japanese exports. North America, however, had an extremely high share of more than 40 percent in the early eighties, but then it followed a declining trend, reaching 29 percent by 1995. The share of Japanese exports to Western Asia increased to 10 percent after the oil shocks and it decreased afterwards to around 2 percent. The rapidly growing East Asian countries became the major markets for Japanese products: their share in total Japanese exports increased from 20 percent in 1985 to 43 percent over the next ten years.

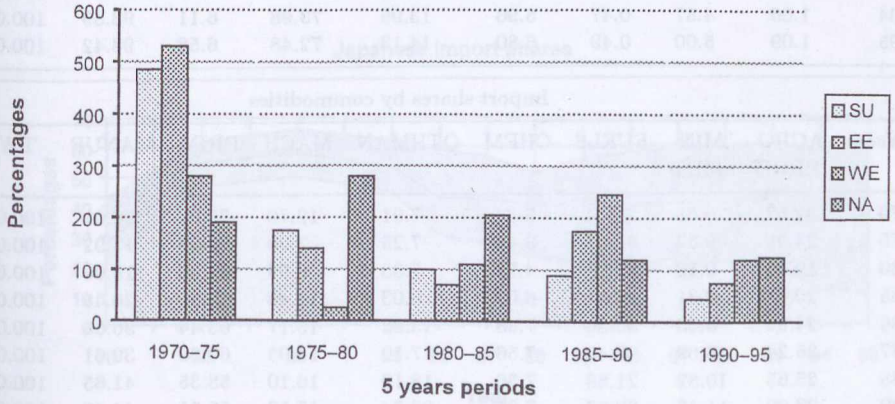

Fig. 2 Japanese export growth

Figure 2 shows the growth tendency of Japanese exports for five-year periods since 1970. The declining trend is visible in the respective cases of Eastern Europe, the Soviet Union/CIS countries and North America. The growth of Japanese exports to Western Europe—except for a decline in the early eighties—remained high until 1990, when it decreased similarly to the other regions. Notwithstanding the visible diminishing tendency, one should not lose sight of the fact that even in the

period of 1990–95 Japanese exports more than doubled—i.e. they increased by 118 percent to Western Europe and by 131 percent to North America.

Table 4

Japanese trade shares by commodities (percentages)

Years	AGRO-PROD	MIN-MET	FUELS	CHEM	OTHMAN	MACH	PRIM	MANUF	TW
				Export shares by commodities					
70	5.08	16.10	0.24	6.36	30.83	41.38	21.43	78.57	100.00
75	2.81	19.32	0.39	6.97	20.04	50.47	22.52	77.48	100.00
80	2.25	13.54	0.39	5.20	22.67	55.95	16.19	83.81	100.00
85	1.57	8.50	0.33	4.29	16.53	68.79	10.40	89.60	100.00
86	1.47	6.78	0.30	4.46	16.00	70.98	8.56	91.44	100.00
87	1.39	6.23	0.35	5.03	15.43	71.55	7.98	92.02	100.00
88	1.39	6.56	0.22	5.25	15.10	71.47	8.17	91.83	100.00
89	1.19	8.23	1.32	5.34	14.96	68.96	10.74	89.26	100.00
90	1.15	5.26	0.44	5.50	15.33	72.32	6.86	93.14	100.00
91	1.12	5.14	0.41	5.53	15.27	72.52	6.68	93.32	100.00
92	1.09	4.78	0.47	5.62	14.89	73.15	6.34	93.66	100.00
93	1.05	4.86	0.55	5.58	14.24	73.73	6.45	93.55	100.00
94	1.06	4.57	0.47	5.96	13.95	73.98	6.11	93.89	100.00
95	1.09	5.00	0.49	6.80	14.13	72.48	6.58	93.42	100.00
				Import shares by commodities					
70	32.57	20.68	20.74	5.34	7.91	12.76	73.99	26.01	100.00
75	24.99	9.52	47.57	3.48	7.25	7.20	82.08	17.92	100.00
80	19.46	9.59	51.95	4.72	7.33	6.95	81.00	19.00	100.00
85	20.43	8.31	44.81	6.03	9.03	11.40	73.55	26.45	100.00
86	24.95	8.03	30.36	7.58	13.92	15.17	63.44	36.66	100.00
87	25.24	8.69	26.45	7.56	17.10	14.95	60.39	39.61	100.00
88	25.65	10.82	21.88	7.36	18.19	16.10	58.35	41.65	100.00
89	23.69	11.15	20.67	7.05	20.34	17.10	55.51	44.49	100.00
90	22.10	10.60	18.93	6.87	20.30	21.19	51.64	48.36	100.00
91	21.54	10.23	21.18	7.05	19.53	20.48	52.94	47.06	100.00
92	22.90	8.25	20.60	7.29	20.59	20.36	51.76	48.24	100.00
93	23.02	7.36	18.98	7.22	22.23	21.20	49.35	50.65	100.00
94	24.63	7.72	10.55	7.57	24.82	24.72	42.90	57.10	100.00
95	22.40	8.32	9.21	7.27	24.64	28.15	39.94	60.06	100.00

Changes in the commodity structure of Japanese-European trade

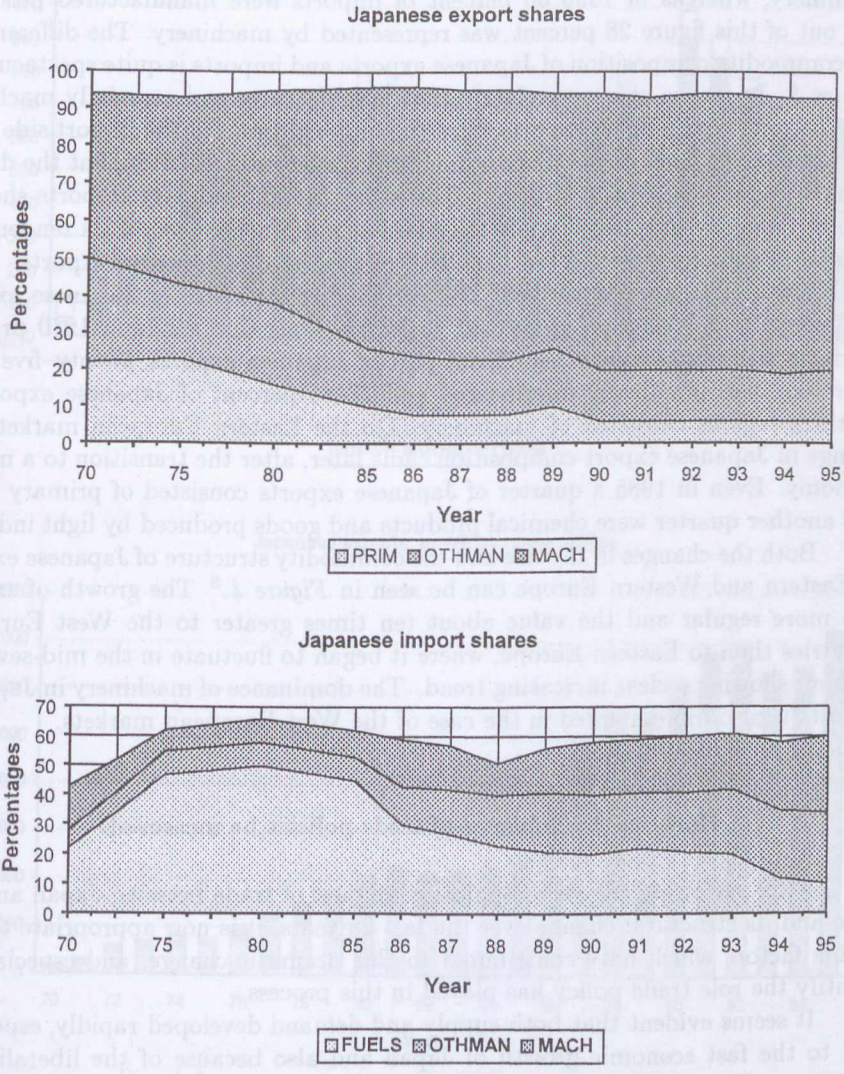

Fig. 3 Japanese export/import shares

The composition of Japanese exports and imports according to six main commodity groups (and two aggregates) is shown in *Table 4*. While in 1970 21 percent of Japanese exports still consisted of primary goods, twenty–five years later 93 percent of exports were manufactures and 72 percent machinery products. The

commodity structure of imports also changed dramatically: in 1970 nearly three-quarters of Japanese imports consisted of primary goods and only 13 percent of machinery, whereas in 1995 60 percent of imports were manufactured products, and out of this figure 28 percent was represented by machinery. The difference in the commodity composition of Japanese exports and imports is quite spectacular in *Figure 3*. It can be seen very clearly that manufactures and especially machinery have become dominant in exports since the mid-eighties. On the import side there was an amazing peak of the share of fuel imports between 1975–85, but the decline of such imports is equally striking. The share of light industry imports shows a regular tendency of growth, while the share of machinery—even if its tendency to increase is similar—remains less than half of the share of Japanese exports.

Table 5 shows, respectively, the commodity structure of Japanese exports to Eastern and Western Europe and to North America. While in 1970 primary products still represented a significant part of Japanese exports, twenty–five years later they had practically disappeared and 77–81 percent of Japanese exports to all three regions consisted of machinery. On the Eastern European markets this change in Japanese export composition came later, after the transition to a market economy. Even in 1985 a quarter of Japanese exports consisted of primary goods and another quarter were chemical products and goods produced by light industry.

Both the changes in the size and the commodity structure of Japanese exports to Eastern and Western Europe can be seen in *Figure 4*.[8] The growth of exports was more regular and the value about ten times greater to the West European countries than to Eastern Europe, where it began to fluctuate in the mid-seventies without showing a clear increasing trend. The dominance of machinery in Japanese exports is also more marked in the case of the West European markets.

How can the influence of trade policies be measured?

After reviewing the very rapid development of trade between Japan and Europe and its structural change over the last 25 years, it is now appropriate to look at the factors which have contributed to this dramatic change, and especially to identify the role trade policy has played in this process.

It seems evident that both supply and demand developed rapidly, especially due to the fast economic growth of Japan and also because of the liberalisation policies in Western and—after the transition started—in Eastern Europe. It is well known that Japanese economic growth was strongly export oriented; as a

[8] In the figure three commodity categories have been used: aggregating agricultural products, raw materials and fuels into primary goods; machinery and all other manufactured goods are shown separately (i.e. in this case OTHMAN includes CHEM).

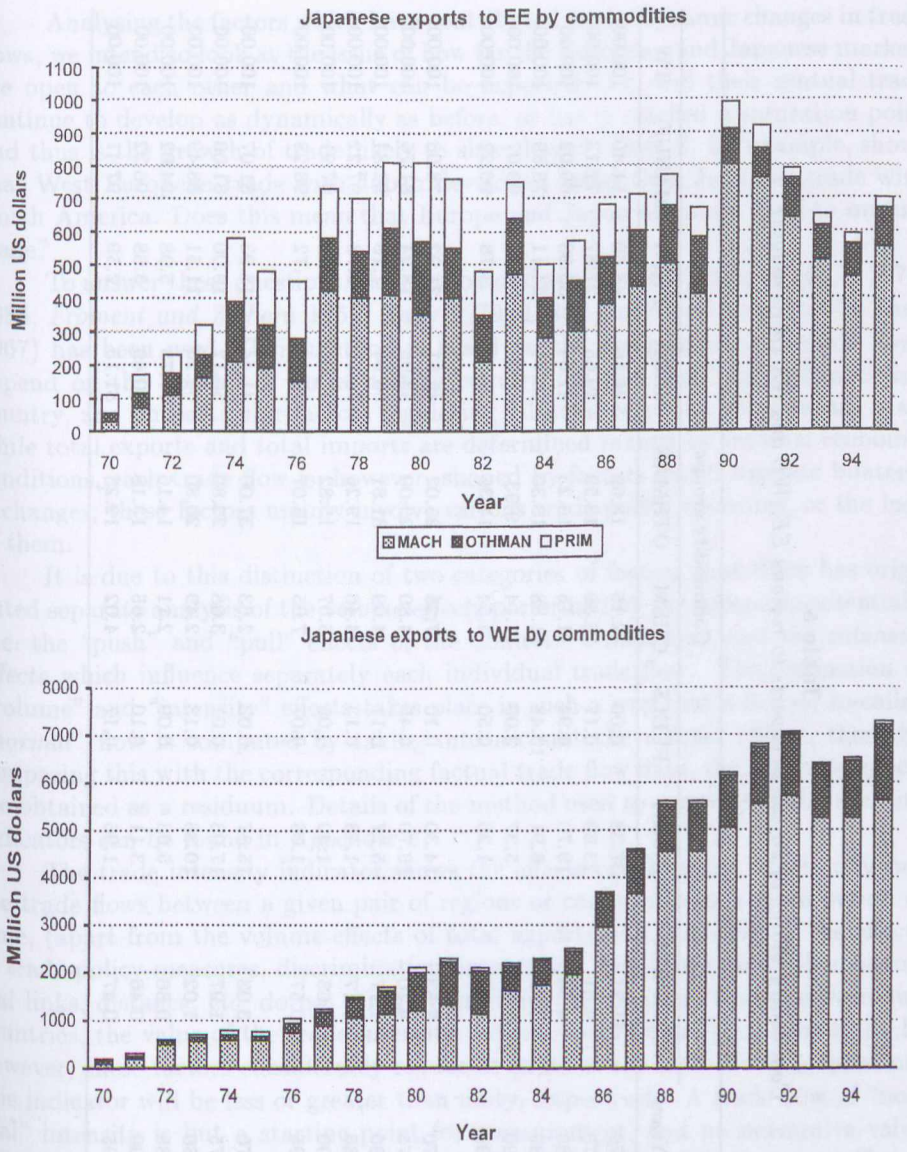

Fig. 4 Japanese exports to EE/WE by commodities

consequence, their export "push" was certainly strong. Growing income and trade liberalisation in Europe increased the "pull" effect of their imports. The growing trade deficit of Western Europe shows that the "push" and "pull" effects in the opposite direction (i.e. from Western Europe to Japan) were not equally strong.

Table 5

Commodity shares of Japanese exports to regions EE, WE and NA (percentages)

Importing regions	Years	Commodity groups								
		AGROPROD	MINMET	FUELS	CHEM	OTHMAN	MACH	PRIM	MANUF	TW
EE	70	11.21	37.38	0.00	12.15	18.69	20.56	48.60	51.40	100.00
	75	4.01	23.69	0.17	8.89	13.59	49.65	27.87	72.13	100.00
	80	4.34	19.70	6.94	11.15	16.23	41.64	30.98	69.02	100.00
	85	3.72	6.91	13.48	11.88	13.30	50.71	24.11	75.89	100.00
	90	1.48	5.37	3.09	11.14	9.93	68.99	9.93	90.07	100.00
	95	2.02	1.26	0.50	5.54	13.35	77.33	3.78	96.22	100.00
WE	70	7.53	14.30	0.10	7.25	25.02	45.81	21.92	78.08	100.00
	75	4.10	13.70	0.45	4.80	23.00	53.95	18.24	81.76	100.00
	80	1.77	5.27	0.11	4.09	31.81	56.94	7.16	92.84	100.00
	85	1.17	1.48	0.13	4.46	19.26	73.51	2.78	97.22	100.00
	90	0.65	1.40	0.05	5.07	15.82	77.02	2.09	97.91	100.00
	95	0.57	1.08	0.07	7.05	15.07	76.16	1.72	98.28	100.00
NA	70	3.03	15.87	0.03	2.63	37.00	41.44	18.93	81.07	100.00
	75	1.97	17.03	0.01	3.08	22.80	55.12	19.00	81.00	100.00
	80	1.02	10.36	0.13	2.49	20.80	65.20	11.51	88.49	100.00
	85	0.86	5.03	0.09	2.11	14.16	77.75	5.98	94.02	100.00
	90	0.46	3.11	0.10	2.65	13.18	80.49	3.68	96.32	100.00
	95	0.47	1.96	0.17	4.02	12.23	81.15	2.59	97.41	100.00

Analysing the factors which have contributed to the dynamic changes in trade flows, we intend to look at the issue of how far the European and Japanese markets are open to each other and what can be expected: i.e. will their mutual trade continue to develop as dynamically as before, or has it reached a saturation point and thus is the growth of trade likely to slow down? *Table 2*, for example, shows that West European trade with Japan developed faster than Japanese trade with North America. Does this mean that Europe and Japan are more open to mutual trade?

To answer these questions, the method of trade intensity analysis (*ECE* 1973; 1985; *Froment and Zighera* 1964; Nagy 1979; 1985; *Panic and Vacic* 1995; *Theil* 1967) has been used. This method is based on the assumption that trade flows depend on the "push" of the exporting country, on the "pull" of the importing country, and on particular factors regulating bilateral relations. This means that, while total exports and total imports are determined mainly by internal economic conditions, each trade flow is, however, shaped by factors which regulate bilateral exchanges; these factors mainly involve various trade-policy measures, or the lack of them.

It is due to this distinction of two categories of factors that there has originated separate analysis of the *volume effects* performed by the economic potentials, (i.e. the "push" and "pull" effects of the domestic economies), and the *intensity effects* which influence separately each individual trade flow. The distinction of "volume" and "intensity" effects takes place in such a way that a fictive, so-called "*normal*" flow is computed by taking into account the *volume effects*; then, by comparing this with the corresponding factual trade flow data, the *intensity effects* are obtained as a residuum. Details of the method used to compute trade intensity indicators can be found in *Appendix 2*.

The trade intensity indicator shows the effects of all factors which influence the trade flows between a given pair of regions or countries over a given period of time, (apart from the volume effects of total exports and imports). If the effects of trade-policy measures, discrimination, integration, traditional and other historical links, distance, etc. do not strongly influence the bilateral trade between two countries, the value of the trade intensity indicator will be unity, or near to it. If, however, these factors considerably reduce or increase the trade flows in question, this indicator will be less or greater than unity, respectively. A trade flow of "normal" intensity is but a starting-point for measurement, and no normative value judgement can be attached to it. If a trade flow is considered to be "normal" this merely means that it is not influenced by trade-policy, distance and similar effects.

These indicators are not always comparable between regions of very different sizes, but—even in this case—they are useful tools for analysing their development over time, in order to see the consequences of trade policy changes between regions. In this sense, by "trade policies" we do not mean simply the barriers to trade and their eventual increase or decrease. Trade policies include trade promotion

efforts, or trade diversion measures, and any other policy interventions (e.g. state guaranteed export credit facilities) which can be considered to have had an influence on the direction of trade. Many of these are, of course, politically motivated.

How have trade policies influenced Japanese–European trade flows?

Table 6

Japanese–European trade intensities—Total trade

Year	JP exports			Exporting regions		
	SU	EE	WE	SU	EE	WE
	Importing regions			JP imports		
70	0.48	0.10	0.33	0.63	0.10	0.25
75	0.71	0.19	0.34	0.50	0.07	0.17
80	0.68	0.15	0.37	0.33	0.06	0.16
81	0.63	0.12	0.38	0.24	0.06	0.17
82	0.74	0.10	0.38	0.20	0.06	0.17
83	0.49	0.11	0.39	0.21	0.08	0.19
84	0.40	0.07	0.36	0.20	0.08	0.21
85	0.42	0.08	0.36	0.23	0.07	0.23
86	0.44	0.07	0.42	0.31	0.08	0.29
87	0.37	0.07	0.45	0.30	0.09	0.33
88	0.40	0.08	0.48	0.34	0.11	0.34
89	0.45	0.07	0.46	0.36	0.14	0.34
90	0.46	0.07	0.46	0.61	0.06	0.37
91	0.43	0.14	0.47		0.31	0.35
92	0.28	0.12	0.47	0.65	0.12	0.34
93	0.36	0.09	0.44	0.71	0.10	0.36
94	0.23	0.07	0.41	0.68	0.09	0.40
95	0.19	0.08	0.41	0.66	0.08	0.40

Table 6 and *Figure 5* show the trade intensities between Japan and the European regions in the 1970–1995 period. The respective Japanese export intensities differ remarkably: the intensity was very low in her exports to Eastern Europe and mediocre in exports to Western Europe and to the SU/CIS region. The former remained below 0.2 over the whole period and, since the mid-eighties, in most years it has been less than 0.1. This means that it was less than 10 percent of what we defined as the "normal" trade flow.

The intensity of Japanese exports to Western Europe remained fairly constant, with a slowly growing tendency occurring from the early seventies to the early nineties and a falling back somewhat later. The mediocre intensities can be

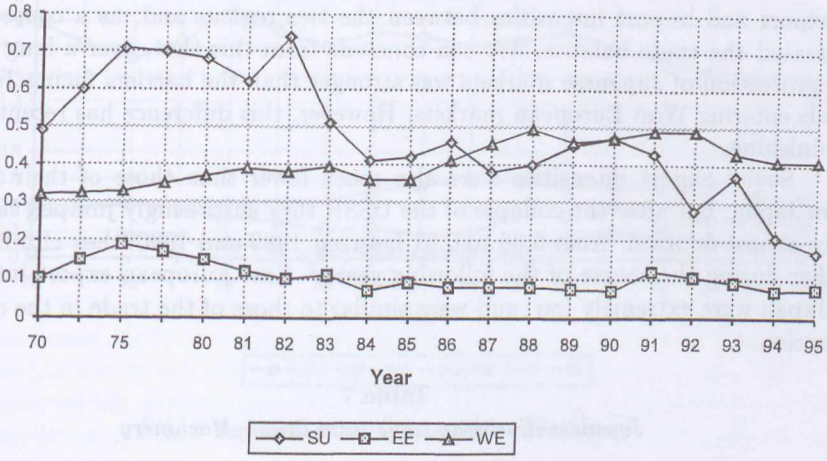

Fig. 5 Japanese export intensities—Total trade

explained by referring to the great distance between the two regions. However, reviewing the indicators of Japanese export intensities to other regions, it is to be suspected that trade policies have also hindered Japanese exports to Western Europe to a significant extent. If it is compared, for example, to Japanese export intensities to North America, we find that it is 4–5 times higher, being between 1.5 and 2.0 for the whole period. Japanese export intensity indicators were higher even in the direction of Latin America and Africa than to Western Europe, showing that these differences cannot be explained simply by economic distance. Here again, referring to the way in which trade policies have hindered more intensive trade, we mean not only the usual (and unusual) barriers to imports, but also export promotion efforts, or the lack of them.

Japanese export intensities to the Soviet Union were always much stronger than to Eastern Europe. It increased strongly from 0.48 to 0.74 between 1970 and 1982, then remained between 0.4–0.5 until the early nineties, declining to 0.19 in 1995 (*Figure 5*). This means that for a long time Japanese export intensities to the USSR were not only stronger than to Eastern Europe, but also stronger than to the West European countries. As Russia is also an Asian country, the distance for some part of the Japanese exports is less than to Europe. However, it can be assumed that—even if diplomatic relations were less cordial—trade policy barriers could have been lower than in the other two European regions.

The respective trade intensities of the European regions to Japan are also shown in *Table 6*. West European export intensities were notably lower up to the early nineties than their import intensities from Japan. This partly explains their negative balance of trade. Nevertheless, export intensities were constantly increasing: from 0.17 in 1975 to 0.40 in 1995. This diminished the difference

of export and import intensities between the two regions and, as a consequence, decreased the trade balance. We can conclude from this that, over a long period, the protection of Japanese markets was stronger than the barriers facing Japanese goods entering West European markets. However, this difference has recently been diminishing.

Soviet export intensities were also much lower than those of their imports from Japan, but after the collapse of the USSR they surprisingly jumped such that they almost doubled: from 0.36 to 0.61 between 1989 and 1990; they climbed even higher during the course of the following years.[9] East European export intensities to Japan were extremely low, and were similar to those of the trade in the opposite direction.

Table 7

Japanese–European trade intensities—Machinery

	JP exports				Exporting regions			
Year	SU	EE	WE	NA	SU	EE	WE	NA
	Importing regions				JP imports			
70	0.30	0.04	0.42	1.79	0.03	0.09	0.61	2.39
75	0.42	0.15	0.43	1.54	0.04	0.03	0.57	2.26
80	0.32	0.09	0.43	1.88	0.18	0.06	0.55	2.52
85	0.21	0.06	0.45	1.62	0.61	0.04	0.53	2.24
86	0.25	0.06	0.51	1.74	0.60	0.04	0.53	2.36
87	0.17	0.06	0.53	1.70	1.07	0.03	0.64	2.33
88	0.19	0.07	0.57	1.63	0.57	0.03	0.63	2.23
89	0.32	0.06	0.55	1.69	0.65	0.14	0.63	1.97
90	0.30	0.12	0.53	1.74		0.47	0.63	2.05
91	0.39	0.16	0.53	1.66		0.48	0.59	1.92
92	0.27	0.15	0.53	1.54	0.40	0.03	0.56	2.02
93	0.29	0.12	0.51	1.44	0.30	0.03	0.60	1.70
94	0.28	0.09	0.47	1.43	0.25	0.03	0.59	1.75
95	0.28	0.10	0.47	1.41	0.22	0.08	0.54	1.66

Machinery exports represent Japan's major export item. *Table 7* and *Figure 6* show the export intensities of machinery trade between Europe and Japan, comparing them to those of North America. As might have been expected, Japanese export intensities in machinery are higher than those of total exports (with the exception of Japanese exports to the Soviet Union). However, it comes as a surprise that both West European and American machinery exports to Japan are more intensive than their machinery imports from Japan. The enormous difference in

[9] This may be partially due to the change in the exchange rate of the rouble, as mentioned in footnote 4.

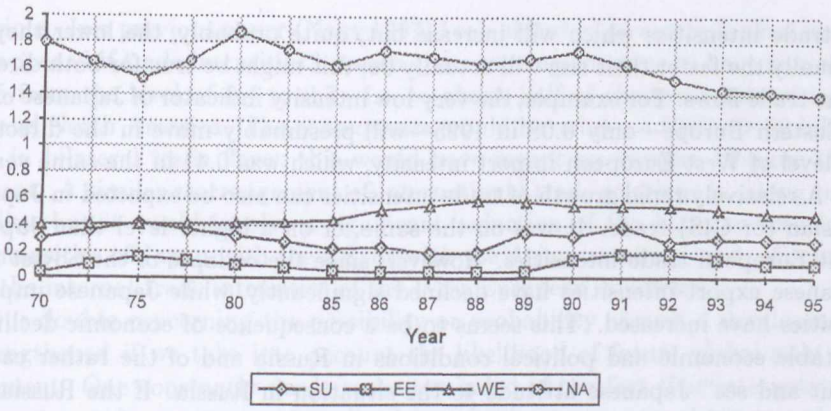

Fig. 6 Japanese export intensities—Machinery

trade intensities between European–Japanese and American–Japanese machinery trade, in both directions, is also very conspicuous: the North American intensity indicators are about three times higher than those of Western Europe.

Concluding remarks

According to the appraisal of the *OECD* (1996), Japan's international competitiveness has been restored after the slump of the early nineties and its share of world trade seems to have stabilised at around 10 percent. Japanese–West European trade has developed extremely rapidly over the last twenty–five years: the value of Japanese exports has grown 25 times and its imports 27 times to and from Western Europe respectively; this growth was faster than the increase of total Japanese trade. The growth of Japanese trade with the ex-socialist European regions was much slower.

The questions arise: trade has much developed among these regions—is it enough? Is it too much, or too little, and compared to what? What can be expected in the future? Will it grow further, faster or slower, than it has done so far? How might changes in trade policy in the future affect Japanese trade with Europe?

It seems easier to answer these question in the case of the East European economies. It is highly probable that the consolidation of market economies in Central–East European countries and the (albeit slowly) growing confidence of Japanese traders and investors will increase their extremely low trade intensities with Japan. This tendency will be strengthened, given that several of these countries are quite likely to join the European Union in the not too distant future and economic integration will gradually develop all over the region. Thus it is not only

low trade intensities which will increase but, quite probably, the lower they were originally the faster their rise will actually be; this might be true for both directions of the trade flows. For example, the very low intensity indicator of Japanese exports to Eastern Europe—only 0.08 in 1995—will presumably move in the direction of the level of West European import intensity, which was 0.41 in the same year.

A relatively rapid growth of trade intensities can also be expected in Japanese–Russian (or CIS) trade. It was on the same, or on a higher level than Japanese–West European trade intensities. However, since the collapse of the Soviet regime Japanese export intensities have declined significantly, while Japanese import intensities have increased. This seems to be a consequence of economic decline, the unstable economic and political conditions in Russia and of the rather cautious, "wait and see" Japanese attitude to the situation in Russia. If the Russian (and Ukrainian, Belorussian, etc.) reform and consolidation processes follow those of the other European ex-socialist countries, it can be expected that the trade intensities will reach a higher level than in the Soviet period. This kind of change could be even stronger—and more probable—if a peace treaty can be attained between Russia and Japan, (thus settling the unresolved territorial disputes between the two countries).

The expectation, according to which trade intensities will increase between Japan and the ex-socialist part of Europe, is supported by the significant increase in trade intensities between Eastern and Western Europe since the transition to market economy and political democracy started in Eastern Europe. If we compare, for example, export intensities of Western Europe to the East European countries between 1989 and 1995, we find that it increased more than three times—i.e. from 0.44 to 1.48. In contrast, Japanese export intensities to Eastern Europe did not change significantly in the same period, as we have seen in *Table 6*.

What can we say about the future development of trade relations between Western Europe and Japan? Any sudden change seems to be highly unlikely, partly because of the huge size of the trade flows involved and partly because of the strong stability of trade intensities between the two regions (see *Table 6* and *Figure 5*). Trade between Japan and Western Europe has developed very forcefully—in fact, faster than the total trade of the two regions. At the same time, a great difference can be noticed between the trade intensities of Japan and North America with Japan and Western Europe: the former is more than three times higher than the latter. It can be expected that this difference will diminish—i.e. West European trade intensities will significantly increase with Japan. With further progress towards globalisation, liberalisation and deregulation, legal trade barriers and other obstacles in both regions will quite probably decrease and trade between them will be promoted even further.

However, it is reasonable to contemplate that a serious shift in trade policies will take place between Japan and Western Europe in the near future. It is not evident what factors could induce a faster increase of trade intensities between the

two regions. In a previous paper (Nagy 1997) I calculated as an example what would have happened if trade intensities between these two regions were to have increased in 1995 from the level of 0.4 to 0.7—i.e. to about half of the trade intensities of Japan and North America. The consequence would have been a USD 40–60 billion growth in bilateral trade flows; this would have meant an increase of more than 80 percent. A similar rearrangement of international trade relations is a long term possibility, but it would involve a significant reduction of the high, or very high trade intensities of Japan with the US, or with the Asian countries, and, of course, also of the internal trade intensities of the West European countries.

Our doubts concerning the possibility or probability of such a development are strengthened if we take into account the likelihood of future global political development. One constantly needs to be reminded of the fact that international trade flows are—in a sense—politically determined occurrences; they are only a rather small part of total trade, and include those transactions which cross state borders and are reported by customs services. As a consequence, the existence and eventual changing of the locations of state borders will determine the volume and structure of that international trade which can be statistically observed.

The *status quo* of state borders, and the national sovereignty which they embody, have demonstrated a remarkable stability over a long period of time since the second world war. In the last decade, however, there have been two major occurrences which, in a sense, went in opposite directions: on the one hand, the Soviet empire has been dissolved and a number of independent states have come into existence, extending the state borders among them to a great degree. A similar development split Czechoslovakia into two, and Yugoslavia into five states. This, of course, increased the volume of international trade, even if some part of it is not yet statistically reported. On the other hand, with increased economic integration within the European Union the economic sovereignty of the member states is diminishing. Furthermore, as the state borders which exist between them gradually disappear, one can expect that in the not so distant future, reported international trade will decrease to a great extent. As trade among the states of the United States, or Brazil, or the former Soviet Union was not regarded as international trade, the commodity flows within the European Union probably will not be part of foreign, but of domestic trade.

Trade among the member states of the European Union is the single largest trade flow in our model: it represented 29 percent of total world trade and 68 percent of the total exports of Western Europe in 1995. If it is not reported any more as international trade, in similar measure total world trade and the trade of Western Europe appear to contract. On the other hand, it will be increased by the reported trade among the former Soviet, Czechoslovak and Yugoslav republics.

Recalculating the trade intensities with the assumption that West European internal trade can be omitted, we found an essential increase in the intensity of Japanese–West European trade: the Japanese export intensity indicator would

have bounced from 0.41 to 0.99 in 1995 and the West European export intensity indicator from 0.40 to 0.89. This means that if the intra-regional trade of Western Europe is no longer regarded as part of the international trading system, trade intensity between Japan and Western Europe cannot be considered to be low, or mediocre, but near to what we defined as the "normal" level.[10]

As a conclusion it is hard to say in what direction future trade policies will move Japanese–West European trade: there is certainly a possibility of increasing trade intensities, especially in those product categories where transportation costs are not important and where hidden barriers have been used to restrain trading. It is not evident how far and when these possibilities will be exploited. However, even if we cannot be sure how trade relations will develop between Japan and Western Europe, one can be quite certain that the extension of European integration in the direction of Eastern Europe and the introduction of the trading rules of the West, will significantly increase trade between Japan and Eastern Europe.

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[10] An interesting feature of this experimental calculation is that as trade intensities under this assumption are increasing between Japan and Western Europe, they are significantly decreasing between North America and Japan. For example, Japanese export intensities, declined from the very high level of 1.57 to 1.12 in 1995. On the other hand, trade intensities between Japan and Eastern Europe instead of increasing, also declined.

Appendix 1

The regions and commodity groups of the trade flow model.

Regions[11]	
1. Soviet Union/CIS states	SU
2. Central and Eastern Europe	EE
3. Socialist Asia/China	SA
4. Western Europe	WE
5. North America	NA
6. Japan	JP
7. Other developed countries	OD
8. Latin America	LA
9. Africa	AF
10. Western Asia	WA
11. East Asia	AS
12. Total world trade	TW

Commodity groups[12]	*Abbrevations*	*SITC numbers*
1. Food and Agricultural materials	AGROPROD	0 + 1 + 4 + 2 − 27 − 28
2. Minerals and metals	MINMET	27 + 28 + 67 + 68
3. Fuels	FUELS	3
4. Chemicals	CHEM	5
5. Other manufactured goods	OTHMAN	6 + 8 − 67 − 68
6. Machinery[13]	MACH	7 + 9
7. Total world trade	TW	0 + ... + 9

[11]The list of countries belonging to the regions can be found in *UN Standard Country Codes, Statistical Papers*, Series M No. 49.

[12]Details of the commodity classification in *UN Standard International Trade Classification, Revision 2 and 3. Statistical Papers*, Series M No. 34.

[13]After investigation it was assumed that the trade in non-specified products (SITC 9) consists mostly of armaments and for this reason it was included in the machinery commodity group.

Appendix 2

The trade intensity indicators

The trade intensity indicator is defined as:

$$\delta_{ijk} = \frac{z_{ijk}}{z_{i.k} z_{.jk}}$$

where:

$$z_{ijk} = \frac{x_{ijk}}{x_{..k}}, \qquad z_{i.k} = \frac{x_{i.k}}{x_{..k}}, \qquad z_{.jk} = \frac{x_{.jk}}{x_{..k}}$$

and

x: means the value of the trade flow,
i: the exporting region,
j: the importing region and
k: the commodity group.

The delta coefficient indicates the intensity of trade of commodity k from exporting region i to importing region j in such a way that it compares the share of the actual flow in total trade of commodity k with the same share of "*normal*" flow. In this sense, a flow is "normal" when its share in the total trade of a given commodity group is equal to the product of the corresponding shares of the exporting and importing countries, i.e. $(z_{i.k} z_{.jk})$.

In previous time series analyses of trade intensities three main types of change were observed:

a) *continuation* of the formerly-observed course—i.e. continued stability of the coefficient in question, or continuation of its former time-trend;

b) "*flattening-out*" of the former trend, whereby the rate of change diminishes and the coefficient approaches a certain level in time;

c) *change* in the former level or trend of the coefficient, due to significant changes in trade-policy factors (given that economic distance usually does not change, or at last, not abruptly).

Behind these typical movements of trade intensities two essential trends were observed:

(i) *intensity indicators approach unity*—i.e. trade flows verge to "normal" flows as a consequence of trade liberalisation and globalisation of the world economy;

(ii) *integration* of certain groups of countries tends to increase the intensity indicators of intra-regional trade *above unity* and to decrease those of extra-regional trade *below unity*.

It was also observed that the more the intensity indicators diverge from a certain centre of attraction—unity in the case of (i), and above or below unity in the case of (ii)—the greater are the changes; this explains "the flattening-out" of trends mentioned in b) above.

Acta Oeconomica, Vol. 49 (3–4), pp. 335–364 (1997–98)

TOP ENTREPRENEURS AND THEIR SOCIAL ENVIRONMENT

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This study focuses on the recruitment of the new economic elite and on values and attitudes of new Hungarian capitalists. The present economic elite, for greater part, was recruited from "eligible" members of the former elite. Participation in the second economy or a managerial position in a state-owned company meant great advantage in becoming a top entrepreneur. The former deputy managers with second economy activities were especially successful. Beside their former position in the economy, cultural capital played an important role in establishing business, too. Even though their political connections played significant role in establishing their business, they played a secondary role, there was only limited opportunity for converting power position into capital. The newly developed Hungarian bourgeoisie has not yet created their own grand bourgeois life style. Hungarian top entrepreneurs do not form a uniform social–political group. They are strongly segregated, with considerable conflicts of interest between the individual groups.

Introduction

One conspicuous change following the economic and political transformation in Eastern and Central Europe has been the emergence of a new capitalist layer. This new layer, in a certain sense, now enjoys a large measure of attention. A significant group of social scientists argues that during the political-economic transformation of 1989–1990 the old elite were able to convert their political position into a good economic position (*Hankiss* 1996, *Szalai* 1990, *Staniszkis* 1991, *Róna-Tas* 1994, Szalai 1995, 1997). Others emphasize the general importance of the possible conversion from different kinds of "symbolic capitals" to later elite positions (*Bourdieu and Coleman* 1991, *Kolosi* 1991, *Böröcz and Róna-Tas* 1995, *Róbert and Sági* 1996, *Sági* 1994, *Szelényi, Eyal and Towsley* 1996). Good personal connections are also considered as a profitable background for later entrepreneurship (*Böröcz* 1993, Böröcz and Róna-Tas 1995, *Kuczi* 1996, *Stark* 1996). Participation in the second economy, or establishing private business during the late period of socialism have also turned out to be great advantages—this was especially true in the period following the political change and helped in the process of becoming a large entrepreneur (*Sík* 1994, *Kolosi and Sági* 1996, *Csite and Kovách* 1997). Other theoretical approaches dispute the importance of norms and value systems which are of basic importance in the development of capitalist societies (*Weber* 1966). A wide range of research has revealed that the offspring of pre-war proprietors "inherited" a bourgeois-entrepreneurial moral attitude and mentality. The rational calculation of costs and benefits, personal autonomy and individualism have been bequeathed over generations and these norms are beneficial for present businesses (*Szelényi* 1988, *Utasi* 1984, Kolosi 1990, *Kovách et al* 1995, Róna-Tas

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and Böröcz 1997). Finally, we would like to mention the theory of "revolution of deputy managers". According to this, in the initial phase of political change it was possible for high cultural, material and social capital to be transformed into a good economic position—however, the previous political position became a disadvantage as all. Consequently, the second line of socialist economic elite—who held similar advantageous elite positions as the most "overexposed" persons, but who did not have to fight the drawbacks of being "politically overexposed" were able to take leading roles (Kolosi 1991, Kolosi and Sági 1996).

While previous analyses have predominantly focussed on the problem of recruiting a new elite, this present study will examine how these new entrepreneurs feel in this changing and often controversial milieu. A study of how top capitalists perceive the general attitude of their own environment towards themselves is by no means without interest. Entrepreneurship, investment and risk-taking is essentially a matter of confidence, and underlying this is the confidence that there is social stability. If capitalists are unsure of the political and economic institutions alongside which they have to operate, they either invest in ventures which offer a rapid and high rate of return or they withdraw their capital from the country.

In other words, trust or mistrust towards politicians and decision-makers directly influence the flow of capital, risk-taking and the long-term economic decisions made by capitalists. When examining how new capitalists feel in present-day Hungary, we will focus on the extent to which the new entrepreneurial layer believes that the ideals of a capitalist society have been achieved in Hungary, and to what extent they consider the political environment in which they risk their capital to be unstable, dangerous or unreliable.

No less important in terms of a market economy based on capitalist principles is the way in which new capitalists feel the affect which public opinion has upon them. Although—in contrast to the perceived attitudes of political and economic decision-makers—the opinion of the "man in the street" does not directly influence their economic plans, it does affect the way in which the new *grande bourgeoisie* conforms to a "capitalist lifestyle" or, as the case may be, conceals the elements of their bourgeois lifestyle from the public eye. The display of success (and of an obvious pride in attaining that success), and the presentation of a successful career might be a model for "others". If, however, successful top entrepreneurs feel that their success, ambition and affluence is viewed with distaste by the general public, they will conceal their own lifestyle from the average man, and thereby deprive them of a possible model; at the same time, the new capitalists will hardly feel comfortable in a "hostile" environment.

In a political democracy public opinion also has a considerable influence on politicians' attitudes. If politicians sense that the overwhelming majority of their electorate supports free enterprise, the rule of law and the protection of private property, and if public opinion holds that entrepreneurs' economic success more or less coincides with the interests of individual citizens, then the existence and career

of top entrepreneurs will be socially accepted. They may even be regarded as role-models and politicians who are opposed to entrepreneurs will have to change their attitudes or face the risk of being ousted from decision-making by other political forces.

In fact, present-day Hungary cannot be regarded as a truly entrepreneur-friendly environment. Showcase trials initiated by politicians, the frequent changing of legal regulations, corruption scandals, and uncertain and inconsistent economic decisions have definitely fuelled the capitalists' distrust in the environment in which they have to operate. Although the present coalition government (of the Hungarian Socialist Party and Alliance of Free Democrats) in theory supports free enterprise as being necessary for a market economy and the country's economic growth, it views growing affluence and an increasing income differentiation with *obvious distaste*. This duality often results in decisions similar to the give-and-take back economic policy of the late Kádár era, and thereby creates an uncertain political environment for entrepreneurs and enterprises.

Another legacy of "goulash Communism", as far as values and customs are concerned, is that the institutions of interest intermediation have not emerged in the entrepreneurial sphere. Instead of an open promotion of interests we find individual interest-mongering. Individual interest realization based on individual connections, and the concealment and informal realization of these interests favours corruption; it creates a tendency towards "secret" pacts behind the scenes of formal political mechanisms, as well as the emergence and consolidation of parallel decision-making mechanisms. This situation is hardly favourable to political and economic decision-makers, since the question inevitably arises as to whom they support, whose interests they represent and what they expect to receive in exchange. Nor is this state of affairs particularly favourable for an emergent capitalist class, because interest intermediation is considerably more difficult on an individual basis than it is when carried out openly and collectively.

The mechanism of informal interest promotion, an unfamiliarity with the careers of successful entrepreneurs and the general lack of capital at the time of the systemic change engendered a general opinion that "one cannot grow rich by honest means". There is general feeling that those people who have become "successful" entrepreneurs did not owe this to their talent, ambition, business acumen or luck, but rather to dishonest machinations.

This general negative attitude may have been strengthened by the strongly egalitarian culture which had evolved in Hungarian society over the past fifty years (i.e. during the era of state socialism). This culture is strongly averse to very large income inequalities and incomes which are inordinately high compared to the average. Another important element is the social-psychological aspect of cognitive dissonance. The living standards of an overwhelming majority of society have declined significantly, while that of a small entrepreneurial layer have risen conspicuously since the systemic change. "Losers" tend to "blame" those who have

managed to be successful among the general pauperization, and there is general agreement that these individuals can only have managed this by dishonest and devious means.

Finally, the negative public attitude to successful top entrepreneurs has also been influenced by the fact that there is a group of *nouveau riche* who have demonstrably acquired an immense wealth within a very short time by unlawful means.

In our investigation we sought to gain insights into the values and attitudes of the new Hungarian capitalists. We will first review how this social layer perceives its social environment and how it reacts to it. What are their economic reactions to the perceived political "guidelines" and what type of political and economic environment do they consider to be favourable for themselves and their businesses? What is their own image of themselves? What kind of image of themselves do they wish to construct? Do they intend to influence public attitudes towards themselves in a positive way? If so, what measures can top entrepreneurs take together in order to bring this about? Pertinent to this issue, of course, is the question of whether they intend to, or are capable of, joint action in promoting their interests.

We also wish to offer an overall picture of the general attitudes towards the emerging new capitalists, their incomes and the reasons for the occurrence of these attitudes in Hungary.

Research methods

The research for this study was carried out by the means of a questionnaire survey, with a separate questionnaire for investigating popular attitudes and the attitudes of top capitalists. The population survey was conducted on a three-stage, stratified probability sample of 1500, representing the adult population of Hungary. The basic totality was established from the data provided by the Central Registration Office and the Election Office. Since there is no reliable registration of successful top entrepreneurs (i.e. the basic totality is unknown), the usual procedures for a representative sample could not be followed in the questionnaires prepared for top capitalists. Instead, we used the "snowball" technique, based on the assumption that successful top entrepreneurs (and their groups) know each other fairly well and that they have reliable information as to who can be regarded as a new capitalist in Hungary. As a starting point, we selected the names and addresses of top entrepreneurs which have appeared in economic and other journals (*HVG, Elit*), dailies (*Népszabadság*) and three other publications: *Kompass Magyar Gazdasági Cégkatalógus* (Register of Hungarian companies), *Magyarország nagy- és középvállalatai 1996-ban* (Large and medium-sized businesses in Hungary, 1996), and *A magyar közélet kézikönyve* (Handbook of Hungarian public life). We first conducted interviews with these businessmen, and then asked each of them

to name other persons among their personal acquaintances whom they considered to be a successful top entrepreneur. We originally planned to roll this snowball until the number of elements in the sample reached 500 individuals. However, this method did not prove truly successful since most top entrepreneurs were reluctant (or downright refused) to give the names of their acquaintances to interviewers. We only managed to collect 205 names with the snowball method. A total of 768 persons were considered as potential interviewees: their names were selected from newspapers and journals, as well as from among the names provided by those already interviewed. However, this number included individuals whose businesses did not reach the order of magnitude which we had defined as characterizing "top capitals", while others did not actually own the business on the basis of which their name was included in our list. In the end, there were 635 names which remained on the list comprising entrepreneurs who met the requirements of the sample. 52.1 percent (N=331) were willing to fill out the questionnaire, 12.4 percent (N=79) could not be reached, while 18.8 percent (N=119) refused to be interviewed; in the case of the remaining 16.7 percent (N=106) we do not know the reason for their omission from the sample. We have assumed that those who refused to fill out the questionnaire did so for personal reasons, and that their refusal has not systematically distorted the sample.

The overwhelming majority of respondents in the top capitalist/entrepreneur sample were men (93.4 percent); 44 percent were middle-aged (40–49 years); about 20 percent were under 40; 29 percent were in their 50s; and 6 percent were 60 years old or older. 84 percent held a university degree, while a further 13 percent had a secondary school certificate. Every second top capitalist lived in Budapest; about 30 percent had their home in one of the county seats, and every fifth lived in a smaller settlement than the two "types" mentioned above.

Every fourth top entrepreneur had a business with an annual turnover of less than HUF 500 million; about one-third had a business with a turnover of between HUF 500 million and HUF 1 billion; another one-third had a turnover of between HUF 1–5 billion; while 9 percent had a turnover exceeding HUF 5 billion. Every second respondent did not rank himself among the top entrepreneurs in Hungary. The reason for this is probably that the greater the business empire one has, the higher the standards which one sets for oneself and the greater the value of the assets one considers as a criterion for being a "top entrepreneur".

The origins of top entrepreneurs

Most of the successful top entrepreneurs were originally motivated by three or four factors which are perceived to promote entrepreneurship. Almost all of them (95 percent) were of the opinion that their exceptional personal abilities and

expertise had played an important role in guiding them towards the life of an entrepreneur. Every second top entrepreneur regarded the boom which followed in the wake of the systemic change as having been a factor underlying their later economic success. Also, every second top capitalist mentioned that he had participated in the second economy which flourished in the 1980s and at least as many were already independent entrepreneurs before the systemic change (even if only as a second job—i.e. they retained their original employee status). Four out of ten top entrepreneurs had been economic managers in one of the large state-owned enterprises and every fourth had participated actively in the privatization of that enterprise.[1] Every third top capitalist had made use of one of the credit schemes with preferential interests designed for supporting businesses, or had exploited the possibilities offered by compensation coupons. Interestingly enough, few of them mentioned that they had user their old (14.9 percent) or new (16.7 percent) political connections in launching their businesses.

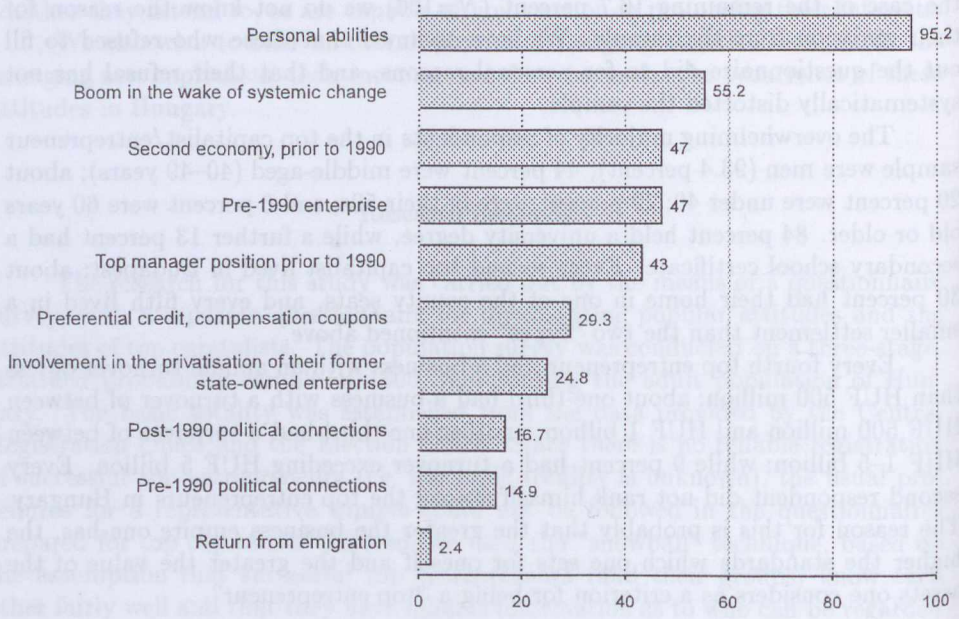


Fig. 1 Use of various opportunities among top entrepreneurs for promoting enterprise

[1] We considered everyone who participated in the privatization of their earlier company as a "former manager" when constructing typical groups, irrespective of whether they considered themselves to have occupied a high-level economic position. Our rationale was that, if someone was actively involved in the privatization of his company, he must have at least held a medium-level managerial position

We could distinguish three main groups, and a further three smaller subgroups among the new Hungarian top entrepreneurs.[2] Most Hungarian top capitalists came from one of the two economic leaderships of the 1980s: they were either members of the economic management in a state-owned enterprise, or they had already launched their independent business or participated in the second economy in the 1980s—or, indeed, both played a role in their becoming entrepreneurs. *Three out of four top entrepreneurs belong to one of these three major, typical entrepreneurial groups.* The ratio of top entrepreneurs who "merely" took advantage of their personal abilities in the boom which followed the systemic change is also significant. 18 percent of the new Hungarian top capitalists belong to this group: they had neither economic, nor any significant political capital prior to 1990.

It is rarely true of present-day top entrepreneurs that they *exclusively* used their political connections when they launched their current businesses: only 2.4 percent claimed that, since they were not in an economically favourable situation prior to the systemic change (i.e. they did not participate in the second economy of the late Kádár era and were not managers in one of the state-owned enterprises), they used their old or new political connections as start-up "capital". (We would here like to note that political connections forged after 1990 seem to dominate—in other words, *very few could become top entrepreneurs by simply using their old political connection—i.e. political capital could not in itself be converted into economic capital.*) About roughly the same percent said that they had lived abroad under the former political regime and after perceiving the political and economic opening, they returned to Hungary and started one or more businesses in the country (*Figure 2*).

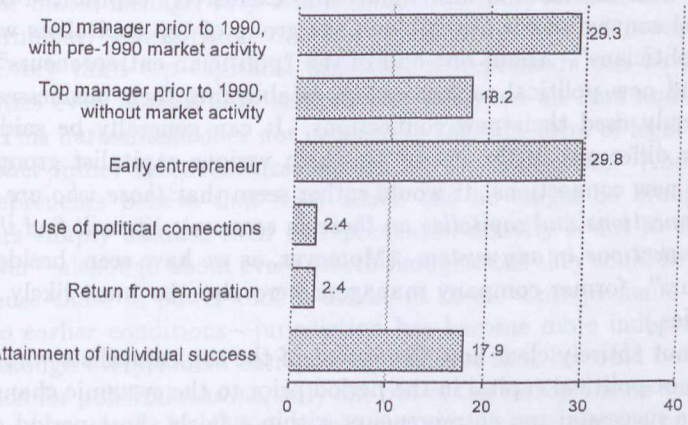


Fig. 2 Distribution of major entrepreneurial groups

[2]By using factor analysis, a mathematical statistical procedure, and by considering the dominant elements we established the typical entrepreneurial groups. We assigned entrepreneurs to one or the other group. However, belonging to one group does not mean that, in creating his business empire, the entrepreneur *exclusively* used the symbolic capital characterizing that group.

Former managers were the most likely to have mobilized symbolic capital when they launched their enterprise. They were the ones who were most likely to have made the most of credit schemes promoting privatization, to have participated in the privatization of their former company, and to have used both their pre- and post-1990 political connections. Interestingly enough, former economic managers share a number of similarities with those current top entrepreneurs who lived abroad during the years of socialism and who returned to Hungary after the systemic change—especially with respect to the opportunities which they choosed to use. Similarly to economic managers in former state-owned enterprises, they were the most likely to have taken advantage of credit schemes promoting privatization, and one out of every two also mobilized his contact capital acquired from the new political élite in order to launch their Hungarian business. Hungarian entrepreneurs who did not occupy a prominent position in the old company hierarchy started out with considerably less symbolic capital; however, they were more active in the second economy of the late Kádár era. About half as many of them took advantage of credit schemes—that is, compared to former company leaders. Furthermore, half as many (i.e. about every tenth such top entrepreneur) activated their political connections—forged either in the old or the new system—as former company managers. The group of top capitalists who we have labelled as "politicians"—i.e. whose political connections were their greatest capital—took advantage of preferential loans to an even smaller extent than early entrepreneurs. At the same time, each of these groups emphasized the importance of their personal abilities and knowledge in attaining their present position. We would here like to note that the ratio of individuals who exclusively capitalized on their former political connections is negligible in the group of top capitalists who we have labelled "politicians". About one-half of the "politician entrepreneurs" used both their old and new political connections in establishing their businesses, while the other half only used their new connections. It can generally be said that there is no major difference in the extent to which various capitalist groups activated their old or new connections. It would rather seem that *those who are apt to forge political connections and capitalize on these in economic life will find the necessary political connections in any system*. (Moreover, as we have seen, beside "politician entrepreneurs", former company managers were also the most likely to use such opportunities.)

It is not entirely clear how 18 percent of the top capitalists who had neither economic, nor political capital in the period prior to the systemic change, nonetheless became successful top entrepreneurs within a fairly short period of time—i.e. it is not clear which factors contributed to their becoming absolute winners during the process of the systemic change. Similarly to other top capitalists, they too emphasized their personal abilities as the key to their success. Only one-third claimed that the boom in the wake of the systemic change was an invaluable factor, and 13 percent participated in preferential privatization; this is roughly the same ratio as

those who made the most of this possibility, but who only had purely political connections. The single element which distinguished them from those highly-trained Hungarians who consider themselves to no more than relative winners in the systemic change and who did not launch their own large business is that, beside a higher than average inclination for a risk-taking, about one-third had foreign connections, even if not necessarily economic in nature. In such cases, it is these foreign connections which seem to have awakened their dormant entrepreneurial spirit.

To sum up this section, we may say that the new top entrepreneurs were recruited from among those who were already playing an important role either in state or market economic life prior to the systemic change. They were the ones who could best take advantage of the opportunities presented by the systemic change. Political connections no doubt played a role in launching successful enterprises, but only as a "complementary element", and as such they seem to have functioned—and still function—rather well.

Perception of the political and economic environment

Trust in jurisdiction—distrust in the government

Our data show that top Hungarian capitalists have little faith in the institutions of a *Rechtsstaat*. It can be said in general that while most top entrepreneurs trust jurisdiction, their relation to the police is somewhat ambivalent; even so, in spite of their mixed feelings, they still tend to have more faith in the former than in the government. The greatest mistrust seems to be directed towards the government. Every third top capitalist feels that entrepreneurs can be harassed by the authorities even if they have scrupulously observed all laws and regulations (*Table 1*). This harassment does not necessarily take the form of legal action, but involves rather minor inconveniences caused by the authorities. About one-half of the entrepreneurs believe that legal action can no longer be brought against entrepreneurs simply because their entrepreneurial activity is not to the liking of those in power—although about every fourth thought that they could be impeached simply because those in power took a dislike to them. Entrepreneurs feel that—compared to earlier conditions—jurisdiction has become more independent from politics. Although every fourth entrepreneur believes that he could be threatened by legal action for political reasons, only one out of ten entrepreneurs suspects that the court would actually be willing to convict an entrepreneur for purely political reasons, without any legal grounds, just because those in power request this. This opinion, however, does not mean that—at least on the level of court rulings—entrepreneurs feel that they enjoy legal security. As a matter of fact, a court should not be able to convict anyone without legitimate legal grounds in a *Rechtsstaat*.

The fact that ten percent of top entrepreneurs feel that such unlawfulness is a distinct danger reflects a certain degree of mistrust towards the institution of law. In other words, trust in the institutions of jurisdiction is relative—that is, it is simply higher than trust in the political establishment. The instability of trust in jurisdiction is also indicated by the fact that, although "only" ten percent of entrepreneurs felt that court rulings grossly violate the law, every third entrepreneur contemplated the possibility that politics could influence court rulings.

Table 1

Trust in institutions among top entrepreneurs

	Disagrees	Neutral	Agrees
If an entrepreneur observes the laws and regulations, he can be sure that he will not be harassed by the authorities.	32.4	25.6	42.0
The days when legal action can be brought against an entrepreneur simply because his activity is to the dislike of those in power are gone.	26.7	21.5	51.8
Even if legal action were brought against an entrepreneur because his activity is to the dislike of those in power, he can be certain that the court would not convict him if he has observed the law.	12.6	22.8	64.6
Court rulings often depend on the guidelines the judiciary receive from those in power.	38.2	32.4	29.4
The police protect honest men from dishonest ones.	43.5	34.0	22.5
The police are powerless against the underworld, and one cannot rely on the police's efforts.	22.9	31.3	45.8
One can trust the Hungarian banks not to give out information on entrepreneurs and enterprises unless there is a court ruling to this effect.	37.3	26.5	36.1

Entrepreneurs have even less faith in the ability of the police to fulfil their tasks. About four or five out of ten entrepreneurs feel that the police are powerless and unable to protect honest citizens from criminals and from the underworld. Similarly to all other attitude questions concerning trust, about one-third of the respondents was uncertain in evaluating the work of the police: they would not say that the police are wholly unable to cope with crime, but then nor did they feel that the police protect the honest against the dishonest (*Table 1*).

Entrepreneurs also have little faith in banks. Only one-third of the entrepreneurs interviewed believed that banks in Hungary practice strictly confidential procedures and that banks only give out information if there is a court ruling to that effect. Slightly more than one-third have practically no confidence in the banks, while about one-fourth were unsure about the confidential nature of banking procedures (*Table 1*).

Top capitalists believe that there is widespread corruption among government officials. Every fourth respondent was convinced that all government officials are corrupt; about one-third were undecided (which in this case means that they feel that some government officials are corruptible, while others are not); and only one in three believed that government officials are honest and incorruptible men. Even though government circles are inclined to emphasize corruption within the ranks of the police, top capitalists consider the police to be far more clean-handed than government officials. Almost two-thirds of the entrepreneurs (58 percent) consider the majority of those in the police force to be definitely honest, and only one in ten thought that most policemen were corruptible (*Figure 3*).

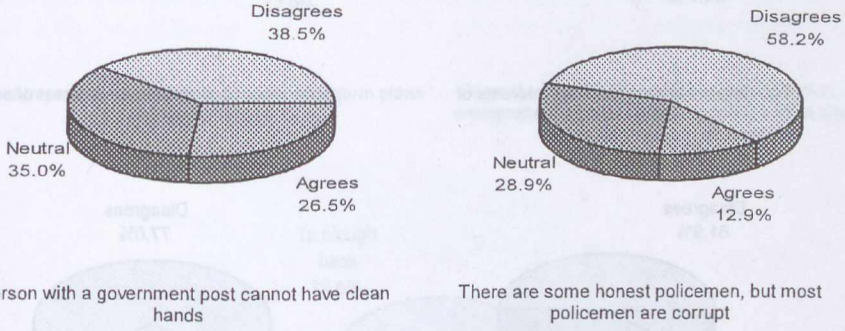


Fig. 3 Perception of official corruption

Top Hungarian capitalists thus show extensive distrust towards state officials. They have very little faith in the government—i.e. in the political establishment—since they believe that top entrepreneurs are "harassed" for purely political reasons, and they also feel that court rulings might be influenced by political motives. There is a slightly greater measure of trust towards the police and an even greater degree of trust towards the judiciary. The ambivalent attitude towards the police is due to the fact that, even though entrepreneurs consider the police to be basically honest, they nonetheless feel that the police are powerless against criminals.

Anti-entrepreneurial political environment

Top Hungarian capitalists not only mistrust the government, but the majority of them (61.9 percent) perceive the government to be expressly anti-entrepreneurial. Only one in ten feel that the government's claim to support entrepreneurship is not an empty slogan, but a fact. A quite significant percentage (37 percent) feels that the government's activity is expressly damaging to the interests of society, and only

one in four maintained that even though the government was nor entrepreneur-friendly, its activity nonetheless served the interests of society (*Figure 4*).

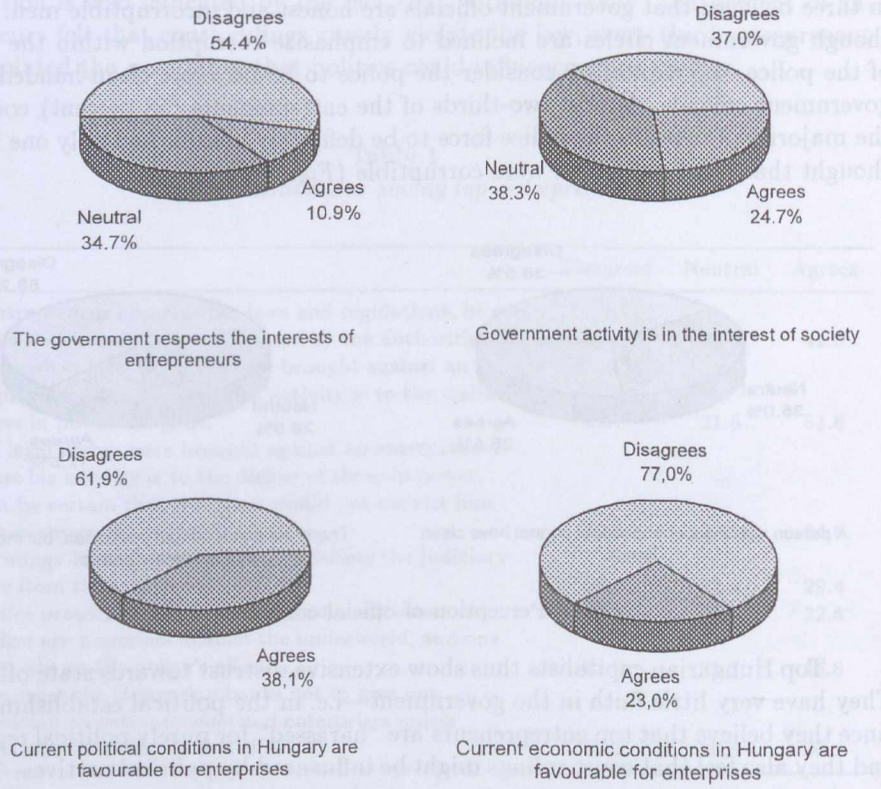


Fig. 4 Evaluation of the government and the general economic and political situation, according to entrepreneurs

The effect of the environment

The unfavourable climate, coupled with mistrust, makes top entrepreneurs merely more careful and more pessimistic, but it does not break their spirit of enterprise or dampen their energy. Although only 18 percent of today's top capitalists claim that they are prepared to make long-term business plans in Hungary, this does not imply that they are only prepared to invest in low-risk, high-return

and short-term ventures. Only one-third of the respondents declared that they would hesitate to invest in a long-term venture with slow returns. Other respondents were quite willing to make long-term plans, even though they were somewhat apprehensive about the outcome (*Figure 5*).

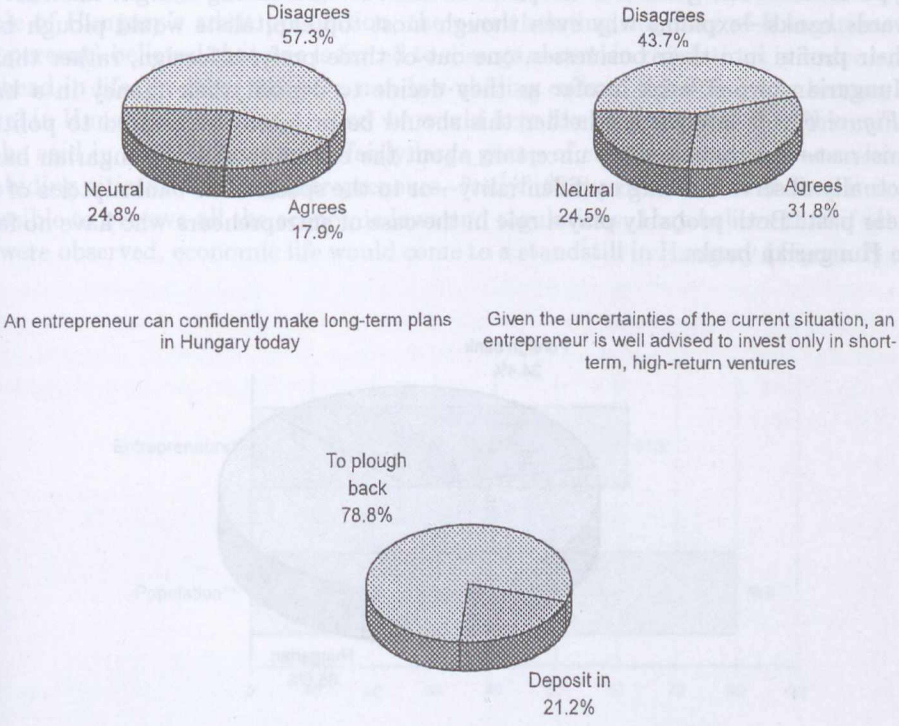


Fig. 5 Economic planning among top capitalists

Furthermore, Hungarian entrepreneurs do not simply prepare long-term plans, but actually act on these: three out of four entrepreneurs claimed that, in spite of the less than favourable conditions, profits should be ploughed back into the business. Thus the business must expanded even if the eventual outcome of the investment and the eventual profits are considered uncertain. In spite of the fact that entrepreneurs perceive the political and economic environment to be unfavourable, this does not dampen their spirit of enterprise, but—in their view—merely increases investment risks. Most Hungarian top entrepreneurs nonetheless accept these risks,

even if with a considerable degree of apprehension—in pretty much the same way as they were prepared to undertake risks earlier, since otherwise they would hardly be where they are today (*Figure 5*).

Obviously, not all successful top entrepreneur are prepared to undertake any type of risk. The general atmosphere of mistrust—including a slight mistrust towards banks—explains why even though most top capitalists would plough back their profits into their businesses, one out of three prefer a foreign, rather than a Hungarian owned bank insofar as they decide to deposit their money in a bank (*Figure 6*). It is unclear whether this should be primarily attributed to political mistrust—i.e. that they are uncertain about the extent to which Hungarian banks actually observe banking confidentiality—or to the spectacular bankruptcies of the near past. Both probably play a role in the case of entrepreneurs who have no faith in Hungarian banks.

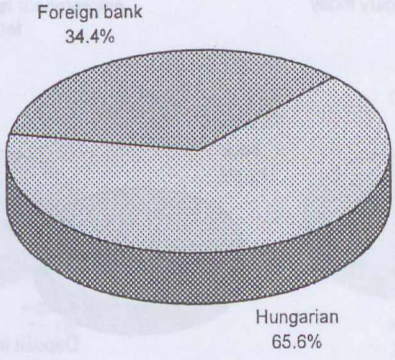
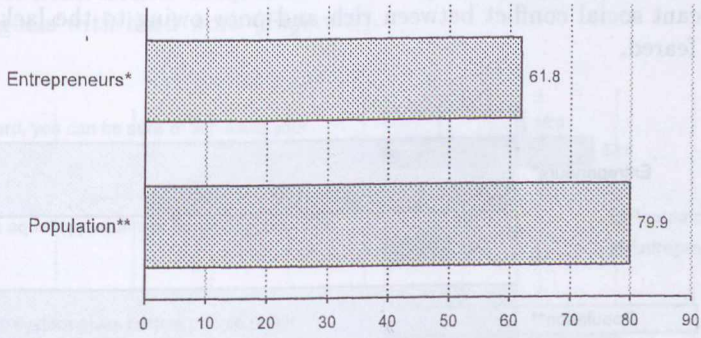


Fig. 6 Trust in Hungarian banks

Attitudes to market capitalist, law-abiding behaviour among entrepreneurs and the population

Most top entrepreneurs consider the rule of law and legal security to be rather uncertain in present-day Hungary. The essential prerequisite for a *Rechtsstaat*—which incidentally coincides with the interests of entrepreneurs and capitalists—is that the existing laws be observed (by citizens, by the government, and by the

civil service). The assumption that the law is observed is the foundation upon which the trust between the participants of a capitalist society is based and which enables them to organize and participate in joint actions. We can hardly claim that either top entrepreneurs or the population in general can be characterized as being law-abiding. According to a 1996 survey conducted on a representative sample of Hungary's adult population, the overwhelming majority of Hungarians (79.9 percent) believed that one is forced to disregard certain regulations in order to get ahead in life. In other words, a non-law-abiding code of behaviour has become general in Hungary. In contrast—and we would here like to emphasize that this can only be said in a relative sense—a fairly large group of entrepreneurs appear to be law-abiding citizens. Among entrepreneurs, "only" 61.8 percent claimed that it is impossible to observe all the economic laws and regulations: they believe that if all laws were observed, economic life would come to a standstill in Hungary (*Figure 7*).



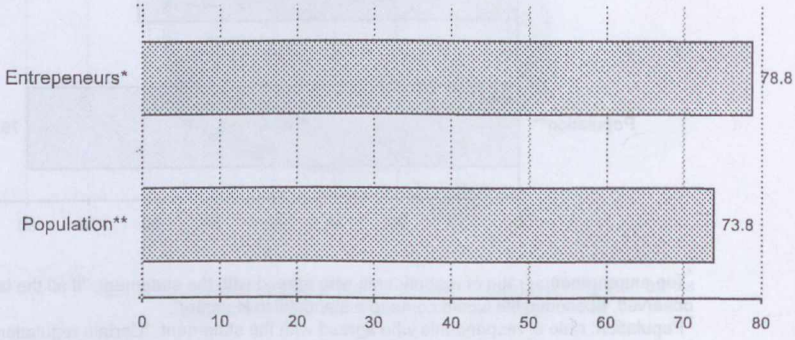
*Top entrepreneurs: ratio of respondents who agreed with the statement. "If all the laws were observed, economic life would come to a standstill in Hungary".
**Population: ratio of respondents who agreed with the statement. "Certain regulations have to be disregarded in order to get ahead". Source: *Hungarian household panel survey*, 1996.

Fig. 7 Inclination to disregard certain laws among top entrepreneurs and the population

This attitude may have been influenced by the fact that during the era of the "soft" dictatorship of the 1980s there was an unspoken, but nonetheless observed "agreement" between the then government and the population according to which certain laws—which were based on the ideological foundations of state socialism but which would have paralyzed entrepreneurship and the second economy—did not have to be taken at face value. It would appear that a part of the Hungarian population and, to a certain extent, the current government, continue to drift along with this inherited attitude. Nevertheless, we believe that the real reason for this is the impenetrable jungle of laws and regulations which practically make law-abiding

behaviour impossible in present-day Hungary. Top capitalists, whose basic interest is a strict observance of the law, feel this very acutely. An assumption that laws are observed is necessary for a planning and for trusting the other actors in the economy. Our survey shows that entrepreneurs feel that the state—in this sense embodied by the government—does not observe the laws to at least the same extent as the citizens in general. The practice that "laws cannot be observed, but then nor can they be taken seriously" is not simply a question of ethics, but rather a cardinal problem for the future of democracy in Hungary. If existing laws tend to constrain the economy, then such laws need to be amended, rather than reacting to the violation of the law by introducing new regulations.

The general practice of disregarding the law implies not only a certain complicity (as well as a defencelessness) between the citizen and the state, but also weakens the legitimacy of inequalities and increases the likelihood of conflict between rich and poor. If about three-fourths of the population believes that the rich acquired their wealth by dishonest means, and eight out of ten entrepreneurs perceive that this is the general attitude towards them (*Figure 8*), the eruption of a significant social conflict between rich and poor owing to the lack of legitimacy is to be feared.



*Top entrepreneurs: ratio of respondents who agreed with the statement. "Most people believe that it is impossible to become rich by honest means".
**Population: ratio of respondents who agreed with the statement. "In this country it is impossible to become rich by honest means". Source: TÁRKI, *Omnibusz 97/1 Survey*, 1997.

Fig. 8 Is it impossible to become rich by honest means?

The drive underlying social advancement

It is a well-known fact that income inequalities are more acceptable in societies where inequalities and "getting ahead in life" are attributed to individual

performance—that is, more acceptable than in societies where public opinion is convinced that this depends on a given circumstance (such as family background, which is independent of individual performance). The belief that individuals with the same abilities and ambitions have equal chances of getting ahead in life essentially legitimizes existing inequalities with respect to individual performance. Following the systemic change in Hungary, however, there evolved a peculiar situation in which even though public opinion attributed getting ahead in life to individual performance, chances were nevertheless regarded as extremely unequal.

The overwhelming majority of both entrepreneurs and the population believe that the economic system gives certain people unfair advantages, while others start out from a disadvantaged position. Two-thirds of the respondents in the population sample believe that a disadvantageous position cannot be counterbalanced with hard work. Only one-third believed that those who work hard will sooner or later achieve their goals. Entrepreneurs are more inclined to have faith in the "profitability" of individual performance: one out of two entrepreneurs believes that in spite of considerable inequalities with respect to opportunities, one can achieve one's goals with hard work (*Figure 9*).

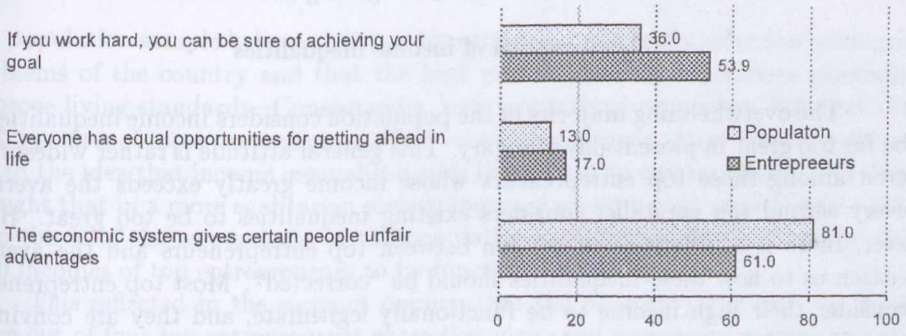


Fig. 9 Attitudes towards the inequality of opportunities among entrepreneurs and the population

In general, it can be said that entrepreneurs attribute success to individual performance: namely, to ambition, innate abilities and hard work. On the other hand, the "right" connections, a wealthy family background and educational attainment are considered less important for getting ahead. Population attitudes differ somewhat: even though individual performance is vital to success, public opinion considers a wealthy family background and influential acquaintances to be at least as important (*Figure 10*).

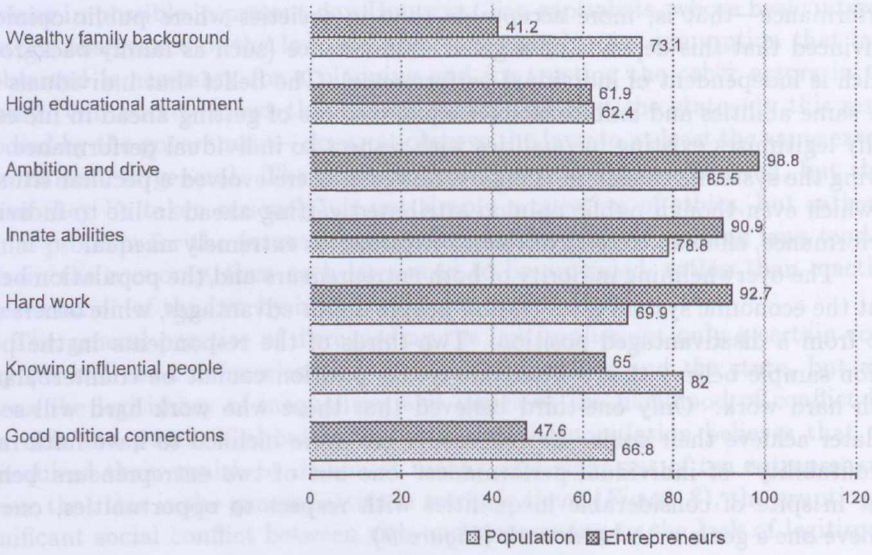


Fig. 10 What is necessary for getting ahead in life

Legitimation of income inequalities

The overwhelming majority of the population considers income inequalities to be far too great in present-day Hungary. This general attitude is rather widespread even among those top entrepreneurs whose income greatly exceeds the average: every second top capitalist considers existing inequalities to be too great. However, there is a difference of opinion between top entrepreneurs and the average citizen as to how these inequalities should be "corrected". Most top entrepreneurs consider their high income to be functionally legitimate, and they are convinced that Hungary's economic problems can be solved by large enterprises, and therefore enterprises—and entrepreneurs—should be allowed to make high profits since this process is the main driving force behind the economy. They feel that even if income inequalities were smaller, the poor would not be better off—but entrepreneurs would definitely be worse off. Thus while income inequalities are considered to be far too great—perhaps as a result of social conditioning during recent decades—entrepreneurs nonetheless consider this to be absolutely necessary. Top entrepreneurs legitimize *their own* high incomes when they cite economic necessity. Every second top entrepreneur believes that great income differences do not *in general* spur people to greater achievement (*Figure 11*).

At the same time, we can hardly claim that economic necessity legitimizes the entrepreneurs' higher income in public opinion. The latter even tends to question the economic necessity of large businesses. Only one-third of the respondents in

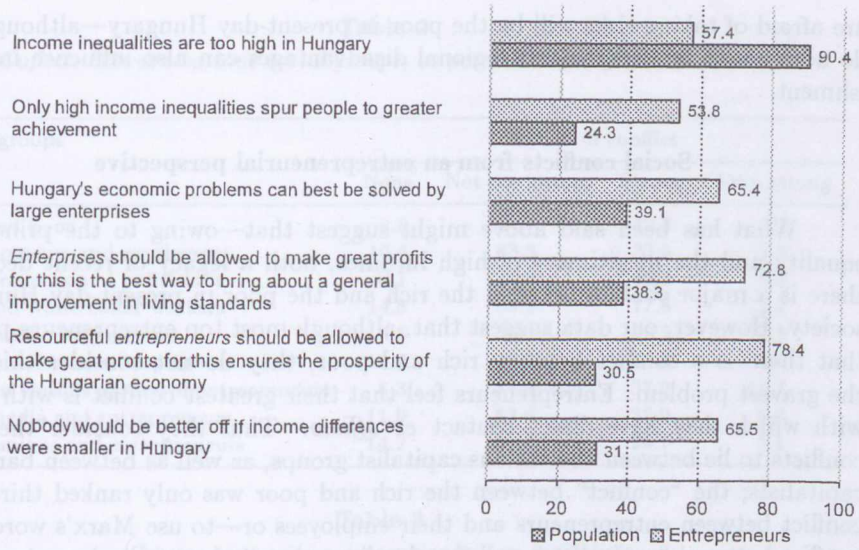


Fig. 11 Opinions on inequalities among entrepreneurs and the population

the population sample believe that private enterprises can really solve the economic problems of the country and that the high profits made by enterprises generally improve living standards. Consequently, only every third respondent felt that the high incomes of top entrepreneurs had an economic rationale. Most respondents rejected the idea that income inequalities spur individuals to greater efforts, and they thought that in a more egalitarian society the poor would be less poor (*Figure 11*). Two-thirds of the respondents in the population sample thus do not consider the high incomes of top entrepreneurs to be functionally legitimate.

This reflected in the succinct opinion that the poor envy the rich—at least three out of four top entrepreneurs share this view, and even every second respondent in the population sample acknowledged that the rejection of the high incomes of entrepreneurs was motivated by irrational envy, rather than rational considerations. The other "irrational" motivation underlying the conflict between rich and poor was that the rich despise the poor. Two-thirds of the respondents in the population sample felt that this was the case—and every fourth entrepreneur also believed that there was a grain of truth in this statement. One possible explanation for the entrepreneurs' "contempt" for the poor might be that since entrepreneurs are convinced that they owe their present economic and social position to their exceptional abilities, ambition, hard work and willingness to take risks, they truly believe that the poor in present-day Hungary are essentially people who lack individual abilities and are incapable of performing in any outstanding way. According to most top capitalists, people who are uneducated, untalented, lack ambition and

are afraid of taking risks will be the poor in present-day Hungary—although they do admit that misfortune and regional disadvantages can also influence impoverishment.

Social conflicts from an entrepreneurial perspective

What has been said above might suggest that—owing to the principle of equality and the illegitimacy of high incomes, both a legacy of recent decades—there is a major conflict between the rich and the poor in present-day Hungarian society. However, our data suggest that, although most top entrepreneurs perceive that there is a conflict between rich and poor, they do not consider this to be the gravest problem. Entrepreneurs feel that their greatest conflict is with groups with which they have direct contact *ex officio*. Thus they consider the major conflicts to lie between the various capitalist groups, as well as between banks and capitalists; the "conflict" between the rich and poor was only ranked third. The conflict between entrepreneurs and their employees or—to use Marx's words—the conflict between "capitalists" and "workers" can hardly be said to be antagonistic. Every tenth entrepreneur feels that his connections with his employees are free of conflict; two-thirds mentioned only slight conflicts; and only 2.8 percent felt that the capitalist-employee relationship was burdened with major conflicts (*Table 2*). In the case of enterprises founded during the economic crisis both capitalists and their employees have come to appreciate that their interests meet on several points. If the enterprise makes a huge profit, the living standards of the employees will also improve, whereas if the enterprise is unprofitable, the employees will also be hurt. Profitable private businesses generally provide a higher income for their employees than the wages paid by state or mostly state-owned companies, and thus those employed by entrepreneurs are more content than those employed by the state. Only 8 percent of the respondents in the population sample thought that entrepreneurs exploit their workers, about one-third were undecided, while *60 percent of the population sample definitely rejected the fact of exploitation*.

The peaceful coexistence of entrepreneurs and employees is also felt by entrepreneurs. Every third top capitalist perceived workers to be pro-enterprise, and another one-third considered workers to be neither pro- nor anti-enterprise (*Table 3*).

New Hungarian capitalists perceive a much higher degree of anti-entrepreneurship on the part of the government (that is, compared to the perceived conflict between rich and poor). According to our data, even though there are conflicts between the rich and poor, this conflict is fuelled by envy rather than by a feeling of being exploited. *The truly deep-seated conflict is between the government and the entrepreneurs*: these two actors have a deep distrust of each other and mutually consider each other as opponents—or, even worse, as enemies (*Table 3*).

Table 2

Coflicts between various social groups, as perceived by top entrepreneurs

Social groups	Extent of conflict			
	None	Not too strong	Strong	Very strong
Rich and poor	2.8	44.7	42.8	9.7
Entrepreneurs and employees	10.4	63.3	23.5	2.8
Entrepreneurs and politicians	6.1	45.0	40.3	8.6
Blue and white collar workers	14.8	65.2	17.8	2.2
Banks and entrepreneurs	15.5	39.2	32.5	12.8
Intellectuals and entrepreneurs	14.8	46.2	30.8	8.2
Between various groups of entrepreneurs	5.3	44.3	37.2	13.3
Mass media and entrepreneurs	11.9	53.6	27.9	6.6
Trade unions and entrepreneurs	14.2	51.0	29.7	5.1

Table 3

Groups seen as pro-enterprise by top capitalists

	Pro-enterprise	Neutral	Anti-enterprise
Government	23.6	39.9	36.9
Police	12.3	65.3	22.5
Workers	37.9	37.0	25.1
Trade unions	15.4	50.2	34.7
Financial institutions	50.3	25.2	24.6
Mass media	41.5	35.4	23.1
Intellectuals	29.2	39.5	31.4

Interestingly enough, while quite a few entrepreneurs consider the relationship between entrepreneurs and financial institutions to be burdened with conflicts, this does not mean that banks are considered to be anti-enterprise. In contrast, every second top entrepreneur feels that banks are definitely pro-enterprise. This suggests that conflicts are seen as "practical conflicts" which are inevitable between entrepreneurs and banks during day to day work; in other words, they are not theoretical in nature.

That the rule of law is reflected by the fact that most entrepreneurs consider the police to be neutral: about two-thirds consider the police to be neither pro- nor anti-enterprise. They also see trade unions as basically neutral. They perceive a slight anti-enterprise feeling on the part of intellectuals, while the mass media are seen as pro-enterprise to roughly the same extent as banks (*Table 3*).

Every second top entrepreneur feels that public opinion is basically hostile to entrepreneurs. Four out of ten top entrepreneurs are influenced by the way the average citizen feels about entrepreneurs. About one-third of the interviewed entrepreneurs tried to come to terms with this hostility by claiming that they were not in the least interested in what people think about successful entrepreneurs; about one-fourth were vague about whether public opinion influences their actions. Entrepreneurs felt that this was a reasonable approach while public opinion is "merely" a factor influencing their personal mood and does not actually threaten them with more violent expressions of outrage. One out of every ten top entrepreneurs fears mass demonstrations or the outbreak of riots—i.e. a more violent form of the expression of the average citizen's dissatisfaction, and a further 16 percent feel that this is a distinct possibility. Every fourth top Hungarian capitalists thus considers the dissatisfaction of the masses not simply as an element influencing their own and public mood, but a factor endangering the economic and political environment and, in essence, the security of their enterprise.

Possibilities for the mediation of political interests

Entrepreneurs are apprehensive about possible political changes in the near future. While most of them consider the two liberal parties—that is, the Alliance of Free Democrats (SZDSZ) and the Alliance of Young Democrats (FIDESZ)—to be definitely pro-enterprise, the Hungarian Socialist Party (MSZP) is ranked as one of the least pro-enterprise parties. (According to top entrepreneurs only the Christian Democratic Party is less pro-enterprise than the MSZP, and the MSZP heads the list of parties perceived as being definitely anti-enterprise.) However, two out of three top capitalists believe that the MSZP will win the next elections (*Table 4*). In other words, top entrepreneurs do not think that the political environment, which is currently seen as anti-enterprise, will change for the better in the near future, and neither are they optimistic that Hungary will provide a friendlier, pro-enterprise environment.

Another legacy of "goulash Communism" as far as values and customs are concerned is that the institutions of interest mediation have not emerged in the entrepreneurial sphere. (This is a similar situation with present trade unions which, in the former regime, instead of advocating workers' interests, functioned as transmiss on belts serving the political establishment.) Instead of an open promotion of interests we find individual interest-mongering. Individual interest realization based on individual connections, and the concealment and informal realization of these interests favours corruption, "secret" pacts behind the scenes of formal political mechanisms, and the emergence and consolidation of parallel decision-making mechanisms. This situation is hardly favourable for political and economic decision-

Table 4

Entrepreneurs' perceptions of how the political parties relate to enterprises

	Pro-enterprise	Neutral	Anti-enterprise
Hungarian Democratic Forum (MDF)	48.4	37.6	14.0
Alliance of Free Democrats (SZDSZ)	68.7	21.9	9.4
Smallholders' Party (FKgP)	39.9	37.7	22.5
Hungarian Socialist Party (MSZP)	39.5	37.1	23.4
Alliance of Young Democrats (FIDESZ)	65.9	28.0	6.1
Christian Democratic Party (KDNP)	27.9	51.8	20.2
Hungarian Democratic People's Party (MDNP)	54.2	37.5	8.3

makers since the question inevitably arises as to whom they support, whose interests they represent and what they receive in exchange. Furthermore, this state of affairs is not particularly favourable for an emergent capitalist class given that interest mediation is considerably more difficult on an individual basis if it takes place openly and collectively. Also, entrepreneurs are thus forced to make use of "secret channels" which, in turn, portrays them as "unscrupulous, dishonest and deceitful" in the public eye.

Entrepreneurs have no intention of remaining as idle onlookers while the prevalent mood in their political and economic environment is one of anti-enterprise. Similarly to their historic predecessors who, when capitalist societies were in the making, first seized economic and, later, political power, the majority of present-day Hungarian entrepreneurs feels the need for a party which can articulate their interests and which would be willing to fight for these in the political arena (*Figure 12*).

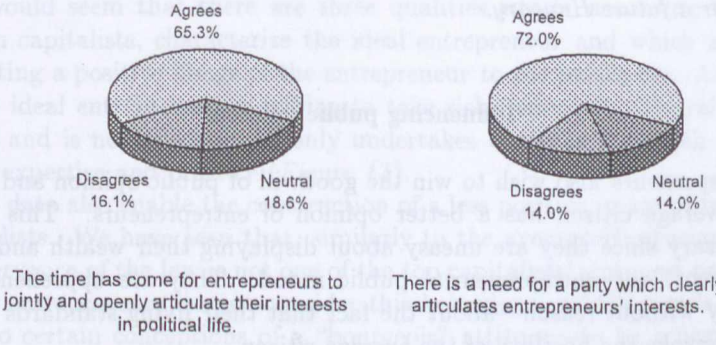


Fig. 12 Need for the articulation of entrepreneurs' interests

Most of top entrepreneurs have clear-cut ideas as to what kind of government they would prefer. Most would prefer a strong-willed cabinet which can lead the country out of the economic crisis, create stability and security and, at the same

time, would adopt a liberal economic policy. Such a government would not interfere in trade and business, nor would it interfere in shaping the extent of income inequalities (*Figure 13*).

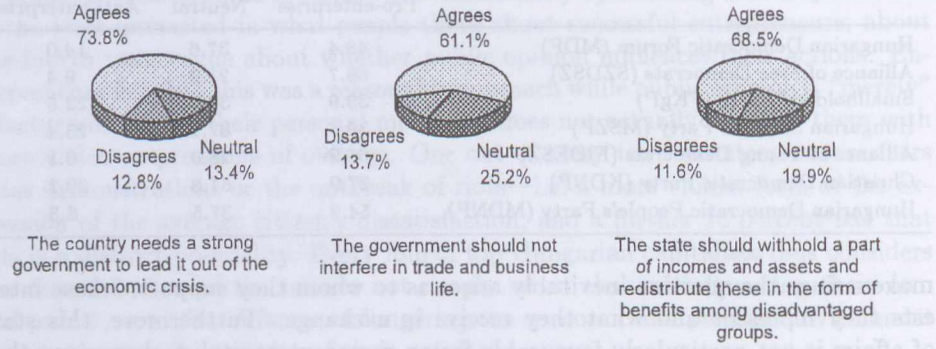


Fig. 13 Characteristics of the ideal state, according to entrepreneurs (percentage ratio of respondents agreeing with the following statements)

This does not mean that the ideal state as conceived by top capitalists would resemble an Anglo-Saxon state—i.e. here conceived to be a state which interferes in social processes only minimally. Most top Hungarian entrepreneurs hold that the state should pursue an active social policy. Two-thirds of top Hungarian entrepreneurs believe that there is a need for redistribution by the state and that it is necessary for the state to withdraw a part of the incomes and assets and to redistribute these in the form of benefits (*Figure 13*). *Top entrepreneurs thus consider a political establishment that best resembles the Western European welfare states as the ideal for a future Hungary.*

Influencing public opinion

Entrepreneurs also wish to win the goodwill of public opinion and to ensure that the average citizen has a better opinion of entrepreneurs. This is all the more necessary since they are uneasy about displaying their wealth and affluence in the current, anti-entrepreneurial public mood. They are apprehensive—and not entirely without reason—about the fact that their living standards and their lifestyles provoke the hostility of the average citizen.

Public opinion would no doubt be positively influenced if capitalists' interests could be articulated openly and in an institutionalized form since this would no doubt dispel the current aura of suspicion surrounding entrepreneurs. Another possible means of influencing public opinion would be the projection of a socially

acceptable, positive image of "nouveau capitalists". This could serve as a model and, not least, present entrepreneurs' actions as being beneficial to the average citizen. Present-day entrepreneurs are reluctant to reveal themselves to the public eye and to display their day to day life. Even though three out of four entrepreneurs are proud of their high living standards—since they feel that they have achieved these through personal hard work—every second top entrepreneur nonetheless claimed that he tries to hide his prosperity from the public eye since he feels that this might provoke hostility. Two-thirds of top Hungarian capitalists feel that a real *grand bourgeois* shuns publicity and does not publicize his lifestyle. At the same time, most respondents mentioned that they would like the mass media to portray present-day top Hungarian entrepreneurs in a positive light and as acceptable role-models.

The *grand bourgeois* lifestyle in a present-day Hungary—dream and reality

We asked top entrepreneurs to select the qualities which characterise the ideal type of a successful entrepreneur (including a "real-life" Hungarian entrepreneur) from a set of standardized quality-pairs. The answers we received reflect a certain stratification as far as entrepreneurs' values and their ideas about a *grand bourgeois* lifestyle are concerned. It is very difficult to pinpoint those qualities which most Hungarian top capitalists would accept as characterizing the ideal top entrepreneur, and which could be used for presenting a uniform, positive "bourgeois lifestyle" to the public eye. As a matter of fact, the few qualities which characterize the ideal top entrepreneur include some which are a far cry from the "bourgeois" values and lifestyle of a modern *grand bourgeois*.

It would seem that there are three qualities which, according to the new Hungarian capitalists, characterize the ideal entrepreneur and which are suitable for projecting a positive image of the entrepreneur to the public eye. According to these, the ideal entrepreneur is willing to take risks, sponsors cultural and artistic events and is not reckless: he only undertakes ventures for which he has the necessary expertise and practice (*Figure 14*).

Our data also enable the construction of a less positive image of top Hungarian capitalists. We have seen that, similarly to the average Hungarian citizen, a strict observance of the law is not one of the top capitalists' strongest points. Most latter day entrepreneurs do not consider this behaviour—which stands in marked contrast to certain conceptions of a "bourgeois" attitude—to be a negative trait. Perhaps this is because almost everybody seems to think and act in this way in present-day Hungary. Only every fifth entrepreneur ranked law-abiding behaviour among the most important qualities of the ideal entrepreneur; and four out of ten claimed that the ideal entrepreneur culls the laws according to his interests, ob-

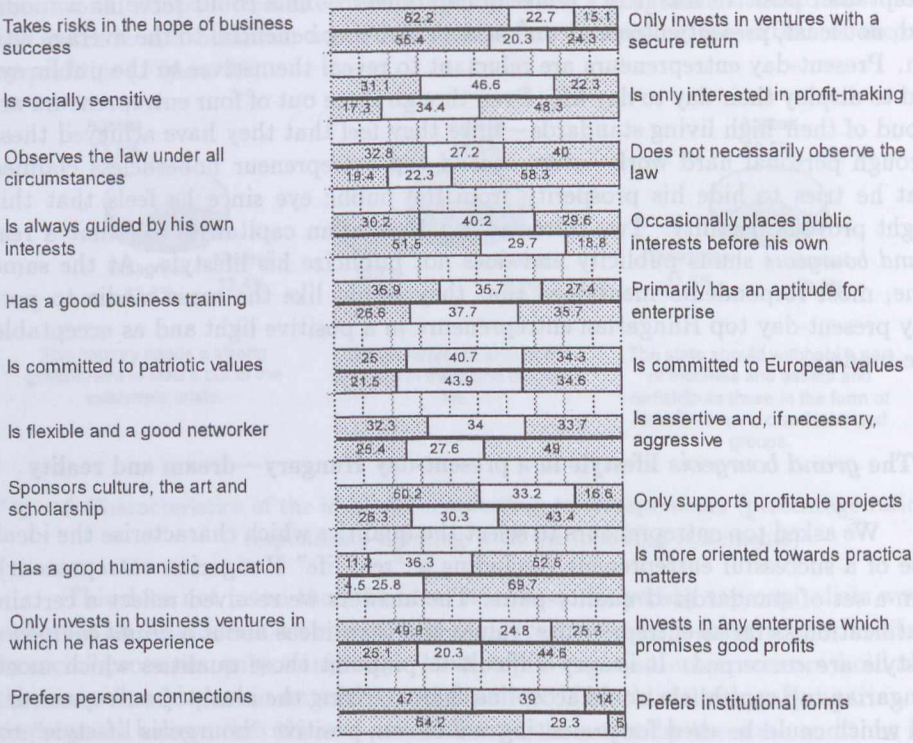


Fig. 14 The ideal entrepreneur—as envisioned by top capitalists

serving some and disregarding others. Citizens of the former socialist countries are also characterized by another, rather peculiar attitude—namely, that they are not particularly confident that matters can be settled officially: they consider the use of personal connections and individual interest promotion to be the more effective than institutional forms. Present-day entrepreneurs are convinced that the ideal entrepreneur is also characterized by his preference for personal connections as opposed to institutional forms. This is most likely due to the fact that the institutional structure is currently under transformation and that efficient institutions articulating and promoting their special interests have not evolved yet.

The image of the capitalist *grand bourgeois* differs slightly from the image of the entrepreneur who is successful in present-day Hungary. A "successful" entrepreneur is tougher and more profit-oriented than the "ideal" entrepreneur. Similarly to the ideal entrepreneur, he undertakes risks, but he is also a person who prefers to get matters settled through personal connections, who puts his own interests before public ones, who is only prepared to invest in economically sound

and profitable projects, and in the hope of large profits he is also willing to invest in ventures in which he has little former experience (*Figure 14*). Top Hungarian entrepreneurs feel that in adopting "bourgeois" values they can overcome the problems of their age and their narrower social environment—as they did in several other fields in the course of their earlier economic activity. They are more honest, are more concerned with public interests, they are less profit-oriented and "pushy" than the perceived environment would demand from a success-oriented capitalist entrepreneur.

The image of the *grand bourgeois* lifestyle which can be constructed from the answers given by the respondents is not simply an "imaginary" image of the ideal Hungarian top entrepreneur—most of Hungary's new capitalists try to live up to this ideal. One out of three entrepreneurs regularly sponsors various cultural, artistic or scientific events, while every second entrepreneur occasionally supports such projects. They also claimed that they contribute to social charities in roughly the same proportion (*Table 5*). Those who sponsor certain events tend to use this more or less consciously for projecting a positive image of themselves, and most entrepreneurs—namely, two-thirds of the respondents—agreed that the support of cultural, artistic and scientific events or projects (as well financial contributions to social charities) definitely improves the general evaluation of entrepreneurs.

Table 5

Activities of sponsorhip undertaken by top entrepreneurs

How often do you support...	Regularly	Occasionally	Never
cultural, artistic, scientific events	39.1	50.0	10.9
social charities	39.0	52.6	8.5
political parties and institutions	0.6	8.8	90.5
churches	8.2	21.5	70.4
other public interests	27.9	55.8	16.3

Although top entrepreneurs willingly sponsor cultural events, it can hardly be said that they actually live the life of an educated *grand bourgeois*. Even though they go to the theatre, opera and concert more frequently than the average Hungarian, only an insignificant number can be said to be regular "culture consumers". Every fifth top entrepreneur regularly goes to theatre performances, every tenth is a regular concert goer, but only 7 percent claim to regularly visit exhibitions. It is also true, that they all consume culture to some extent. Most attend cultural and artistic events occasionally (*Table 5*).

It is a fact that most Hungarian entrepreneurs are highly-qualified professionals. 84 percent hold a university degree, 13 percent have a secondary school education. 71 percent speak at least one foreign language. This in part implies that an entrepreneur could hardly have become a successful top capitalist without

some cultural capital, and it also offers a solid foundation for creating a positive image of entrepreneurs: the majority of present-day Hungarian top entrepreneurs come from among highly-qualified men who essentially only invest in business areas in which they have the necessary qualifications and expertise.

Conclusion

Most top entrepreneurs come from the ranks of the élite of the period prior to the systemic change. Participation in the second economy or a high-level managerial position in a state-owned company meant a great advantage in becoming a top entrepreneur. Top entrepreneurs invested a significant amount of symbolic capital accumulated during the period directly preceding and succeeding the political changes in order to establish their later economic positions. Beside their former position in the economy, this cultural capital played an important role. Even though their political connections played a significant role in establishing their businesses, these played a secondary, auxiliary role. Very few could convert their exclusively political capital into economic capital, and the former political élite did not establish itself in business life after the political changes.

Top Hungarian capitalists are characterized by a deep distrust of administrative organs. They have little trust in the government and in the political establishment. They tend to trust the police slightly more, even though their opinion of the police is rather ambivalent. The gradual emergence of a *Rechtsstaat* is reflected in the fact that entrepreneurs consider the work of the judiciary to be truly independent and they evaluate its work according to the principles of a *Rechtsstaat*.

Most top Hungarian entrepreneurs consider the political or economic climate to be unfavourable for entrepreneurship. They perceive the political and economic environment in which they work to be hostile, or obstructive at the very least. However, no matter how unfavourable, this economic and political climate has not dampened the spirit of enterprise among the new top Hungarian entrepreneurs. They prepare long-term business plans and plough back profits into their enterprises even though the social environment obstructing enterprise in general increases their investment risks.

Top entrepreneurs perceive that public opinion is slightly anti-enterprise, and that it views affluence and income inequalities with disfavour. Still, they do not believe that there is a major conflict between capitalists and workers, or rich and poor. In their opinion, these are eclipsed by the conflict between entrepreneurs—i.e. the economic élite—and the political élite. In their view, the time has come for entrepreneurs to articulate their political interests and to promote their economic interests in the political arena. In this, they expect the support of the average Hungarian citizen too, since in their opinion there are considerably greater

tensions between citizens and the establishment than between entrepreneurs and other groups of society who have been excluded from power.

A joint stand is made difficult by the fact that top Hungarian entrepreneurs do not form a uniform social-political group, and by the fact that even the capitalists are strongly segregated, especially given the considerable conflicts of interest between individual groups of capitalists.

Hungarian *nouveau* capitalists have not yet created their own *grand bourgeois* lifestyle which could be set as an example or act as a role-model and, not least, would project a positive image of entrepreneurs as being useful to the average citizen. Even though the values and the lifestyles of top capitalists are closer to the law-abiding attitude of the educated "bourgeois", the almost all-pervasive disrespect for the law in Hungarian society—or at least its acceptance—is also characteristic of entrepreneurs. The reason for this can be attributed to the legal over-regulation of the economy. The "jungle" of laws and regulations often jeopardizes the functioning of the economy and thus of progress in general. Deregulation seems to be only solution.

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Acta Oeconomica, Vol. 49 (3–4), pp. 365–396 (1997–98)

INTER-ENTERPRISE OWNERSHIP LINKS IN HUNGARY

I. J. TÓTH

In this study the author examines the appearance and characteristics of cross-ownership links in Hungary on the basis of the company tax returns and the data of surveys which include various company groups. The results obtained make it possible to make some (empirically established) statements concerning the inter-enterprise ownership links and the characteristics of the given enterprises, and to compare these with the results of other examinations. On the basis of the results the author criticizes the concept of recombinant property with regard to the Hungarian transition economy and questions the relevancy of the theory of post-communist managerialism regarding diffuse and impersonal property.

Introduction[1]

In the process of the transformation of the Hungarian economy we can observe not only the radical transformation of the inner structure and market orientation of enterprises, but also the appearance of new enterprises and the restructuring of business and ownership links between enterprises already in operation. Statistical data on the distribution of Hungarian companies with regard to size confirm that the structure of Hungarian industrial companies has also been undergoing transformation since the change of the political system; moreover, the so-called "reversed pyramid" has disappeared. This process is accompanied by the formation of links between firms established from the former state-owned companies and newly-formed companies among which the ownership (a) and supplier-buyer (b) links of the companies occupy a special place. In the following study we shall examine the first type of these links.

First we will discuss the interpretation of inter-enterprise ownership links and the background of their appearance, then we will introduce the databases and indicators used and define the limits of the analysis. In the third part of the

[1] This study is a short and revised version of a longer one. For the original study see *Lengyel* (1998). The study is closely related to research which was carried out by the author in the Central European University Privatization Project between 1995–1997. The writing was supported by the OTKA (T013497) and the Department of Sociology of the Budapest University of Economics (FKFP 0040/1997). I would like to thank Attila *Bartha*, György *Lengyel*, József Péter *Martin*, Zoltán *Szántó* and Éva *Voszka* for their valuable remarks regarding the previous version of this study. I also increased my understanding of the topic considerably at the Central European University from conversations with my former colleagues, Gabriella *Pál* and Joel *Turkewitz*. I am grateful to the late László *Csontos*, whose encouragement contributed to the completion of this study.

study we will estimate the prospects for each group of companies and entrepreneurs investing in other companies.

Interpretations of inter-enterprise ownership links

It was David Stark who called attention to the role that inter-enterprise ownership links—or one of their forms, the so-called *recombinant property*[2]—play in the transformation of the Hungarian economy (*Stark* 1996). From his and the results of others (*Móra* 1991 and *Voszka* 1997) we know that the corporization or privatization of large state-owned companies has often meant that from the large state-owned companies—which were the results of the big wave of centralization which took place in the 60's and 70's—company networks were formed which were connected by ownership links. Very often the transformation and privatization has occurred through the disintegration of the given firm into companies, and the ownership structure of the newly-formed company has been determined by the combination of state-owned and private properties. But the formation of ownership links is not a phenomenon which stays within the boundaries of former state-owned companies. Several signs indicate that company ownership links have become general not only among former state-owned companies but also among newly formed, privately-owned companies.[3]

Three strands of ideas can be drafted during the interpretation of investments in other companies, representing a phenomenon which has been a feature of the transformation of the Hungarian economy.

According to the first strand, company investments and company networks resulting from these are phenomena which accompany economic transformation and, as such, do not last for long. The multiplication of inter-enterprise ownership links can be observed at the micro-level and can be considered as a specialty of privatization during the transformation. It means nothing else but "blowing up"—that is, cutting up former state-owned companies.[4] During this process companies established using the equipment of a former state-owned company became partly private properties, often indirectly or directly owned by the management of the

[2] In the following the concepts "inter-enterprise cross-ownership" and "inter-enterprise ownership links" will be treated as synonyms but "recombinant property" will be interpreted differently. This latter refers to a special relationship and means that state properties and private properties are linked together through companies or company groups.

[3] Among others things, this is confirmed by the fact that the owners of large enterprises who have been developing their role as enterpreneurs since the change of the political system often establish holdings. Several examples of this have been collected by Gábor *Juhász* (Juhász 1996).

[4] Voszka (1997) describes this in detail in relation to the transformation of so-called "selected companies". These are companies where the problems, due to their business role or political importance, were dealt with in a special way by the communist leaders after 1968.

formerly state-owned company, and this strengthened the decisional position of the managers.[5] In accordance with this, company investments can be unambiguously related to state-owned companies. Furthermore, in firms, where state ownership plays some role, they are more likely to appear than in any other type of company.

However, there is another version of the explanation related to economic transformation and this is independent of privatization. According to this, after the very concentrated restructuring and amalgamation campaigns of the sixties and seventies (*Schweitzer* 1982 and Voszka 1984), one way of returning to a more effective company size has been the radical change of the company structure. This can be characterized as a "reversed pyramid",[6] involving the disintegration of the formerly established company conglomerates.[7] As a result of the decentralization activities of the management of state-owned companies which were supported by the contemporary economic policies, this process had already started in the second half of the 80's, before privatization had even been mentioned (*Tóth* 1991).[8] According to this approach, the activities of large (state-owned) companies were divided up and some of them were restructured to make new companies. This meant the establishment of vertical networks which then depended on a central company (as a structural innovation), and in its essence it represented the first step of the adjustment to market requirements (*Laki* 1994).

The explanation is entirely different if the question of cross-ownership is considered as a phenomenon which has been in existence for a long time and which may characterize the Hungarian economy at the level of the enterprises and their long-term relationships. This phenomenon is a specialty of the Hungarian transformation and, beside the free market and the state control, it can be considered as the appearance of a new, a third coordinating mechanism (*Bruszt and Stark* 1996).

To assume the long-term existence of inter-enterprise ownership links it is not necessary to consider it as a specialty of the Hungarian or East European transformation. If the sectors of the Hungarian economy are at all characterized by cross-ownership links and if these are characteristic links between the individual enterprises, then we are not stating anything else other than the fact that in this area the situation in Hungary is the same as in the Western European frameworks.

[5] Naturally, a manager's position in a company can be secure even without a share in the ownership if the weak owners (e.g. state-owned companies or governmental institutions) dominate the company. However, the fact that we cannot show the decisive role of the management's direct ownership in the company does not mean that the management cannot be real owners of the given company. If we ask a manager "How big a share do you or your family have in the company you manage?", we underestimate the actual ownership role of managers.

[6] On the restructuring campaigns and the changes in the distribution of companies according to size see Voszka (1984) and Schweitzer (1982).

[7] Beside the cutting up of state-owned companies the fast rate of the foundation of private enterprises also supports the radical change of the previous company structures.

[8] An example of this is MEDICOR, a firm manufacturing medical instruments, which established a company structure in 1985–86 based on profit-centres and independent divisions.

With the establishment of holdings the structural division of enterprises is becoming similar to the model which is more or less characteristic of Western European economies. In North America, for example, beside integrated companies the conglomerates and integrated companies made up of divisions are more characteristic, while in Western Europe and Japan various types of holdings are characteristic—that is, there is a system of subcontractors connected to the companies, or networks of small companies which depend on each other (*Perrow* 1993). Ownership links between the various segments of Hungarian companies can also mean that in the Hungarian industry it is not the integrated types of companies which are dominant (as is the case in the USA) and not the model based on the symbiosis of small and large companies (as in Japan) but holding-like companies or sets of companies carrying out diverse activities (as is the case in Western Europe).[9]

If the empirical basis for the special coordinating mechanism based on recombinant property and characteristic of post-socialist economies is only a result of the existence of inter-enterprise ownership links then it is obvious that we are going along the wrong road. In order to realize this it is enough if we look at the complicated network of company investments and cross-ownership links in Western European countries. On the other hand, we are reminded of this phenomenon's existence in developed countries by the fact that, since the beginning of the 80's, research on cross-ownership links between companies has been at the centre of research related to economics, management and organizational studies, as is shown by Grandori's survey study (*Grandori and Soda* 1995). Among Western European countries (in France for example, where there is a relatively large public sector) ownership links are very frequent between the largest state-owned and the private companies (naturally, their intensity varies). These relationships played an impor-

[9] We must add that the Japanese industrial structure is significantly different from that of Western Europe. On the one hand, in Japan holdings are more extensive and more frequent than in Western Europe and companies belonging to the same network are not inferior or superior—rather, they are mutually dependent of each other (*Whitley* 1992, pp. 25–42). We can differentiate between two types of Japanese company groups: the vertically structured *keirecu* and the horizontal *kigyo shudan*. The wide use of these types is well characterized by the fact that in 1980 65 of the 100 largest Japanese companies belonged to the 16 largest holdings and these controlled 26 percent of the capital of all companies (not financial), supplied 33 percent of industrial production and 50 percent of those working in industry were employed in these companies (*Hamilton et. al* 1990). Because of the smaller companies which do not legally belong to the largest companies but, because of their market links, depend on them, statistics do not reflect that, regarding both output and employment, Japanese industry is less concentrated than the industries of the USA or of the Western European countries (*Scherer and Ross* 1990). Fukuyama calls attention to the fact that this is closely related to the vertical *keirecu* links of the large companies: "...it is more important that Toyota commissions subcontractors to do most of the assembling tasks, while GM is a vertically integrated company which is the owner of many of the component manufacturers. Toyota is the leading company in a so-called vertical keirecu and only carries out the designing and the final assembly. On the other hand, it is related to hundreds of subcontractors and component manufacturers within a network of informal but continuous co-operation". (*Fukuyama* 1995)

tant role in the privatization decisions of the eighties (*Hamdouch* 1989). Furthermore, the large French (state-owned and private) companies formally still belong to such a complicated network of company cross-ownership (*Morin* 1996). In the case of Hungary this can be described on the basis of the data of the 200 largest companies and the 30 largest banks (Bruszt and Stark 1996; *Stark and Kemény* 1997).

Considering that we are talking about networks made up of inter-enterprise ownership links, it is worth clarifying the meaning of these links. It is Stark's achievement that he drew attention to the establishment of company networks and their role in privatization, and took steps to determine the various types of these networks. We must add, however, that the networks described by him (Stark 1996) have two essential deficiencies. It is because of these that it is impossible to determine what the relationships examined mean with regard to those business actors who are in the network. Thus, we cannot attach any relevant economic or sociological interpretation with respect to Stark's networks. The first problem is that ownership links are characterized as directed relationships, not as undirected.[10] (If company A owns B, then A's relationship with B is different than B's with A.) According to this, transitivity (which occupies a central place in Stark's recombinant property concept) does not occur in every case when there is some kind of relationship between companies A, B and C. But as Stark usually describes ownership links using indirect graphs (Stark 1996; Bruszt and Stark 1996; Stark and Kemény 1997) and in the case of indirect graphs transitivity is a general rule, there is no reason why the networks of owners should not be considered as supporters or generators of the transfer of production factors or as the appearance of a new coordinating mechanism. On the other hand, still considering graph theory and network analysis, ownership links can be described by a special type of direct graphs—the so-called "valued graphs". Since we are talking about relationships between companies, due to economic considerations we do not attribute as much influence to 0.1 percent of shares as to 25.1 percent, or to 75 percent, which would indicate a relationship of very different quality.[11]

Stark's recombinant property theory, therefore, overestimates the strength of the relevant relationships which have an effect on the lives and decisions of the

[10] We talk about directional relations if it is a decisive factor as to whether it is directed from "A" to "B" or from "B" to "A". However, it is non-directional if it is not decisive and we only care whether these relations exist or not. It is an example for the first case if "A" lends money to "B", while for the second if "X" is a relative of "Z" or works with "K".

[11] If we take into consideration both absent factors in the case of ownership links, we can see that, considering only certain ownership shares, over 25 percent of networks previously considered to be closely connected may disintegrate into sub-graphs and sets of disconnected points. According to the research investigating the cross-ownership links between the companies of the ÁV Rt (State Property Agency) which existed in December 1993, using the respective network data (*Ungár* 1996) in 40 percent of the companies with ownership links the proportion of shares was less than 10 percent.

business actors and, with this, the role of inter-enterprise networks in the Hungarian economy.[12] We can reach this conclusion not only by logic but, as we will see later, empirically, as well.

However, none of this means that approximation through network analysis is not important in understanding the operation and role of relationships between companies and getting to know the various types of company networks. On the contrary, it is a significant characteristic of the group of entities—in our case this is the set of Hungarian companies—how dense their graphs and sub-graphs are.[13] It makes a difference if there is a definite group within a company which is usually in a central position within the given graph, or if a percentage of the companies is not related to any other companies. Why? To understand it better, let us imagine that only three companies make up a set and there are only non-directed relations between them (*Figure 1*). Here we can distinguish between four basic cases of relationships between the companies (Wasserman and Faust 1994, p. 100) which provide different meanings for the networks formed by these companies.

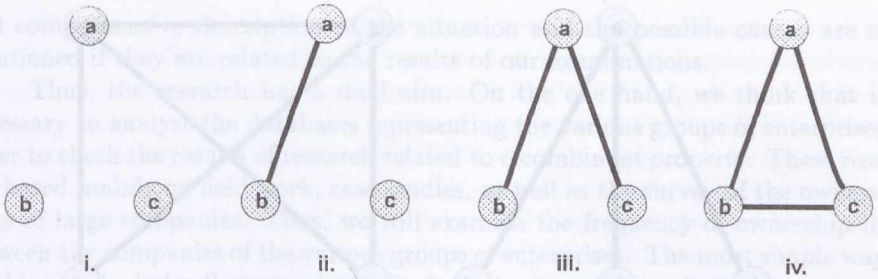
In the first case (i) none of the three companies is linked to the others—that is, according to the terminology of network analysis these are considered as isolated points or disconnected points.[14] In the second case (ii) two companies are linked and the third is an isolated point, while in the third case (iii) all three companies are related but from B to C we can only get through A; thus among the three companies A is in a central position. In the fourth case (iv) each company can be reached from each company. There are no isolated companies, and none of them is in a central position. Naturally, if we have more companies and we examine the directed relations between them, as in our case, then the situation is more complicated[15] but it is very important that from among the possible relationships between the points (companies): how many are realized; what is the proportion of the isolated

[12] The same conclusion was reached by Szanyi who, taking a sample of 23 companies from the population examined by Stark (Top 200 companies), examined such types of relationships between companies as ownership and business links, as well as overlapping management (*Szanyi* 1997).

[13] Here no attempt is made to get involved in the discussion of indicators used in network analysis to measure the graph characteristics or their exact definition. Interested readers can find their definition and formulas in handbooks dealing with network analysis (*Wasserman and Faust* 1994 and *Scott* 1991). We should say as much, however, that one of the most important indicators of the quality of networks is density, which is measured by the ratio of actual and possible links. In the case of non-directional relations $D_{nd} = l/(g(g-1)/2)$, and in the case of directional relations $D_d = l/(g(g-1))$, where l is the number of acrual links, and g is the number of entities or points in the graph (in our case these are companies).

[14] Ownership links are interpreted as directional relations. In this case we can talk about isolated points in the case of points i for which both the outdegree and the indegree are equal to zero (Wasserman and Faust 1994, p. 128)

[15] In the case of three actors and digraphs (directed graphs) the relationship between the actors can only be classified according to the 16 basic types (Wasserman and Faust 1994, p. 244).



Source: Wasserman and Faust 1994, p. 100.

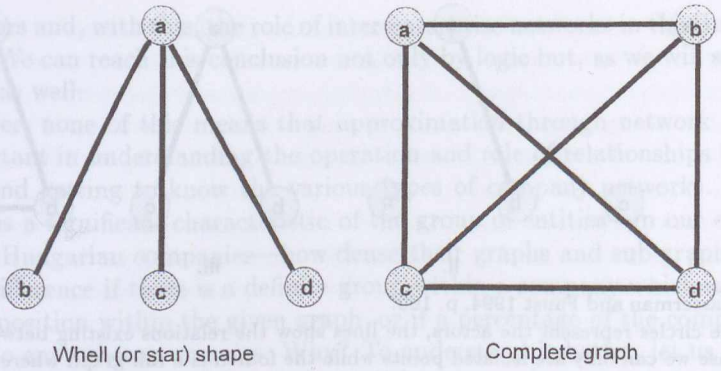
Notes: The circles represent the actors, the lines show the relations existing between them. In the first case we can only see isolated points while the fourth is a full graph where each actor is related to all of the others. In accordance with this, in the first case the graph density is 0, and in the fourth it is 1.

Fig. 1 Four possible triadic states in a graph

points within all points; what is the number of points in central positions; or how many points can be reached from each point directly or indirectly?

All these are included in the characterization of the given network and the entities it contains (in our case these are Hungarian companies). From the aspect of economic and sociological interpretation it makes a difference whether the company networks are mainly networks without centres (in an extreme case each company is directly related to all other companies) or each of these networks is organized around some companies and to this is linked a multitude of companies among which there are no relevant relationships. The Japanese *keirecu* is the closest to the first type in which the companies are cross-owners of each other while the other is the *holding-type company network* which characteristically occurs in Western Europe and North America.

In the case of four actors, for the sake of simplicity we represented these types with non-directional relations and we can talk about wheel (or star) pattern, or full graphs (*Figure 2*). In these two cases the positions occupied by the companies in the network are quite different, as are their chances of taking advantage of their position within the network. If company A of the wheel formation is the owner of companies B, C and D, then it can establish a relationship between them with regard to the production or transfer of income and it is always A who determines the measure and direction of the process. In the case of a full graph (i.e. in case of cross-ownership links) the companies included in the graph are equal and the members, as a team, determine the market behaviour and business relations of the company group. The reasons for the establishment of company ownership networks can be the same at company level, but the above-described network types can result in the



Notes: One of the actors in the wheel or star-shaped graph ("a" in our case) is in a central position as all other actors of the graph can only reach each other through him. If we take this actor out of the graph, then it disintegrates into a multitude of disconnected points. In the case of a complete graph there is no such central actor: if any one of the actors falls out, the relations between the other actors stay intact. The wheel-type graphs can also be called simple graphs or trees in which the number of relationships is one less than the number of actors. According to the definition, in the full graph all possible relationships are realized. Thus its density is 1.

Fig. 2 Wheel (or star) shape and complete graph in the case of non-directed relations

different positions of the companies they include. In economies based dominantly on one or the other type, the subjects of business transactions will be different and the role of the market can be different, too. In economies based on holding-type company networks the subjects of business transactions are usually the member companies of the holdings and they have a distinguished role in the determination of the prices while, if most of the companies belong to some business groups, then the market, which expects autonomous actors, is narrowed down to transactions between company groups.

Up to now we have been talking about ownership networks mainly seen as representing a phenomenon effecting the whole economy. However, we cannot evade the analysis of inter-enterprise ownership links in relation to the conditions and aims of business actors responsible for their formation. First of all, we need to find the rational considerations on the basis of which the business actors decide to invest in other enterprises.[16] The aim of this study, however, is not this but a more exact

[16] We must agree with the representatives of methodical individualism in that when investigating the reasons for a phenomenon occurring in the society the viewpoint of the doer (actor) and the examination of the alternative decisions must be of central importance (*Boudon* 1979; *Coleman*

and comprehensive description of the situation and the possible causes are only mentioned if they are related to the results of our examinations.

Thus, the research has a dual aim. On the one hand, we think that it is necessary to analyze the databases representing the various groups of enterprises in order to check the results of research related to recombinant property. These results are based mainly on field work, case studies, as well as the survey of the ownership links of large companies. Thus, we will examine the frequency of ownership links between the companies of the various groups of enterprises. The most simple way to do this is to include all companies in the investigation and to select a representative sample from each group of enterprises.[17]

On the other hand, beyond this critical approach, we aim to examine the character of the ownership links. We would like to find out what type of companies and entrepreneurs characteristically invest in other enterprises and what are the tendencies with regard to investment in other enterprises. We will also mention a few assumptions about the decisions of the business actors and what they are based on regarding investment in other companies—that is, establishing ownership links between the two companies.

The limits of analysis

During the examination of ownership links we will review the frequency of investments in other companies and the relationship of this frequency to other characteristics of the given enterprise.[18] The deed of investment will be measured by nominal variables and we will use the tax returns of Hungarian companies and surveys related to the companies as sources of data.

1990). According to this, to understand the general use and economic role of investing in other companies and building a network structure we must try to find out the rational motives of the business actors bringing about these conditions.

[17] The analysis of inter-enterprise ownership links is interesting not only because it helps us to define the inner structure of the Hungarian industrial sector but also because it may help shed light upon the limits of empirical research based on individual company data. That is, if inter-enterprise ownership links are as widespread as it is stated by the theory of recombinant property, then the observation unit of a realistic economic and sociological analysis should not be a company, but the company group to which the given company belongs. The importance of this aspect is confirmed by the new field of economic-sociology (*Granovetter* 1994). From this aspect, the researcher is in a more comfortable situation than an actor of the business life. The former will have no financial disadvantages due to the inaccurate description of the subject of the observation, while the latter can lose large amounts if he is not cautious and makes decisions concerning planned business risks on the basis of the financial and business conditions of the potential business partner, without taking into consideration the fact that the future business partner is a part of a company group connected through ownership links.

[18] A short description of the databases used in this study can be found in the Appendix.

The questionnaires included the following questions: "Do you have shares in other companies or banks?", "If yes, in how many firms and what is the proportion of your shares in these?" and "Are there Hungarian companies among your owners?", "If yes, what is their proportion?".

In the tax return database (CTAXRET), which is based on the tax return data, we use the "interests" indicating the investments of the observed company in other companies and the distribution of the observed company's capital among the owners; moreover, we can follow through the appearance of domestic companies as owners among the owners of the company examined. According to the study, which is a comprehensive analysis of the consistency and reliability of the Hungarian tax returns database (*Rózsahegyi* 1996), "interests" are among the reliable economic data and the data related to the ownership structures of companies can also be considered reliable. Hungarian companies, apart from a few exceptions, consider investments in the capitals of other registered firms as "interests".[19]

After all this we think it is necessary to draw the readers' attention to the two limits of the analysis.

The first stems from the character of the databases used. In the study we will not use databases from which we could draw the actual system of relations of each company (network data) but databases which include the characteristics of the surveyed enterprises and companies which do not supply information on companies they are connected with.[20] Thus, we examined the deed of investing in enterprises and the ownership structure of the observed company. We cannot analyze the types of networks formed by the links connecting the companies. We can analyze, however, how many investments the observed company has in other enterprises and what their ratios are, as well as how the frequency of investments in other enterprises[21] has changed in the Hungarian economy. This frame of analysis enables us to examine one of the important characteristics of the network and the proportion of isolated points within the networks. From this we can determine the proportion of companies within the observed population which have ownership links with at least one company and the proportion of companies which belong to networks connecting at least three companies.

[19] Exceptions exist because, during the establishment of the dual-level banking system, state-owned companies were obliged to subscribe for shares of the newly-established banks. These investments usually represented small ownership ratios and state-owned companies still existing during the examined period could have kept them recorded among their bonds.

[20] The reason for this is that, in order to map the networks, for each company included in the sample we would have to know which companies they are related to. Only with this knowledge would we know how many and what type of networks the respective companies of the sample belong to.

[21] By not being able to take into consideration the intensity of ownership links we are not making a mistake if we are aware of the interpretation limits of the results of this observation.

The other limit of the analysis is related to the aim of focusing on ownership links. Using the terminology of network analysis, inter-enterprise links can be interpreted as multiple relations and ownership links are just one of these, although probably not the most important. A close relationship can develop between two companies even without ownership links when the former is based on formal personal (e.g. connections between members of the board of directors and supervisory board) or formal impersonal relationships; they can be based on technological links,[22] can be determined by inter-enterprise links based on contracts or without contracts (i.e. ad-hoc alliances) or informal personal links. We can assume a close positive relationship between the above but it is also possible that the formal and informal links complement each other. The joint appearance of the various types of links as well as their absence—e.g. in the case of ownership and business links—can contribute significantly to the understanding of the character of Hungarian inter-enterprise networks. It is very important to clarify how and to what extent the business actors can depend on the advantages of actual and formally existing networks when making their decisions. However, an examination of this exceeds the limits of this study.

Results

Characteristics and likelihood of the inter-enterprise ownership links

It can be said that ownership structures formed after the privatization of state-owned enterprises in Hungary are such that, with the exception of about 50 companies on the stock-market and the OTC, three-quarters of the firms are in the possession of three owners and in about 81 percent of the companies one owner has the majority (above 50 percent) of shares (*Table 1*). As a result of this, in most of the larger Hungarian companies the management have limited power to enforce ideas or intentions which are different from those of the owners. We must add, however, that in almost half of the large manufacturing companies (48.1 percent) members of the management or the employees are directly present as owners. Furthermore, where they are present their average ratio of ownership is over 50 percent. On the other hand, here we should take into consideration cases

[22] The relationships between the personal links of large Hungarian companies and banks and the characteristics of the firms are analysed by *Vedres* (1998) using network data on interlocking management memberships. The Hungarian characteristics of strategic alliances, which is one of the types of business links, are reviewed by Szanyi (1997) based on case studies and empirical surveys.

Table 1

Distribution of medium-sized and large manufacturing firms by number of owners and whether they had a majority owner in 1995 (percent)[a]

Number of owners	Percentiles of firms	Percentage of firms within all firms where there is a majority owner[b]
One	19.0	19.0
Two	31.0	29.0
Three	25.2	19.0
Not more than three	75.2	66.2
More than three	24.8	14.8
N	210.0	210.0

[a]Among firms where the number of employees was between 100 and 200 in 1995.
[b]There is an owner whose share of ownership is more than 50 percent of the initial capital.
Source: *Ábrahám* (1996).

where the management are not directly owners and their ownership has its source in their own companies or company groups.[23]

These data draw our attention to the fact that among the owners of large Hungarian manufacturing companies the roles of the managers were not insignificant in 1995 (behind the scattered employee ownership we can presume the strong position of the management). That is, by 1995 in Hungary we could talk about not only business decisions being centred in the hands of the management, for they were also assuming responsibilities as owners. These results, while confirming the importance of the economic role of managers, also question the relevance of statements about post-communist managerialism (*Szelényi et al.* 1996) concerning diffusive ownership, and the absence of private property in the post-communist economies.

On the other hand, due to the fact that only a small number of owners have a relevant role to play in making decisions which determine the business lives of larger companies, the ownership links between the companies can only have a real function if there are other Hungarian enterprises among these owners.

Let us examine what a Hungarian company is like as an owner of another Hungarian company: first among companies with legal entities, then among the representative sample of the large manufacturing companies.

[23]The source of the data is the survey entitled "Corparate governance in Central Europe and Russia". This research was carried out in 1995 by the Privatization Project of the Central European University and the World Bank and included the data of 255 Hungarian enterprises, where the number of employees was between 100–2000 heads in December 1994. Within the framework of the related OTKA research (T 013497) we investigated the ownership structure of the companies in question, as well as changes in their ownership since their foundation or formation. The case studies supplied several examples where the management's share of ownership in the

The CTAXRET database includes data suitable for our purposes from the year 1992, when the new law of accountancy (Law No. XVIII of 1991) came into effect. According to this, between 1992 and 1995 every tenth Hungarian company had a share in another Hungarian company. This proportion increased somewhat in the first three years we examined (from 8.1 percent to 11.6 percent), which was followed by an almost one percent decrease.

Most of these investments cannot be explained by the fact that during the establishment of the two-tier banking system the more significant Hungarian companies were obliged to buy the shares of the newly formed state-owned banks.[24] We are not satisfied with the explanation that the stimulating or active role of the ministries, the management of state-owned companies or the first institution to privatize state properties (the State Property Agency) is confirmed by decisions regarding investments in other enterprises. In companies which had no investments in 1992, in two-thirds of the cases there was no state ownership and in 63.9 percent of these state ownership was not in a majority position. This, on the one hand, could mean that by 1992 the dispersion of state property had reached a state in which all corporations formed at the end of the eighties as well as the central company, had already ceased to exist or had been privatized. On the other hand, it could indicate that important part of the inter-enterprise ownership links may have been established independent of the privatization of state properties. In the CTAXRET database the number of companies with investments increased to more than double (from 3084 to 6554) between 1992 and 1995 while, within the same group, the number of companies owned mainly by the state or the local government have decreased radically (from 30.3 percent to 5.2 percent).

No significant difference can be seen in the number of investments between the various sectors of the economy. Nevertheless, it is closely related to the size of the enterprises: the larger the company, the more likely that it has a share in another firm. With regard to this there are extreme differences between the 600–1200 largest and the rest of the companies (*Table 2*; *Figure 3*). We can also see that during the examined period the number of investments in small, medium-size or large companies had in other enterprises changed in the opposite direction. While among the former this had increased such as to almost double in three years, among the latter there was a decrease of almost 30 percent. This tendency draws attention to the fact that the reasons and characteristics of investments in enterprises could be different among the 600–1200 largest companies from those of small and medium-size firms.

companies they managed was insignificant, while they had a decisive influence as owners through the companies they owned.

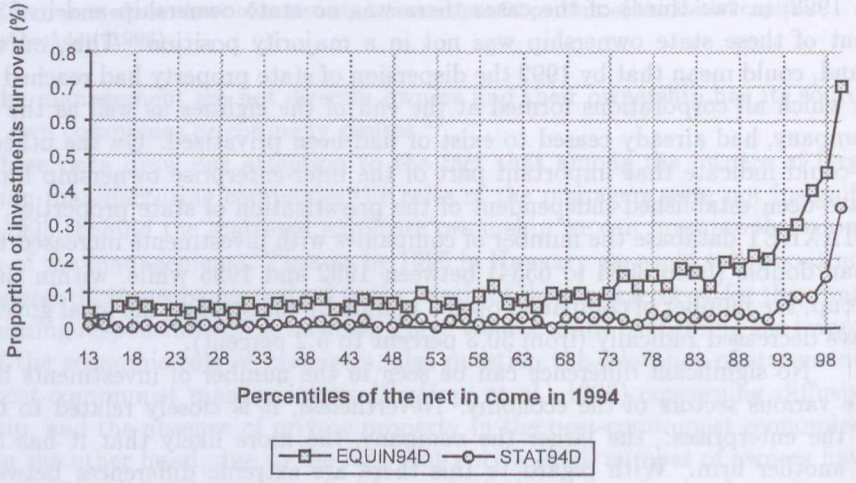
[24] These shares enabled the management of the given company to obtain information on the financial conditions of the given bank at the annual general assembly. This explains why the legal successors of the companies in question did not hurry to get rid of these shares in the 90's.

Table 2

The share of firms with ownership links in two segments of Hungarian firms and in the entire sample (percent)[a]

Groups of firms according to the extent of their net turnover	1992	1993	1994	1995
Lower 98 percent	6.5	9.8	10.7	9.8
Upper 2 percent	77.9	66.3	62.1	58.2
Total sample	8.1	10.8	11.6	10.8
N	39,084.0	45,879.0	52,378.0	61,184.0

[a]We have exluded the firms in which the net turnover or the amount of total assets equal zero.



Notes: EQIN94D: investments in other enterprises in 1994. Its value is 1 if the company has any such investment like this, otherwise it is 0.
STAT94D: state ownership in 1994. Its value is 1 if the state has a share in the company, otherwise it is 0. The horizontal axis of the figure shows the percentages of firms with respect to their net turnover, the vertical axis the proportion of state ownership or investments in other enterprises among the companies included in the given percentage.

Fig. 3 Average percentage of ownership links and the appearance of public property in percentiles of firms, according to the net turnover in the CTAXRET dataset in 1995, in percent

Among companies owned by various groups of owners (public, Hungarian private, foreign) we find significant differences if we examine the number of investments on the basis of the CTAXRET database: among companies with majority

public ownership both in 1992 and in 1995 the number of companies which had shares in other firms was higher (respectively, 34.7 percent and 35.9 percent), while those with foreign private ownership refrained from this (6.1 percent and 9.1 percent, respectively).[25] If we represent the odds for investing in a company and the existence of state ownership according to the size of the company, then we can see that with the increase of the company size the odds for the appearance of state ownership increases with the number of investments (*Figure 3*).

Alongside data related to all companies with legal entities (CTAXRET) we must state the same for the largest manufacturing companies (EXPORT96). However, in the FIRM96 dataset (which is considered to be the most up-to-date data source and is related to other types medium-size and large companies) there is no difference in the number of investments in other companies with respect to ownership categories. The reason for this could be, on the one hand that, by 1996 privatization was almost over and as a result most of the formerly state-owned companies had become private properties while the new owners had not yet sold ownership shares resulting from earlier decisions or, on the other hand, it may be that among Hungarian individual owners the need to establish ownership links had increased.

The effect of company size, as a decisive factor, can be shown by comparing the examined samples. The percentage of company investments is the highest in the EXPORT96 sample (40.1 percent) which included the answers of the larger companies, while it is lower in the FIRM96 (34.7 percent) which contains the medium-size enterprises. There are big differences between the respective sectors of the manufacturing industry regarding investments in other companies (EXPORT96). In companies of the food industry this phenomenon is almost twice as frequent (57 percent) as in machinery production (30 percent).[26] Moreover, according to the type of majority ownership, we can see that in the case of companies owned by Hungarian individuals or foreigners, the odds for investing in other companies is only half (respectively 28 percent and 36 percent) of what it is in the case of companies under state or mixed ownership (respectively 59 percent and 61 percent).

The EXPORT96 and FIRM96 data sets make it possible to examine how many companies have been affected by the above-discussed investments (*Table 6*). The differences between the companies can be seen not only in the differences in the number of their investments in enterprises but also in the average number of companies they own: 37–42 percent of the companies examined only own one

[25] This fact corresponds to the observation that in developed market economies the actors will favour enterprises which are transparent and have controllable company structures. This can prompt the given company to get rid of firms which are in its possession but do not fit into its profile.

[26] As a result of the crisis of the structural system of Hungarian agricultural production and the collapse of the steady supply links, most companies in the food industry had to procure shares in agricultural companies in order to ensure continuous production (*Mohácsi* 1996).

Table 1

Japanese foreign trade (million USD)

	Japanese exports, importing regions													
Years	SU	EE	SA	WE	NA	OD	LA	AF	WA	AS	TS	TD	TG	TW
70	341	107	744	2910	6578	1054	1112	1073	541	4855	1192	10542	7581	19315
75	1625	574	2519	8081	12411	3083	4663	4590	5536	12668	4718	23575	27457	55750
80	2778	807	5570	21463	34086	5981	8542	5958	13114	31242	9155	61530	58856	129541
85	2751	564	12878	24934	70566	7476	7763	3484	11326	33917	16193	102976	56490	175659
86	3150	682	10232	36927	86781	7689	8698	2903	9275	42464	14064	131397	63340	208801
87	2563	717	8644	45155	89868	8145	8086	3704	8336	53569	11924	143168	73695	228787
88	3130	776	9913	55736	96684	9802	8672	3684	8222	67754	13819	162222	88332	264373
89	3082	673	8684	56283	100523	10940	8855	3383	7775	74544	12439	167746	94557	274742
90	2563	996	0	62412	97619	10133	9712	3835	9570	90108	3559	170164	113225	286948
91	2115	922	0	68325	99342	9981	12243	3973	11583	106041	3037	177648	133840	314525
92	1128	762	0	71584	103579	10917	15053	4648	14201	117779	1890	186080	151681	339651
93	1581	660	0	64117	112681	11997	15914	5263	12569	136129	2241	188795	169875	360911
94	1298	598	0	65134	124619	13157	17650	4815	9821	158507	1896	202910	190793	395599
95	1215	794	0	73874	127844	13205	18522	4912	8892	193679	2009	214923	226005	442937

Table 4

Distribution of firms according to the share of ownership in their own firms (percent)

The firm owned	FIRM96		EXPORT96	
	more than 25 percent share	more than 50 percent share	more than 25 percent share	More than 50 percent share
All firms are owned with...	48.0	29.0	37.2	21.0
There is at least one firm with...	25.0	28.0	34.3	39.0
There is not a firm with...	27.0	43.0	28.4	40.0
Total	100.0	100.0	100.0	100.0
N	100.0	100.0	95.0	96.0

Table 5

Domestic firms and banks as owner (percent)

	CTAXRET			FIRM96	EXPORT96
	1993	1994	1995		
Domestic firm as an owner of the observed firm	16.0	16.5	15.4	20.1	27.3
Bank as an owner of the observed firm	n.a.	0.6	0.5	1.0	7.5
N	46,263	53,443	61,184	291	295

company. From this we can deduce, on the one hand, that the density of the network of the sets of Hungarian companies is low; companies with ownership links belong to a set of star or wheel shaped sub-graphs, and it is highly unlikely that they would form full or almost full sub-graphs.[27]

Beside the number of companies owned, the proportion of shares the owners have in these also makes a difference. If the ownership share is under 25 percent then, knowing that four-fifths of the large Hungarian companies have majority owners, it is highly unlikely that this owner could have any influence on the life of the enterprise. Accordingly, through the numbers of *Table 7* we can take a closer look at the ownership links between Hungarian companies. According to this, in the case of about 27–29 percent of the companies with shares, their shares are under 25 percent in every company they own. It is likely that in these cases the owner

[27] As in a full graph each company is linked to all others. For this, most of those with investments would need to have shares in six or more companies. However, as can be seen from the table, only 14–16 percent of the companies observed can be classified as such.

Table 6

Distribution of firms owned by banks or domestic firms according to sectors, size and share of exports in the CTAXRET in 1995 (percent)

	Domestic companies as owner	Bank as owner	Total number of enterprises surveyed
Does the firm own a domestic enterprise?			
No	80.5	51.3	89.2
Yes	19.5	48.7	10.8
Sectors			
Manufacturing	30.6	38.4	23.8
Construction	9.0	4.4	11.0
Trade	37.6	26.1	43.1
Services	22.8	31.1	22.1
Size (number of employees)			
–10	64.0	31.1	77.6
11–20	11.0	6.3	9.0
21–50	11.1	15.7	7.2
51–100	5.0	7.9	2.9
101–250	4.9	13.2	2.0
251–	4.1	25.8	1.3
Share of export in the net turnover (percent)			
–10	85.9	71.7	87.7
10–50	6.8	17.3	5.1
50–99	6.0	10.7	5.3
100	1.3	0.3	1.9
N	9,393	318	61,184

Table 7

Frequency of ownership links among the firms in the CTAXRET in 1995 (percent)[a]

		Is there a domestic firm among the firm's owners?		
		No	Yes	Total
Does the firm own a domestic enterprise?	No	<u>76.7</u>	12.5	89.2
	Yes	7.7	3.1	10.8
	Total	84.5	15.5	100.0 (N= 61,184)

[a]The underlined number shows the percentage of disconnected firms

company does not have much influence on the life of the company it partly owns. The percentage of parent companies with strong links, which have majority shares in all the companies they own, is estimated to be 21–29 percent of the companies with investments.

Table 8

Frequency of ownership links among the two samples of Hungarian firms in 1996 (percent)[a]

		Is there a domestic firm among the firm's owners? FIRM96			EXPORT96		
		No	Yes	Total	No	Yes	Total
Does the firm own a domestic enterprise?	No	46.7	18.6	65.3	49.3	10.4	59.7
	Yes	21.0	13.7	34.7	26.5	13.7	40.3
	Total	67.7	32.3	100.0 (N=291)	75.9	24.1	100.0 (N=289)

[a]The underlined numbers show the percentage of disconnected firms

Up to this point only the investments of the companies have been discussed. However, ownership links can be observed if, instead of looking for enterprises owned by the observed firm, we try to find out if there is another Hungarian company or bank among the owners of the observed firm. The data of the CTAXRET indicate that this occurs in 15–16 percent of Hungarian enterprises and 27 percent of the large manufacturing companies. The respective banks' proportion of shares is small (*Table 8*). Privatization now having taken place, Hungarian banks own only an insignificant number of Hungarian companies[28] and because of this they cannot influence the lives of these companies by control through ownership; control is usually execised through other channels (*Fogarassy and Szántó* 1996; *Fogarassy* 1996).

Ownership links initiated by the observed companies supply important information on how ownership relations directed to and from the given company correspond to each other. Besides, it is worth examining the likelihood for the appearance of ownership links with respect to company size, industrial sector and output and, within this, the proportion of its exports. The reason for this last aspect is that the higher proportion of exports assumes more stable supplier and buyer links and decreases the need for the company to counterbalance the resulting instabilities by establishing ownership links; this could be seen in the case of companies in the food industry.

[28] The main reason for this is that valid laws regulating banks and their activities (Law No. LXIX of 1991) put a very strict limit on the corporate ownership of banks.

Table 9

Frequency of majority ownership links among the two samples of Hungarian firms in 1996 (percent)[a]

		Does a domestic enterprise own more than a 50 percent share of the firm?					
		FIRM96			EXPORT96		
		No	Yes	Total	No	Yes	Total
Does the firm own more than a 50 percent share of a domestic enterprise?	No	63.6	16.8	80.4	67.2	11.6	78.9
	Yes	16.2	3.4	19.6	17.6	3.6	21.1
	Total	79.7	20.3	100.0 (N=291)	84.8	15.2	100.0 (N=289)

[a]The underlined numbers show the percentage of disconnected firms

On the basis of the results (*Table 9*) we can see that the two indicators of ownership links are closely related: those companies are more likely to have ownership shares in other companies where there are other Hungarian companies among the owners. Almost 20 percent of the latter have shares in other enterprises and this is almost twice the number observed in the whole sample.

From among the various sectors, more Hungarian firms as owners are present in the manufacturing industry and, if we consider company size, mainly in those with more than 50 employees. But there is no significant difference between companies selling at home or abroad.

Bank ownership occurs more frequently in the manufacturing industry, among larger companies and among those in which the proportion of foreign sales within the turnover is not exclusive but significant. On the other hand, almost half of the companies owned by banks have shares in other companies. According to this, by examining the properties of banks we can find the company group in which the cross-ownership links are frequent. The 200 companies with the largest turnover (which were observed by Stark) are a good example of this.

The next step in the mapping of ownership links is to simultaneously examine investments in other companies and the presence of other Hungarian companies among the owners. If we look at this using the sample of Hungarian companies operating in 1995 (CTAXRET), then we can see that 76.7 percent of Hungarian companies do not have any shares in other companies and there are no other companies among their owners. In other words, they can be considered as isolated points in a graph which is made of ownership links (*Table 10*). Only 3.1 percent have ownership links in both directions—that is, they are parts of a network for which it can be stated that it has at least three members.[29]

[29]This 3.1 percent includes an insignificant number of cases where two companies are owners of

Table 10

Logistic regression estimations of interests in any domestic company (IC) in the CTAXRET in 1992 and 1995[a]

Variables	1992	1995
Sectors (SECTOR)		
Manufacturing	0.6082[d]	0.7677[d]
Construction	0.6358[d]	0.7472[d]
Trade	1.4905[d]	1.0595[b]
Services (reference)		
Number of employees (SIZE)		
–10	0.0770[d]	0.1664[d]
11–20	0.2461[d]	0.4005[d]
21–50	0.5745[d]	0.7372[d]
51–100	1.5809[d]	1.4841[d]
101–250	4.2791[d]	2.3733[d]
251–(reference)		
Share of exports in the net turnover (EXPR5O)		
–10 percent	0.4684[d]	1.0926
10–50 percent	1.7039[d]	1.6915[d]
50–99 percent	1.4469[c]	1.1304[b]
100 percent (reference)		
Type of majority owner (OTYP)		
Public	1.2880[c]	1.4181[c]
Foreign	0.4519[d]	0.6421[d]
Domestic company	–	1.3612[d]
Hungarian individual	–	0.8540[b]
Private	0.7289[d]	–
Other (reference)		
N	37,226	60,536
– 2 Log Likelihood	13,210.097	35,851.453
Modell Chi2	8,058.175	5,661.096
Pseudo R^2	0.3789	0.1364

[a]The cells show the effect of a unit change of the explanatory variables (Exp(b)) on the odds of the dependent variable

[b] $p < 0.05$

[c] $p < 0.01$

[d] $p < 0.001$

As it is more likely that larger companies are the parts of company networks it is not surprising that both in the sample of the largest exporters and among the medium size and large enterprises (FIRM96) the proportion of isolated companies is smaller (47–49 percent); and the ratio of companies with ownership links in both directions is almost 18 percent.

100 percent of the other.

However, we still need to be cautious when interpreting of ownership links. We can assume that in more than 50 percent of the companies ownership links play some kind of a role but we have no proof as to their intensity. If, however, only the presence or absence of these links is the only information, then we obviously underestimate the measure of cross-ownership relevant from the viewpoint of the decisions of the economical actors. However, as we can see from the results published, we can still find a lot of companies where even these, very loosely defined company ownership links appear.[30]

Let us narrow down the definition of ownership links by considering a relationship relevant only if the companies are majority owners of each other. In this case the number of companies which are related decreased by more than 30 percent, while the number of isolated companies increases to 64–67 percent, both within the large manufacturing companies and within the medium-size and large companies. The proportion of companies in which Hungarian companies are among the majority owners but which also have majority ownership in Hungarian companies is a little over 3 percent.

These results draw attention to the fact that some of the large companies belong to a minority whose ownership links are such that, through direct ownership, they can influence the allocation of resources and incomes within the company group. According to this, effective company cross-ownership links between Hungarian companies are considered to be uncommon phenomena, rather than dominant ones; this is not only true of the Hungarian economy but of medium-size and large firms, as well.[31]

Estimations

In the following we will examine the relationship between the characteristics and market orientation of the companies and the likelihood of ownership links, on the basis of the CTAXRET database. We aim to find out in which groups

[30] These conclusions can be read from the data published by David Stark. Among the owners of the 200 companies with the largest turnover and the 20 largest banks we find Hungarian corporations in 40 percent of the cases. This proportion decreased by more than 50 percent, to 19 percent of the cases, when we only considered those companies where the Hungarian company was the majority owner (Bruszt and Stark 1996). According to this, in 60 percent of the examined sample company cross-ownership has no role and we can only talk about holding-type company formations. About 23 percent of the companies in the TOP 200 are owned by a company which belongs to a company group (Stark and Kemény 1997)—that is, 77 percent of the largest companies are not connected directly through ownership relations.

[31] About 8 percent of the small and medium-size firms (FIRM96) and 11 percent of the largest manufacturing companies (EXPORT96) own at least two Hungarian companies with a 25 percent share and, beside the former, in about 5 percent in both respective samples there are also other Hungarian companies among the owners.

of Hungarian enterprises did investments in other enterprises play a role between 1992–1995. The results of case studies and surveys of small samples show that at the beginning of the 90's the existence of these investments was closely related to the disintegration of state-owned companies (Voszka 1997). Our previous results confirm this. We expect, therefore, that majority state ownership has a positive effect on the existence of an investment even when comparing companies which belong to the same sector and are of the same size.

It follows from the nature of things that larger companies, due to their larger capitals, can have more extensive ownership links than the smaller ones. Empirical researches related to the inter-enterprise ownership links confirm the validity of this relationship (*Stokman et al.* 1985, p. 267). Moreover, because of this, we have no reason to expect something else in the case of Hungary than what is indicated by the analysis of the inter-enterprise links of developed countries.

The establishment of company networks can be closely related to the risks caused by unstable business conditions and unpredictable supplier links.[32] Behind this action we can see the intention of the companies to minimize risks resulting from the instability of the market.[33] If the management of a company does not invest in its own company but in another company, they buy or establish it; the aim of this seemingly irrational step is to improve their own market possibilities and to serve the strategic interests of their own company. As a result of this, we can assume that investing in other enterprises is less characteristic of companies which depend less on Hungarian companies as suppliers. This is either because they work with foreign suppliers, or due to the fact that because of the amount of their capital they have been able to work with dependable suppliers. Companies with foreign majority ownership and companies mostly producing for foreign markets can be categorized as such. They are less likely to have problems related to undependable supplier links than those under Hungarian ownership and producing only for domestic markets.[34]

The decision to invest in another company could be the result of the shortage of capital necessary to start new activities, and to produce and circulate new products. If this cannot be realized from private resources (profits and/or depreciation), or loans and shares cannot be issued either, then the obvious solution is to find a business partner and establish a joint company.[35] In this respect companies

[32] This is assumed by *Grabher and Stark* (1997) and Stark and Kemény (1997).

[33] In other words, in order to minimize the increased transaction costs resulting from their unstable business relations the business actors decide to establish a hierarchy—that is, inter-enterprise ownership links (*Williamson* 1985).

[34] It can be proved that the proportion of foreign ownership within this company has a significantly negative relationship with the share of Hungarian suppliers in the purchases of the given company (*Tóth* 1997b).

[35] At the beginning of the 90's, having a two-digit and unpredictable inflation and transformational recession, Hungarian companies could not even consider issuing bonds. Increasing the capital is not only a more expensive and longer procedure than establishing a new company, but

with foreign majority ownership are in a special position for they can depend on the capital of foreign owners and this is usually higher than that of Hungarian private companies. Furthermore, their chances of obtaining foreign loans to finance their investments are a lot better than those of Hungarian private companies (*Tóth* 1997c) and, because of this, they are likely to have significantly less investments than other companies.[36]

The above assumptions were tested in two models (using data for 1992 and 1995). They can be generally described as follows:

Prob (IC=1) f(SECTOR, SIZE, EXPRO, OTYP)

where

IC	=	interest in any domestic company (its value is 1, if there are any interests, otherwise it is 0)
SECTOR	=	sector
SIZE	=	number of employees
EXPRO	=	share of exports in the net turnover
OTYP	=	type of majority owner (public, domestic private, foreign or mixed)

The effects of these factors were summarized in a logistic regression model. In this, using the characteristics of the given company, we estimate the odds for the company to have investments in other companies. The model can be described as:

$$\text{Prob (IC=1)} = 1 / (1 + e^{-Z}),$$

where, in the case of an n number of factors ($i = 1...n$)

$$Z = B_0 + B_1X_1 + B_iX_i + \ldots + B_nX_n$$

supplies the estimation of the log odds of the dependent variable (in our case IC).

The results accurately show the previously described role of the size and ownership structure of the companies in the odds for investments. When considering company size we must note that it is not the largest companies (i.e. those with more than 250 employees) in which the odds for having investments are the highest, but

sometimes it is not the best solution for the owners of the company because it does not leave the original ownership structure of the company intact.

[36] Foreign-owned companies are usually quite reserved with regard to the establishment of ownership links with domestic companies. The empirical analysis of the inter-enterprise links and interconnections among the boards of directors indicates that the affiliated companies of foreign-owned corporations and multinational companies operating in a country are only loosely connected to the networks of the domestic companies of the given country (Stokman et al. 1985, p. 272).

among those which are smaller than these but their number of employees is still of a sufficient total. With the increase of the number of employees the odds for ownership links also increase in every case.

The effect of the share of exports within the net turnover is not unambiguous: on the basis of the 1992 data we can see, on the one hand, that if a company does not export or exports only a small amount, then the odds for investments are lower than if it sold abroad. However, if the ratio of exports is above 10 percent and below 100 percent the effect is the opposite. Estimations for 1995 show the same results.[37] The results, therefore, do not confirm the assumption regarding the relationship between the market orientation of the companies and their decisions related to investment in another company.

The assumption regarding the type of majority ownership, however, can be confirmed on the basis of the results obtained. Public-owned companies both in 1992 and 1995 had positive parameters. That is, if a company was owned by the state or the local government during the years examined, then its odds for investments in another company were better than for the other companies. If, out of two otherwise similar companies, one had majority public ownership, then this fact increased the odds of ownership links by 29 percent in 1992 and by 41 percent in 1995 (this is indicated by the respective 1.29 and 1.42 parameters related to public ownership) as compared to those with other types of ownership. In accordance with the expectations, this was decreased by majority foreign ownership (by 55 percent in 1992 and 36 percent in 1994). Thus this phenomenon, which is also characteristic of Western European countries, can also be found in Hungary.

The parameter related to companies owned by domestic private companies draws attention to a possible new interpretation of investments and inter-enterprise networks. In the case of domestic private companies we can observe that if these were the majority owners, then the odds for investments increased by 36 percent in 1995. Thus we can confirm the assumptions that investments are positively related not only and not exclusively to state ownership: companies with a majority of domestic private ownership were more likely to invest into other companies than the rest of the sample. Behind this we suspect the fact that among them the need to reduce risks related to suppliers is greater than usual, or that they need this fund-raising method more than companies with foreign or mixed ownership.

In the case of companies owned by individuals this effect cannot be demonstrated: if a company is owned by individuals this negatively influences the odds for investments. However, we don't think that this is due to the difference between the behaviours of individuals and private companies. This is probably because individ-

[37] During the evaluation of the results we must take into consideration that companies which were selected as references with only export sales were usually companies doing inward processing. In other words, these are companies with stable supplier and buyer links. Those which are not exporting products of inward processing do not necessarily have such links.

uals own companies directly as individuals, not through their companies. However, these relationships can only be found in databases where the units of observation are the entrepreneurs themselves.

Conclusions

The results obtained have several consequences with respect to the characterization of the ownership structure of Hungarian companies after privatization and the determination of the role of inter-enterprise ownership links which appear in the Hungarian economy.

The analysis of the ownership structure of the important Hungarian companies shows that by 1995–1996—the end of privatization—the Hungarian economy was characterized by the concentrated ownership structure of companies and the dominance of individual private property. Most of the companies are owned by a relatively small number of owners and in most of the cases there are owners with majority shares. On the other hand, by 1995 the role of state ownership in the ownership structure of companies in operation and worth mentioning decreased to a minimum and the number of companies with majority ownership of Hungarian individuals is estimated to be almost 70 percent (*Table A1*). According to this, in the case of Hungary we cannot say that in the transition economy there are no individual private owners, nor that the property relations of the transition economy are characterized by diffuse ownership as it is stated, for example, in the theory of post-communist managerial capitalism (Szelényi et al. 1996).[38] On the contrary, as opposed to coupons and various distribution techniques, one of the greatest achievements of Hungarian privatization was that it helped the rightful owners to gain the ownership of enterprises.[39] This fact should be taken into consideration when discussing the micro-level adaptability (flexibility) and the improving efficiency indices of the Hungarian economy (*Kornai* 1996).

The data published in the study also draw attention to the fact that the probability of ownership links between companies is very different in the various groups of Hungarian companies: this effects not only the partly state-owned companies, which is in accordance with statements related to recombinant property (Stark 1996). Hungarian privately-owned companies also have shares in other enterprises, but not as frequently as we saw in the case of companies still owned by the state.

[38] The researchers who set up the theory in question wish to formulate relevant statements regarding the subject "*in statu nascendi*". Due to the nature of this, however, it is not the same if they do it based on empirical data from 1993 or using data obtained two, three or five years later.

[39] In this sense, Kornai's suggestions preferring individual private property were finally accepted in the case of Hungary (*Kornai* 1990).

Furthermore, we can observe that if a company was owned by domestic private companies in 1995, this increased the odds that the given corporation invested in another corporation or in corporations.

Furthermore, it can also be asked whether we are facing a pervasive phenomenon which, in some way, has an influence on most companies effected by the Hungarian transition. As can be seen, nine-tenths of the companies do not have any shares in other firms, there are no domestic firms among 85 percent of the owners, and for 77 percent both of these statements are valid. Thus, those belonging to this 77 percent can be interpreted as isolated or disconnected points within the inter-enterprise network of Hungarian companies.

If, for the examination of inter-enterprise ownership links, we first select a specific group of firms and we would choose these large firms, then the situation will be different. For example, in the group of manufacturing companies with more than 100 employees only 36 percent of the companies can be listed as isolated companies, and we can assume that 64 percent of them have ownership links. Thus, if we examine the ownership links between these companies we get the impression that Hungarian enterprises are interwoven with cross-ownership links. This, however, is a simple optical illusion.

Cross-ownership of various strengths between firms is characteristic of a specific group of companies, usually the large companies; yet even among them it is not general (as we could see earlier, almost half of those companies are isolated points) and the odds for this decrease with decreasing company size.

Thirdly, from the yearly changing of the possible inter-enterprise links we can neither deduce that we are facing a phenomenon effective for a long time (due to the short time which has passed since the beginning of the economic transition) nor can we acknowledge the relevance of universal explanations regarding the general existence of company investments. Among the smaller and generally privately-owned enterprises the increasing number of investments in other firms can be attributed to other factors (we might say, they result in other types of company networks) than their establishment and maintenance among the large companies. This justifies the separate examination of the phenomenon of smaller firms investing in other enterprises.

It is another matter that the companies are connected by ownership links of different strengths and the general existence of ownership links of different intensity vary in each company group. We do not know what characteristic networks Hungarian companies usually form or the proportion which belongs to each network type.

In other words, we can say that in this study we examined evidence regarding the formal existence of cross-ownership. Nevertheless, the fact that we can show formal relationships between companies does not provide any information with regard to their role in the decisions of the business actors. From this point of view we can insist that it is not worthwhile, or even necessary to examine the

direction or intensity of ownership links given that the information flow between the firms and the strength of weak ties emphasized by *Granovetter* (1973) are the essence of these relationships. The possibility of information flow is independent of the direction and intensity of formally existing ownership links, and what is more, the information surplus resulting from these weak ties can help companies most effectively to adapt to the market. This train of thought, however, implicitly states what it should be proving, that is: when making decisions concerning the companies the owners and/or management of companies connected by ownership links depend on information supplied by this network. However, regarding this we do not have any empirical data which could be refuted by statistical methods—thus, we can only make a trivial statement: "As company A has ownership links with company B, it is possible that there is a flow of important information between the management or owners of company A and the management and owners of company B, which are necessary for the business decisions of the two companies." However, the question is related to the odds regarding the word "possible": do the economic actors make use of the possibilities resulting from the ownership networks? If the answer is yes and often, then these must be considered as important means of economic integration during the examination of the Hungarian transition. With regard to this, is there a difference between the behaviour of the companies of transition economies and those of the developed countries? If the answer is yes, then we can talk about a special type of ownership links valid only in the case of transition economies.

It can be seen that here we are talking about not only recombinant property but about the existence and role of inter-enterprise ownership links, and a special type of these is the result of recombinant property. The empirically- and theoretically-based investigation of both the micro-level (from the aspect of business actors) and the macro-level (in relation to the economic structure) roles that inter-enterprise links play in the Hungarian economic transition are tasks to be carried out in the future.

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Appendix

Data used

The analysis was built on four sources of data which belong to two categories. On the one hand, these are company surveys and, on the other hand, information obtained from the tax returns of companies.

a) Surveys of companies conducted using questionnaires. These are the following:

— Sample of medium-size companies (FIRM96): this contains the data of 293 enterprises with over 50 employees, operating in the manufacturing and construction industries as well as in trade (except for the trade of public transportation vehicles and fuels) and their plants are located in Budapest or in county towns. The survey was carried out in 1996. The survey and the concept of the research were elaborated by András *Semjén* and the author. The sample necessary for the survey was supplied by the Central Statistical Office of Hungary and the survey was conducted by Tárki (Social Research Informatics Centre) between November 2–30, 1996.

— Sample of large companies (EXPORT96): The survey included the data of 295 enterprises. The companies were selected from among 1000 manufacturing companies which had the largest exports in 1996. The companies questioned, after weighting, represent the multitude of the 1000 largest exporters according to sector and staff categories. The concept of the research and the questionnaire were elaborated by the author; the survey was conducted between October 1996 and January 1997.

b) Balances and tax return data (CTAXRET). The 1992–1995 tax return data of companies which submitted tax returns used dual-accounting, and belonged to the manufacturing, construction, trade and servicing sectors.

During the surveys the questioners visited the owners or managers of each enterprise and asked them about the actual data of the companies (e.g. number of employees, net turnover, balance of account), their expected changes and other characteristics of the company's management (exports, business links, ownership structure), as well as their subjective opinion with regard to the company's conditions. In this study we used the answers given to questions regarding investments in other companies and ownership structures.

Table A1

The distribution of firms by variables analysed in the CTAXRET (percent)

Variables	1992	1995
Sectors (SECTOR)		
Manufacturing	26.0	23.9
Construction	12.3	11.0
Trade	42.0	43.0
Services	19.7	22.1
Employment (SIZE)		
–10	71.2	77.6
11–20	9.5	9.0
21–50	9.2	7.2
51–100	4.2	2.9
101–250	3.2	2.0
251–	2.8	1.3
Share of exports in the net turnover (EXPR5O)		
–10 percent	94.5	87.6
10–50 percent	3.1	5.2
50–99 percent	2.1	5.3
100 percent	0.3	1.9
Type of majority ownership (TTIP)		
Public	7.2	1.6
Foreign	10.2	14.4
Domestic company	–	11.5
Hungarian individual	–	68.6
Private	70.4	–
Other	12.3	3.9
N	37,226	60,536

Acta Oeconomica, Vol. 49 (3-4), pp. 397-414 (1997-98)

SMALL VENTURES IN THE SHADOW OF LARGE ENTERPRISES IN THE 1990S

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In the 1990s the economic position of large enterprises has become stronger while that of small ventures, especially ones subject to income tax, has become weaker. Numerous large enterprises have been bailed out by the government and normative re-distribution, too, has tended to prefer the big companies. Subsidies for large enterprises have grown while withdrawals have occurred in the domain of small ventures. Chances for ventures to develop have begun to differ more and more. Resources assigned for accumulation have been concentrated in larger enterprises.

The organisational system of "socialist" enterprises began to change and then fell apart in the late 1970s and the early 1980s. Until then, economic organisations were preferred or dispreferred on the basis of three considerations: their form of ownership, size and method of management. At the highest point of the hierarchy there were the large state-owned companies headed by directors personally reporting to the authorities. Then there were cooperatives—collectively owned, small and medium-size enterprises governed by their members. At the foot of the hierarchy there were the "prisecs"—that is, self-employed or micro-entrepreneurs of the private sector. In an attempt to give an organisational answer to a looming crisis by the early 1980s the government tried to ease the over-centralisation of the corporate system, to improve its operation and to break the exclusion of the private sector. This released loose energies hidden in the private economy and provided a legal space of movement for the growing second economy. New legal forms for small ventures, like civil law partnerships, enterprise co-operatives etc. came into being. From 1982 onwards small cooperatives, too, could be set up and unlike the afore-mentioned forms, these had legal entity. In 1985 the method of management of state-run companies was changed inasmuch as they were placed under municipal control. The changes eased the hierarchical dependence of state-owned companies as the scope of movement of company management was broadened. Another important step was when the Company Act was passed in 1988.

As a result of the changes, the position of "socialist" corporations, up until that time the strongest economic interest group, weakened. They were no longer bailed out automatically and unconditionally by the state from their permanent crises. Some were dismembered, others liquidated and, in general, current and investment subsidies were radically reduced. (*Major and Voszka* 1996) In other words, the preferences of the central economic management were rearranged in such a way that the position of large enterprises became weaker and that of small

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ventures was strengthened. Now, in the 1990s, there seems to be a process which is exactly the other way around. This study attempts to throw light on this process.

Production factors and the performance of small ventures

In the following I will review production factors, and the performance and economic position of small and micro-ventures. The analysis is based on tax returns for the years 1992/95.[1]

The 1980s brought a wave of company foundations which was unprecedented in the history of planned economies. The new companies were partly newly established, but a lesser part of them came into being as a result or organisational decentralisation—i.e. by separation and independence. Following the 1989/90 transition, the process accelerated in the case of cooperatives by the dismantling of legal barriers, and in the case of state-run enterprises by privatisation and their transformation into companies, respectively. Over and above the entrepreneurial heritage of the 1980s[2] and privatisation, post-transition developments were largely affected by a slump in employment, a rapid growth of unemployment (the first massive lay-offs happened in the second half of the 1980s) and the resurrection of the myth

[1] Tax returns may contain manifold distortions of unknown direction and size. Beside carelessness and errors, the possibility of deliberate distortions cannot be excluded in practically any part of the returns, irrespective of the size of the venture. It is, however, likely that invisible economic transactions not shown in tax returns are more often in connection with a smaller venture.

[2] I. Gábor R. (1992) describes the negative entrepreneurial heritage of the eighties as follows: "... we inherited a severely segmented private economy with loose business morale, that was characterised by massive in-flow and intensive exchange within a few non-profitable 'dead-end' professions that required neither skills nor capital and which scraped along in a few traditional branches on the one hand, and by comfort provided by a buyers' market in some investment, contact and/or human capital intensive branches on the other. Business ties among their units—with hardly any capital and geared to the acquisition of auxiliary income—were sporadic and unstable, while their ties to the industrial sector became manifold and stable. A typical actor of this economy was the half-salaryman-half-entrepreneur who was more skilled in finding a loophole in the law, and uncovering the corruption of the authorities and representatives of the first economy, and less skilled in the handling of horizontal contacts. He was pro and anti-market at the same time. His main criterion was that he learned how to eke out a safe living as the employee of a state sector that never had enough manpower, and at the same time, thanks to the insufficient product supply and the poor efficiency of that sector, he was able to grasp the opportunity of earning additional income in the second economy. Also, he learned how to overcome chronic difficulties in procuring the necessary input (material and implements) resulting from the over-demand for such inputs and the regulation of their distribution (preferring first-economy organisations), and still coping with insecurities of their operational conditions resulting not so much from market but rather bureaucratic, political regulations. With such a heritage, is it not self-deception to expect the liberalisation of the private sector to rapidly accelerate the development of the small-venture sector and to channel it toward a market economy?" (p. 947)

of entrepreneurship. For many, these circumstances paved the way to the chance[3] (or pressure) to become an entrepreneur. This upgraded the processes that had started in the first half of the 1980s but were slowed down by the government in the second half of the decade. However, the changes were irreversible and changed their quality.

The increase in the number of small ventures accelerated, as part of the economic transition, from 1990 onwards. The total number of enterprises registered has been growing ever since, albeit the number of individual ventures fell in 1990. As for all forms of venture, the enterprising "boom" is not over yet, and it is only the growth rate of the number of ventures that has been slowing. By the end of 1996, the number of registered ventures was over 1 million, up to three-quarter of which were individual ventures, one-tenth deposit companies and another one-tenth limited liability companies. These are the main categories. The number of unlimited associations, companies limited by shares and cooperatives is merely a fraction of the above. As for their size, the overwhelming proportion (97 percent) of all ventures are micro-ventures that employ less than 10 people, and 2 percent are small ventures with between 11 and 50 employees. Up to 30 percent of the registered companies are dormant.

The role of small and micro-ventures in employment has significantly grown. By late 1995 less than 30 percent of the workforce was employed by large companies employing more than 300 people, while small and micro-ventures employed 56 percent. The growth in the average number of people employed by small and micro-ventures was slower than the decline of the workforce of medium-size and large enterprises. If we include private entrepreneurs and their employees, between 1992 and 1994 small ventures absorbed some 80 percent of those laid down by medium-size and large enterprises. Between 1992 and 1994 the capability of small ventures to absorb labour was close to the level of the numbers laid off by the corporate sphere, but by 1995 this situation had changed considerably.

In 1995 enterprises with more than 300 employees accounted for 57 percent of the total registered capital, while small and micro-ventures accounted for 25 percent. The registered capital of small and micro-ventures is growing more rapidly than that of large ones, yet here we should not disregard that a great number of the former are a result of the disintegration of the latter. The analysis of the relation of own and registered capital, however, indicates that the amount of reserve capital going from small ventures toward big ones is growing monotonically, while micro-ventures not only lack reserve capital but their own capital is dwindling—that is, they are about to use it all up.

The share of large corporations from proceeds has decreased while that of small and medium-size ventures is growing. In 1995, large companies were produc-

[3]Between 1988 and 1990 the percentage of those who would have liked to be involved in a private venture rose from 25 to 44. (*Lengyel and Tóth* 1993). (See also *Szelényi* 1992.)

ing no more than 36 percent of the net total proceeds, as against 44 percent realised by small and micro-ventures. The share of small and micro-ventures in accounting for the proceeds of certain economic sectors has been dominant: 88 percent in education, health and social care, 76 percent in the sector that includes computer technics, consulting and real estate leasing, 62 percent in trade and 50 percent in construction. On the other hand, their share in the processing industry was a mere 19 percent in 1995. It is safe to say that in certain branches the number as well as the performance of small ventures is a decisive factor, but has not reached the average of Western-European market economies in other important sectors, such as the processing industry. Small and micro-ventures were responsible for 27 percent of all exports in 1995 and they accounted for over 30 percent of the GDP.

With regard to small ventures, here we find three, clearly different groups occupying various positions.[4] The groups were formed by using average numbers; the position of individual ventures within the group may be largely different.

The first and biggest group is that of micro-ventures subject to personal income tax. The majority are self-employing entrepreneurs. Their role in counterbalancing growing unemployment was decisive in 1995; it was this group who absorbed most of the labour laid off by medium size and large enterprises. Their position deteriorated in every way in 1995. Their visible performance fell, and so did their revenues in real value, their income in nominal value and their accumulation expenditures. Changes in tax and social insurance regulations during 1996/97 only added to their burdens, and so they cannot hope for any improvement at the moment. This is the group of entrepreneurs best capable of hiding its revenues. Within the whole of the small and micro-venture sector, they represent 69 percent of the number of ventures, 36 percent of those employed and 13 percent of proceeds.

The second group is that of micro-partnerships. These are smaller than the former group but their role in employment and job creation is significant. They enjoy a somewhat better position: their performance (revenues and exports) was better than the economy's average in 1995 but their profitability these assets decreased and is now very negative. Their assets in real value have diminished (i.e. they are using has up). 28 percent of all small and micro-ventures belong to this category; they employ 36 percent of the workforce and account for 47 percent share of revenues.

The third group are the small partnerships. Their role in employment is significant and was still growing in 1995, while the growth rate of the sector as a whole slowed down. 10 percent of the total capital belongs to them. Their revenues and exports were growing quickly, the former better than the national average. They are profitable. They have the biggest average tax burden and although they are the best within the sphere of small and micro-ventures with respect to accumulation, it is still limited and is lagging far behind the possibility

[4] For more about this see *Kállay et al* 1997.

of medium size and large enterprises. Of all ventures, the productivity and capital efficiency of small partnerships are the best. They account for 2 percent of all small or micro-ventures, employ 26 percent of the labour and have a 38 percent share of all revenues.

0.2 percent of all small and micro-ventures are subject to personal income tax, they employ 2 percent of the workforce and have a 1 percent share in the sector's total revenues. With regard to their characteristics, they stand closer to the first group. Their performance had been deteriorating and their profitability is negative. The most conspicuous difference is that their accumulation expenditures have grown considerably.

All these facts clearly show that the position of an enterprise subject to company tax is generally better than that of those subject to personal income tax.

The latest data we have is for 1995 but it is safe to presume that the situation did not improve in 1996/97. The fiscal government wanted to provide more resources for the entrepreneurial sector in 1996 and 1997, and differentiated to the expense of small venture. The 1996 bill on company tax specified and narrowed the list of tax-deductible costs. This change naturally had an adverse impact on smaller ventures. At the same time, each and every HUF of the income of individual entrepreneurs became liable to tax since the zero-tax category was abolished. Since 1997 differentiated minimum incomes have been prescribed for each branch and social insurance withdrawals have also been drastically raised.

Growth possibilities for small enterprises

The economic policy pursued after 1994[5] gave priority to the restoration of the fiscal balance as against growth and to the suppression of inflation as against the decrease of unemployment.

Hungary's international competitiveness became considerably weaker in the early 1990s. The slow growth started in 1994 had induced a significant growth of imports. The balance of foreign trade showed a large and growing deficit. The increasing deficit of the state budget, and central and social insurance budget were also worrisome. One of the (less significant) causes was the population's excessive consumption; moreover, consumption had started to grow in 1993, and in 1994 the net increase in wages had considerably overstepped the improvement of the economy's performance. Another, more significant reason was the excessive spending of the state. By 1994 the internal state debt had reached the magnitude of the GDP. Interest on the internal debt added at least HUF 200 billion p.a. to the state deficit. Therefore the growth of the internal debt had to be cut back. The deficit

[5] *Information...* (1994); Bulletin of the Ministry of Finances (1996); Information titled "The domestic..." (1996a); *Békesi* (1997).

could no longer be financed from domestic savings. Since this could only be done at the expense of accumulation by the entrepreneurial sector, it further deteriorated economic performance. In this situation the economic policy wanted to severely modify the expenditure proportions of the gross domestic product at a time when it stagnated or slightly grew. Within this, it targeted a reduction of consumption of both households and state and the increase of accumulation; within accumulation, it wanted to decrease the rate of stockpiling and the increase of the rate of investment, respectively. In other words, the aim was to modify the position of big income makers at the expense of the state budget and households, and to the benefit of enterprises. With respect to the deficit of the foreign trade balance, this was to be lessened by cutting back imports and significantly expanding exports.

As a result of the above economic policy, the measure of income centralisation fell from 61 percent of the GDP to 50 percent in the years between 1994 and 1996. The deterioration of the internal and external balance stopped and the rapid growth of debt turned into a slow decrease. Restoration of the balance slowed down economic growth, yet it did not cause a recession in the economy. Exports jumped and this helped maintain the one-percent growth of the economy inspite of the fact that the drastic (approximately 15 percent) decrease in real wages and the cutbacks in state expenditures resulted in a narrowing of the domestic market. The inflation rate was rising until 1995 but it has been falling since. Employment fell in 1995; in 1996, the level of unemployment was unchanged.

Table 1 clearly shows the improvement of the income position of the entrepreneurial sector and the deterioration of the households sector.[6] It should be noted, however, that here the decrease of the state's participation is envisaged for 1997 only.

Table 1

Distribution of domestic disposable income (percent)

	1994	1995	1996	1997
Economic units*	16	19	21	23
Households**	81	75	73	72
State	3	6	6	5
Domestic available income	100	100	100	100

*Operation results minus income tax. Operation results=added value minus wage costs plus subsidies, minus production taxes.

**Wages plus miscellaneous incomes, plus allowances, minus income tax.

Source: Ministry of Finances, 1996a

[6]Most individual entrepreneurs subject to personal income tax are recorded in the private household category.

Table 2 shows the decrease of the rate of incomes from work and the growth of income that may be spent on accumulation within the income of the sector.

Table 2

Income and cost structure of the corporate sector

	1994	1995	1996	1997
Value added by companies (billion HUF)	1672.0	1991.0	2478.0	3028.0
Employees' income (billion HUF)	1268.0	1464.0	1698.0	1938.0
as a percentage of GDP	35.8	33.7	30.9	29.3
as a percentage of the value	75.8	73.5	68.5	64.0
Added by companies own resources* for accumulation purposes (billion HUF)	136.0	246.0	432.0	671.0
as a percentage of the GDP	3.8	5.7	7.9	10.1
as a percentage of value added by companies	8.1	12.4	17.5	22.2

*Depreciation, plus pre-tax profits, minus company tax

Source: Ministry of Finances, 1996b

Between 1993 and 1996 employees' incomes grew one and a half times and resources earmarked for accumulation grew nearly fivefold (at current prices).

This was the macroeconomic framework characteristic of the position of the entrepreneurial sphere. Now we are going to examine how the position of ventures in the competitive sphere is being differentiated, and how the tendencies shown in the economy are being realised in the groups of ventures of various sizes.

Looking at disposable incomes with respect to the size category of enterprises, it can be seen that a larger and more spectacular movement in the rearrangement of company positions happened between 1992 and 1994. Over the period the share of micro-ventures in the total income of the competitive sphere decreased by 1 percent, while that of large enterprises decreased by 7 percent; the share of small and medium size ventures as a total grew just as much: that of small ventures by 3 percent and medium size ones by 5 percent. This structure changed only slightly between 1994 and 1995.

The growth rate of disposable income decreased between 1992 and 1995 (as we move from small ventures toward large companies). The index of micro-ventures was between the values of medium size and large ones. At the same time, it can be seen that the periods 1992/94 and 1994/95 show different tendencies. The decline of large companies stopped in 1994 and by 1995 their disposable income was growing more quickly than that of small and medium size ventures. Interestingly the position of micro-ventures, too, had greatly improved in 1994/95 since their growth was more rapid than that of small and medium-size ventures.

The proportion of employees' income within the GDP is, however, decreasing. All in all, that index fell from 46 to 36 percent between 1992 and 1995: most

Table 3

Disposable income according to size categories (billion HUF)

	1992	1994	1995
Microventures	120	190	278
Small ventures	95	202	277
Medium size ventures	146	307	409
Large companies	478	713	1007
Total	839	1413	1971

Source: TFCA

conspicuously (respectively, from 56 percent to 40 percent, and from 49 percent to 36 percent) at small and medium size ventures, from 44 percent to 34 percent at large companies and finally, from 42 percent to 34 percent at micro-ventures.

Table 4

Employees' income according to size categories (billion HUF)*

	1992	1994	1995
Microventures	82	122	135
Small ventures	85	134	154
Medium size ventures	160	232	271
Large companies	396	483	556
Total	723	972	1116

*Wage costs+personal payments

Source: TFCA

Employees' incomes at large companies grew slower in 1992/94 and quicker in 1994/95. Hence changes here were just the opposite of other groups of ventures where growth was quicker in 1992/94 and slowed down later. On the other hand, the change in the incomes of employee's at large companies—as we will see later—showed a trend opposite to the change of resources meant for accumulation. The distribution of growth of employee's incomes at the individual categories was less extreme than it was with regard to the accumulation resources. Between 1992 and 1995 41 percent of the growth of employees' incomes occurred at large companies, 28 percent at medium-size, 18 percent at small and 13 percent at micro-ventures.

It is most remarkable how the own resources of ventures for accumulation changed. As against the GDP, these reached 1 percent in 1992, 14 percent in 1994 and as much as 17 percent by 1995—that is, they were rapidly growing, in accordance with the government's intentions. Their proportion fell between 1992 and 1995 only at micro-ventures and the index considerably grew at all other

categories: from −3 to 17 percent at small ventures, from −9 to 16 at medium size ones and from 3 to 20 percent at large companies, respectively.

Table 5

Change of own resources for accumulation according to size of ventures

	1992	1994	1995
Micro-ventures	20	15	27
Small ventures	−5	38	4
Medium size ventures	−25	45	110
Large companies	27	241	326
Total	17	339	536

Source: TFCA

Between 1992 and 1994 micro-ventures' own resources for accumulation decreased, while those of small ventures grew by 43 billion HUF, of medium size companies by 70 billion HUF and those of large companies by as much as 220 billion HUF. The growth at large companies was spectacular, both in absolute value and compared to the GDP they produced. This is due to the fact that amortisation which occurred at large companies was already, in 1992, more than two times that of the amortisation at all other company categories;[7] however, there were large losses, not independent from the development of amortisation (two-thirds of all losses suffered by the competitive sphere occurred here) which offset the gains. As large enterprises turned profitable by 1994, their accumulation resources also soared. Between 1992 and 1994 own resources for accumulation grew in a more balanced way in all categories but their concentration cannot be denied. On the whole, in the years 1992–1995, 8 percent of all own resources for accumulation accrued at large enterprises, 26 percent at medium size ventures, 15 percent at small ones and 1 percent at micro-ventures, respectively.

These circumstances largely limit the development possibilities of small and micro-ventures, all the more since the credit stock of these groups has, since 1994, been decreasing—first in real value and from 1995 onwards nominally as well. Be-

[7] In the course of their reorganisation into companies, their assets were revaluated. The value of assets was the result of bargaining between the State Assets Management Co. Ltd. (ÁVÜ; ÁV Rt.), the management of the company concerned and the prospective buyer when the reorganisation and privatisation coincided. According to Péter *Mihályi* (1997) company managements were in most cases interested in the overrating of their assets, "because this enabled them to reach higher prices of the end-product at the settlement of amortisation". (p. 57) They were just as interested in forming resources for development. In certain cases, however, company assets were also devalued for reasons that will not be dealt with here. According to a SAM investigation using a relatively small sample, in 70 percent of all reorganisations the property value of the newly formed company exceeded the book value and in 23 percent of the cases it was less. (Mihályi, p. 59)

sides this the proportion of credits of small ventures, too, has bee showing a downward tendency within all credits. (Kállay et al. 1997, p. 116)

It can be stated that, as against the general tendency in the competitive sphere, the respective positions of ventures of various sizes have developed in a differentiated way. As compared to the GDP, own resources for accumulation grew and employees' incomes decreased. Within these, however, a considerable concentration of the growth of both resources for accumulation and employees' incomes went on in the sphere of large companies. Hence the possibilities of enterprises of various sizes, with regard to own as well as external resources, had become largely differentiated; those of small and micro-ventures deteriorated and those of medium size and large companies improved over the period under review.

As mentioned above, statistics view individual ventures as part of the household sphere. There is no data available about individual entrepreneurs that might enable us to make the calculations in question. Nevertheless, it is a proven fact that the income of individual entrepreneurs between 1992 and 1995 increased (to 373, 664 and 800 billion HUF for the respective years) but it decreased when compared to the performance of both small and micro-ventures. As for the proceeds of micro-ventures, individual entrepreneurs accounted for 33 percent of the total in 1992 but only 28 percent by 1995, and the respective percentage was 3.2 and 2.8 percent for small ventures. Their taxable income fell from 40 to 32 billion HUF from 1994 to 1995. Therefore, it is safe to say that the economic position of individual enterprises deteriorated if we compare their situation with that of partnerships. On the other hand, if we take into account that employees' earnings nominally rose between 1994 and 1995, then it can be concluded that in spite of a sizeable decrease in real wages the position of individual entrepreneurs deteriorated more seriously than did that of those living from wages and salaries. At this point, however, it must be noted that the latter group has hardly any possibility to hide their incomes. This means no regrouping of incomes since neither other enterprises nor the state may exploit any deterioration in the position of individual entrepreneurs; moreover, it results in less tax revenues for the state.

Redistribution I—curtailments and subsidies

With regard to the role of the curtailment and redistribution of incomes within the economic sphere, we have to look at the balance of subsidies and curtailments—that is, at the proportion of incomes curtailed at and given back to the various groups of enterprises. This is, however, an impossible task because of the numerous forms, institutions and actors of redistribution. Furthermore, apart from normative and open forms of redistribution, there are also individual and hidden ones, and one must consider all these in order to get an overall picture

of the economic management's preferences and their changes. The first form dealt with here is open redistribution mediated by the tax system.

In the following we will examine the balance of subsidies and withdrawals for each category of size. As a preliminary, it should be noted that individual entrepreneurs may be subject to company tax and personal income tax alike but most belong to the latter category. Their entrepreneurial proceeds and personal income combined are subject to personal income tax. Therefore in the case of individual entrepreneurs the proceeds from their venture are known, but the amount of tax they have paid is not since this latter also depends on the magnitude of their incomes from outside their venture. In the case of companies, however, the sum of profit tax payable can be easily traced. We not only have no data on the amount of tax payable by ventures subject to personal income tax, but there is also nothing with regard to tax exemptions or subsidies granted to them. Therefore, here the proportion of withdrawals and subsidies cannot be examined.

With respect to the total company tax paid by enterprises with single and double book-keeping, large enterprises paid in most: 45 percent in 1992, 41 percent in 1994 and 31 percent in 1995. The respective percentages for medium size ventures are 17, 16 and 24. Small ventures paid in 15 percent of the company tax in 1992, 17 percent in 1994 and 18 percent in 1995, while micro-ventures paid 23, 24 and 26 percent in the respective years. It can be seen that large enterprises are paying less and less taxes, while companies in other categories are paying more in percentage and absolute value alike. The steepest increase in payments happened at medium size ventures.

Table 6

Tax payable by enterprises with single and double book-keeping

	Tax payable, billion HUF			Proportion, percent		
	1992	1994	1995	1992	1994	1995
Micro-ventures	15	28	26	23.4	24.6	26.0
Small ventures	9	20	18	14.7	17.7	18.1
Medium size ventures	11	19	24	16.9	16.4	24.3
Large companies	29	47	32	45.0	41.3	31.6
Total	63	115	100	100.0	100.0	100.0

Source: TFCA

The sum of tax exemptions[8] grew until 1994 and fell in absolute value to less than a half between 1994 and 1995. The circle of beneficiaries had changed between 1992 and 1995: first micro-ventures were preferred but from 1994 onwards such exemptions got more and more concentrated at large companies. This was to such an extent that in 1994 56 percent and by 1995 as much as 72 percent of all tax exemptions went to that group of companies. Certain exemptions were literally custom-made for this or that big enterprise.[9] Tax exemptions for large enterprises had risen in absolute value and decreased in all other categories in 1994/95. Tax allowances for other than large companies fell drastically between 1992 and 1995. Moving from micro-ventures to medium size enterprises, their respective totals went back by 5.25 and 49 percent, while it soared by nearly 60 percent at large corporations.

Table 7

Tax exemptions for ventures with single and double book-keeping

	1992	1994	1995	1992	1994	1995
Micro-ventures	12.3	2.0	0.6	36.4	5.0	3.1
Small ventures	5.5	3.6	1.4	16.3	9.3	7.1
Medium size ventures	7.1	10.8	3.5	21.2	27.5	18.1
Large companies	8.8	22.8	13.9	26.0	58.2	71.7
Total	33.7	39.2	19.4	100.0	100.0	100.0

Source: TFCA

The volume of income of individual entrepreneurs subject to taxation soared from 7 billion to 40 billion HUF between 1992 and 1994, but went back to 32 billion by 1995. The income per venture also declined. It is remarkable that the income subject to taxation, with respect to small and micro-ventures employing less than 50, fell in 1995 but that of bigger individual enterprises grew.

Another component of withdrawals, more important than the company tax and also bigger, comprise social insurance contributions. No doubt social insurance payments, too, are distributed unequally among enterprises of various size. Large companies provide more than one half of all social insurance contributions, medium size ones provide one-fourth and small and micro-ventures another one-fourth, respectively. The share of large companies is on the decline, although it was dominant as late as 1995; the proportion of other categories rose slightly. Between

[8] Tax exemptions were granted on investment, foreign economic companies, dividends invested by foreign members of a company, interest on credits and loans, investment in special economic zones, and off-shore ventures.

[9] For instance, a 50 percent tax allowance may be granted for production-purpose investments of at least 1 billion HUF, provided it adds 25 percent, or at least 600 million HUF to export proceeds. (*Company Act*, Chapter 21, Para. 1.)

1992 and 1995 contributions by micro-ventures rose by 82 percent, small ventures by 100 percent, medium size ones by 79 percent and large companies by 46 percent.

Table 8

Social insurance contributions paid by ventures with single and double book-keeping

	Billion HUF			Proportion, percent		
	1992	1994	1995	1992	1994	1995
Micro-ventures	22	35	40	9	9.8	9.6
Small ventures	26	45	52	10	12.6	12.6
Medium size ventures	56	86	100	22	24.0	24.1
Large companies	152	191	222	59	53.6	53.7
Total	256	357	413	100	100.0	100.0

Source: TFCA

Taking into account the social insurance contributions of individual entrepreneurs would modify the above only slightly. They paid in HUF 19 billion in 1994 and 21.4 billion in 1995. These included, the share of large companies would be reduced to 51 percent for 1995, that of small and micro-ventures increased to 26 percent and medium size ones changed to 23 percent, respectively.

The inclusion of social insurance expenditures corrects the preferred position of large companies with regard to their tax burden—moreover, it turns it around. Drawing a balance of subsidies and withdrawals, as well as the social insurance costs of the three years, it can be seen that the proportion of withdrawals was growing as we move from micro-ventures towards large companies.[10]

Redistribution II: individual and hidden forms

Following a temporary standstill, redistribution gained new momentum in the early 1990s.[11] Its revival coincided with the establishment of a central assets management organisation. Probably, its most important feature is that, unlike in the planned economy before, it did not integrate the whole economy: a great number of companies were operating exposed to market influences, independently from the state. Institutions that guided and managed redistribution also changed. The

[10] This applies, however, only if large companies not simply run their social insurance obligations through their books but actually pay them. Well, this is not always the case. The lion's share of arrears in social insurance contributions were accumulated by large enterprises that had reason to be confident that a part or all of their arrears would sooner or later be cancelled—that is, shouldered by the state.

[11] The following is based on a study by Éva *Voszka* (1996).

Table 9

*Proportion of subsidies and vithdrawals at companies with single and double book-keeping**

	1992	1994	1995
Micro-ventures	1.8	2.4	1.7
Small ventures	3.5	3.4	2.8
Medium size ventures	4.7	4.0	4.0
Large companies	5.1	5.3	4.5
Total	4.2	4.0	3.5

*(Social insurance contribution+tax payable−subsidies−tax allowances)/net proceeds
Source: TFCA

Ministry of Finance kept on being influential, but the role of other ministries diminished while the influence of commercial banks and other banking institutions—such as ÁFI and MBFB—grew. Especially important were the agencies exerting state ownership and control.

A variety of new forms of redistribution, not or hardly ever applied in the planned economy, emerged in the '90s. The emphasis shifted from current subsidies and investment preferences to the reduction of debts, and from open subsidies to hidden methods.

Among major public actions was the repeated financing of losses in the coal mining industry and the Borsod steel industry.[12] There was also crisis management of 13 large state enterprises from 1992 on,[13] followed by years of bank and debtor consolidation. The total debt of those thirteen enterprises amounted to between HUF 80 and 85 billion in 1992. The main element of crisis management was the conversion of debt into state property.

The consolidation of banks and debtors became necessary because of the heightening of company crises. Of 57,000 economic units with double book-keeping in 1992, 5.529 had long-term debts or losses of over HUF 50 million. It was the group where 94 percent of all losses, 93 percent of bank credits and 94 percent of the state property were concentrated. Their debts to banks, the state (including social insurance) and other companies were 39, 28 and 33 percent, respectively. (*Ministry of Finance* 1993) The bank consolidation concerned banking institutions and was actually meant to provide capital for them, while debtor consolidation

[12] ÁPV spent HUF 10.6 billion on the reorganisation of the Borsod steel industry in 1996, from a total HUF 15.7 billion.

[13] The arguments are familiar from the now defunct planned economy: their importance with regard to exports and employment. New elements are the impact of liquidation on suppliers and creditors, the importance of preserving certain professions and the realization that the liquidation of some companies might cause greater havoc than a partial cancellation of their debts.

directly concerned companies as well. In the procedure, the Ministry of Finance bought up bad credits from banks and passed them on to the ÁVÜ, ÁV of MBFB. This latter was set up for conducting reorganisation. The consolidation of debtors worked similarly. The property managers often cancelled or re-scheduled debts. The various steps of bank consolidation swallowed about HUF 316 billion and were followed by debtor consolidation that cost another HUF 50 billion.

Redistribution implies allowances granted to foreign companies, such as several years of tax exemption, government guarantees for investments, subsidies from the Employment Fund etc. Tailoring the terms of exports and imports to certain enterprises should also be mentioned here. Another method was when property management organisations themselves had to raise capital for companies in trouble, or had to finance their investments. It often happened that part of the income earned from privatisation was left at the company. According to a report of the State Audit Office, the ÁVÜ had, by mid-1995, given guarantees of up to HUF 56 billion in 248 cases; there is no data available on the full volume of guarantees undertaken by the ÁV. In 1996, it was reported in the press that in late 1995 the ÁPV undertook guarantees of HUF 300 billion in connection with the privatisation of energy suppliers. Consequently, obligations in full were close to HUF 400 billion by May 1996. According to official figures, the central property management had to reckon with the cashing-in of HUF 41 billion by mid-1996. (Voszka 1996) The ÁPV spent HUF 2.6 billion on its obligations stemming from guarantees and warranties in 1996. (*Information...* 1997, p. 5)

State guarantees were not limited to companies. Loans of small ventures were guaranteed by Hitelgarancia Rt. which had been set up for just that: HUF 3,759 million in 1993, HUF 3,702 million in 1994, HUF 5,639 million in 1995 and HUF 8,495 million in 1996: this is a total HUF 21.6 billion. This served as a guarantee for HUF 40 billion of loans for small ventures. Up until now they have had to cash 4 percent of these guarantees but the moratorium of most loans has not yet expired. The general manager of Hitelgarancia Rt. reckons that 15 to 20 percent of all guarantees will have to be cashed. (See: *Népszabadság* April 2, 1997.)

Voszka summarised the impact of various redistribution methods on the budget as follows: "... direct budgetary expenditures were replaced by forms that bring losses in revenues (tax exemptions, leaving privatisation revenues behind), delay payments (credit and export guarantees), add in the first place to state debts and only a lesser part of them (bank consolidation) has to be borne by the budget, or losses are diverted to special funds, organisations or other creditors".

All these things mean that there is no way to summarise or express the details in figures. The aforementioned forms of support sometimes do not even appear on the enterprises' books (guarantees), and if they do, not under the heading "subsidies" (exchange of debt against shares, capital increase).[14] Also there is no

[14] Éva Voszka and Iván Major, in a study on the post-transition position of 49 large, formerly

way to isolate the effect of redistribution in the change of position of ventures of various sizes. In other words, we can only presume that hidden and individual forms of redistribution have had a primary role in improving the position of large enterprises.

Clearly the '90s brought about a turn in the economic management's priorities: it is again large enterprises that enjoy preferential treatment. Nevertheless, there is no reason to draw a parallel between the '90s and the '70s since large companies are not preferred in the same way, nor are small ones dispreferred as they were back at that time.[15] To mention just the most conspicuous differences: firstly, with the state property shrinking and privatisation progressing, the room for manoeuvre of state-promoted crisis management is getting smaller and smaller. Secondly, preferences given to large companies are applied to a lesser scope of resources. Until the '70s, the satisfaction of the demands of large companies for labour accompanied by political campaigns had directly threatened sectors other than large enterprises and state-run companies.[16] However, it stopped as unemployment appeared on the scene. Thirdly, small ventures ceased to be political outcasts and were no more banished to the illegal world of the second (or grey) economy. The freedom of enterprise should not be mixed up with its complete lack. It is another matter that the grey economy could not be wholly whitened—moreover, grey, tax-evasive activities have even grown in recent years and the fiscal government has tried out many instruments, ranging from minimum tax to minimum income, to fight them.

There is, however, no denial of the fact that an economic policy that wants to stabilise the economy, restore the balance of payments, promote exports and curb imports, cut back and control subsidies—that is, one that serves the growth of exports and profitability—does not necessarily favour small ventures, let alone micro-ventures. It does not favour them because the greater part of such ventures is not so much growth- but consumption-oriented; this is because they are present on a shrinking domestic market and not on external ones, and also because most of them serve the population's, and not the production's consumption.

In the wake of social discontent, which expressed itself in farmers' demonstrations against the 1997 modifications of tax and social insurance regulations, government activity related to small ventures gained an impetus. A bill on small ventures and venture capital companies is being prepared and a commissioner has

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state-run enterprises, tried to summarize the exemptions and allowances they received between 1988 and 1995. Their composition included: cancelled or suspended debts HUF 60.7 billion, rescheduled debts HUF 14.7 billion current production subsidies HUF 23.7 billion, debt for shares HUF 20.1 billion, export and credit guarantees HUF 24.5 billion, privatisation revenues flown back HUF 25.1 billion, and capital increase and reorganisation HUF 14.6 billion: that is a total of approximately HUF 200 billion. (Major and Voszka 1996)

[15]The privileged position of large companies in the planned economy has been analysed in several books and studies by Erzsébet *Szalai* (1989; 1990)

[16]See Mihály *Laki* (1983) and Kálmán *Kőhegyi* (1994).

been appointed to the Ministry of Finance to coordinate the promotion of small and medium size enterprises. A booklet explaining the system of allowances and subsidies was published, the budget allotted HUF 500 million to subsidise interest on investment credits for small and medium size ventures, the implementation of the national supplier programme was accelerated and so on. Inspite of all these visible efforts, no immediate and palpable improvement can be expected. It would require another study to present and examine why only about one third of the otherwise large sector are full-time entrepreneurs who live solely from the revenues of their venture, who employ others, venture their own capital and are inserted not so much in consumption but accumulation. On the other hand, although there is an array of forms of subsidies[17] aimed exactly at that circle of "serious" small entrepreneurs, they do not really reach them,[18] just as supplier programmes[19] and venture capital[20] too may improve the position of only a part of this narrow circle of entrepreneurs.

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[17] See László Kállay (1994), Kállay *et alia* (1997), pp. 150–175.

[18] We have no overview of the utilisation of subsidies, preferential credits and guarantees. Yet sporadic data available indicate that very few of the small ventures did receive such favours. For instance, between 1992 and 1996 6951 ventures availed themselves of micro-credits offered by the biggest of such organisations, the Hungarian Fund for the Development of Enterprises, and 85 ventures received Phare loans. The Start Garancia Fund of the HFDE registered 362 guarantees by late 1996. Hitelgarancia Co. Ltd. undertook 641 guarantees and Agrárvállalkozási Hitelgarancia Co. Ltd. undertook 641 in 1995/96. (Kállai et al. 1997)

[19] "Most suppliers were small and medium size enterprises but it would be a mistake to identify the suppliers with this circle of companies, even in the processing industry. Many Hungarian documents stand out for the strengthening of the sector while stressing their role as suppliers. This opinion disregards that (1) the share of large companies as suppliers is significant, (2) the production and supply of end-products plays a similarly important role in the output of many small and medium size ventures and finally (3) numerous small and medium size ventures enter the market in roles other than suppliers". (*Román* 1995)

[20] "... risk capital is financing very few small and medium size ventures, and only ones promising quick and huge returns. Owing to its very nature, risk capital will never be a general solution or an alternative for bank credits for the long-term funding of small and medium size ventures. Therefore it is safe to presume that the new law on risk capital will ease the operation of such capital but it will hardly enable small and medium size ventures to get much more long-term investment that might cease their dependence on bank credits." (*Karsai* 1997, p. 173.)

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Acta Oeconomica, Vol. 49 (3–4), pp. 415–438 (1997–98)

HOUSEHOLDS AND HOW THEY GET BY IN A DISADVANTAGED AREA

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This study aims to explore the characteristic features of the livelihood of households, their daily routine, procedures and strategic elements. At first the relevant literature is surveyed, then the issues raised are tested with the help of the empirical data. It was regarded as particularly important to locate the various household activities in social stratification. It is among our most important conclusions that the functioning of households cannot be understood exclusively with the help of a single explanatory logic; stratification, traditions and the scale returns appearing in the economy of households all have a significant role in the explanation of household activities. While social inequalities behave as usual in the market and in the use of commercial institutions, we have received interrelationships contrary to the expected ones in several fields of subsistence economy. Linkage to the type of settlement obviously manifests itself even within a small region; consequently, one may speak about urban and rural self-supporting activities respectively. By checking the effect of the region it can be used by the poor. Rather it can be said that this solution is applied most frequently by the middle strata.

How can families get by in everyday-life? What routines and procedures do they use to get their everyday businesses settled? How can they adapt to the rapid change of economic and social circumstances during the transition? Is there any difference between the activities of the households belonging to different social groups, and if there is any, how can it be characterised? It was such questions as these which formed the basis of our empirical research[1] in Balassagyarmat, and in five villages[2] belonging to its urban region in 1994 and 1995. In this study a number of our results are presented.

As with most empirical studies this one also bears the impact of the theoretical interests of the researchers, the research traditions in the field of the mentioned discipline, and the social beliefs and facts, interacting between them, spread in the scientific community. These points will be dealt with in the first part of the study. After this we will begin to analyse some aspects of household economy: food production, self-service activities and the changing consumer behaviour of households.

[1]The research was funded by OTKA (National Fund for Scientific Research) (F 4610).

[2]Balassagyarmat, and the five villages belonging to its close surrounding region, are about 80 km northeast from Budapest, close to the Hungarian–Slovakian border. The town has a 20,000 strong population, and the villages are inhabited by about 1000 people each. The area does not belong to the worst situated north-eastern region, but unemployment here is also well above the average. The specific problems which most Hungarian areas have to cope with were present here, too, during the period when the research was carried out. The 560 households interviewed were the result of a random selection. For a full account of the research see *Spéder* 1995.

The relationship between techniques used in household economy, and stratification were given special attention.

Theoretical approaches, and empirical studies on everyday subsistence

Approaches emphasizing the importance of household economy

It is obvious for the East European, and especially for Hungarian social sciences, that the performance of household economy, like housework is one of the most important factors of personal welfare, and it constitutes an indispensable, essential part of everyday subsistence. There are two approaches that are worth mentioning briefly because in our opinion they have up to now delayed the exploration of how household economy works. One set of these approaches is general and is based on evolutionary theories and we believe they become rooted in much of the reasoning in this field of study. Based on these theories it has become an implicit supposition, almost like a creed, that households living by subsistence are the result of underdevelopment, and they exist in countries which are backward and poor. The more particular set of theories is derived from the interpretation of the "second economy" phenomena which formed in the 1980s in Hungary. These views present a picture according to which any work organised outside redistribution is "market-oriented", "private", or "business-like". However, there are analyses (*Kovách* 1988) from which it was obvious that, for instance, work done in small-scale production or in house-building serves exclusively the supply (self-sufficiency) of the household members; this contrasts with some scientific opinion and public opinion according to which work done in the second economy was associated with the notion of entrepreneurship.

The idea of households getting emptied was also held by many western social scientists, so they were not particularly interested in how households do work. Yet what types of approaches drew our attention to the importance of household activities? In the late 1970s, and early 1980s new questions were put and new approaches began to develop in various scientific disciplines. These focused on unpaid work done in households, the network of connections among relatives, and other activities taking place outside big institutions.

Jonathan *Gershuny* (1978) in his very impressive and influential book and in his later works criticises, based on pure logical arguments and statistical analyses, *Bell*'s (1973) widely recognised concept on post-industrial society; this may be seen as carrying on classical evolutionary theories. It is a central element of Gershuny's alternative concept that household economy is gaining ground in modern societies.

It this worthwhile citing his reasoning. In his opinion the household decides rationally whether it meets its demands "the traditional way"—i.e. as direct

market consumption—or in an "innovative way"—i.e. as home production or self-sufficiency. As the latter way has been *getting relatively cheaper* since the 1950s, in modern societies more and more households have taken advantage of this. As a result of technological advance and of increasing purchasing power, the relative prices of small machines, and gadgetry helping work done for one's own household—compared to the costs of traditional services—have fallen significantly (Gershuny 1978; 1988); thus more and more households are involved in subsistence activities.

The fact that in the area of women's studies there is criticism of the precondition (and often, at the same time, a final conclusion) according to which household work is sexually defined ("household work is for women"), has also greatly helped to make household work the subject of thematic research. Throughout this research the underlying (and, now, accepted) assumption is that unpaid household work should be seen as labour in the same way as labour market activities, albeit of a different type. It is also clear now that household work is not a sign of backwardness since it is a structural part of the working of modern societies (*Oakly* 1974; *Ostner* 1978; *Kontos and Walser* 1979).

Research into the *informal (grey, hidden or irregular) economy*—including surveys of domestic work, analysis of transactions between households and of voluntary work, and, in the end, the planning of subsistence strategies—has required a redefinition of labour, economy and resource husbandry. It has also meant reconsideration and reinterpretation of the economic function of households (*Pahl* 1984; *Jessen et al.* 1988; *Mingione* 1991).

Alongside the above, and as part of the results of the mentioned research, it has become clear that not only markets and the state can be seen as institutions producing and generating welfare but also the household itself. Furthermore, voluntary organisations are often mentioned among the main types of welfare-producing institutions (*Zapf* 1984; *Glatzer* 1987). With regard to the relation between household and other welfare producing institutions, it should be highlighted that the subsistence household, besides being involved in substitution, also has a supplementary, cooperative nature. According to this welfare conception household economy may be approached from two different perspectives. On the one hand, it is itself one of the welfare-producing institutions; on the other hand, it integrates the performances of the mentioned institutions on the household level. Those works (Pahl 1984; Mingione 1991) which suppose, regarding all possible types of work, that households are employing "household work strategies" for subsistence, may be interpreted as variations of the latter approach.

Different from the above, there are those approaches that interpret *household work strategies and subsistence procedures in some well-defined situation* (*Caplovitz* 1984; *Tardos* 1988; *Rose and Haerpfer* 1993; *Sik* 1995; *Harcsa* 1994; Spéder 1994a). The basic question may be formed like this: how do households react to various emergencies, and in such cases of emergency, what resources can they mobilise? Of course, emergencies do not affect the same group of households, and the serious-

ness of a particular emergency is different for the different households. (Sik 1995). For the *majority* of households, stagnation of the economy, inflation, or some kind of natural disaster are social facts that make reaction inevitable. (Unexpected) changes in the life of individual families (e.g. one of the members losing his/her job, his/her protracted illness, death, a divorce, the break-up of the family) require the adaptation of the *affected families* only. Research, so far, has been done mostly in the former case, especially given the fact that economic recession and inflation are regarded critical situations (Caplovitz 1984; *Pahl and Wallace* 1995). The following can be considered as means of adaptation: gaining surplus-income; self-sufficiency and self-service; mobilising of savings; consumption kept lower or changing its structure; rationalisation of buying-in; intensification of the reciprocal exchange of labour (Sik 1988); mobilisation of the network of connections with relatives; and taking advantage of social benefits. The actual way of adaptation is defined by outside circumstances (e.g. state of the labour market, organization of trade, system of social policy institutions, and so on) combined with resources of households (e.g. range and strength of the network of connections with relatives; the size and form of accumulated wealth; and the way of life).

As for Hungary, the basic dilemma was recognised by Róbert Tardos as early as in the 1980s. According to this, households have two alternatives when circumstances are worsening. They may try to work (and earn) more or consume less. According to Tardos' research, most Hungarian households have opted for the first alternative: i.e. they chose moonlighting or small-scale agrarian production (Tardos 1988). Since the beginning of the economic transition, circumstances seem to have altered thoroughly. This—according to our supposition—has meant in one respect the alteration and tightening of possibilities for gaining surplus-income; the growing availability of freely useable labour (as a result of unemployment and retirement); and changing the system of institutions and structure of consumer behaviour.

Surveys of purchasing on so-called COMECON market places is also generated partly by this tradition.[3] At the end of the 1980s, commercial institutions appeared which, up until then, had been "unknown": COMECON market places; trading in underground passages; networks of salesmen; discount stores; mail-order houses; tele-shops, and so on. The emergence of the above meant, with regard to *consumer behaviour* of households, genuinely new surroundings. Besides sales, price reductions of commodities also became increasingly popular. So, after the long recession period of the 1980s, it was only natural that researchers became more interested in trade institutions and the consumer activities of households (Sik 1992; *Ékes* 1992; Harcsa 1994).

Strategies and adaptation of households were mentioned above several times, and these terms refer to the "consciousness" of households. We do not challenge the

[3] The "COMECON-markets" are bazar-like informal markets, where most of the suppliers are from former socialist countries and China, and are not registered traders in Hungary.

fact that, in running the household economy, many rational decisions are arrived at; however, it is necessary to draw attention to the fact that these decisions, along with the allocation of resources within the family, do not always form according to measures of common sense. Sometimes, decisions are not even recognized; use of resources "just happens" (*McCrone* 1994). This warns us to be cautious about using the term "strategy", and to use the term "subsistence" techniques instead.

All these approaches have influenced our conviction that activities and decisions arrived at in the family must not be interpreted in themselves but within the framework of the household economy. Of course, we are aware of the fact that, as researchers began to analyse one or another elements of household economy (and starting from a wide variety of approaches) *it would be out of place to speak of well-defined and closed paradigms in connection with the working of household economy.*

Household economy procedures linked to social strata

Some of the approaches presented here touch upon one of the classical fields of sociological research: namely, social stratification. The latter is dealt with explicitly and implicitly. Mingione (1991) and others hold that households are self-sufficient and self-servicing because they do not have enough money for consumption. The household economy is a type of substitution which occurs due to the insufficient income of households. This implies that self-sufficiency is an indispensable element of subsistence among people in unfavourable income positions—i.e. among the poor.

Pahl formed his social polarisation theory while carrying out empirical research (Pahl 1984; 1988; Pahl and Wallace 1995). According to his findings, households can be divided into two groups: "work-rich" and "work-poor". Work-rich households have more earners and in such households work is more intensive. Therefore, it is easier for them to join network transactions either for money or as a favour. Those with more favourable income positions have more "objects" (e.g. own home, car, garden); these are preconditions for household self-sufficiency (Pahl 1988; *Jorges* 1981). On the other hand, it is characteristic of "work-poor" households, that their members have no job (i.e. they are unemployed, inactive or just family members); moreover, they cannot do much work at home because they do not have the money to buy the inputs needed for self-sufficiency; also, they do not have the workplace connections that would allow them to take part in the grey economy (Pahl 1988). According to "social polarisation" theory, various informal jobs—including self-sufficiency activities—contribute to the increase of primary social inequalities. The processes involved have the effect of increasing the gap between the middle and underclasses; furthermore, they shift the welfare position of the middle classes towards the higher ones.

Jessen and his colleagues interviewed shipyard workers and they studied the distributive effects of informal work. According to their analysis, patterns of self-sufficiency and informal work are widespread in certain environments, and they are linked primarily to a rural way of life; thus it is proper to speak of "economics of the way of life" (Jessen et al. 1988). It can be deduced from the research of the Jessen-team—although they leave it unsaid—that informal jobs create inequalities connected to the type of settlement (i.e. town/country).

Main points of the Balassagyarmat research

We could only test a number of the above-mentioned hypotheses through our empirical research. When making the questionnaire, our main purpose was to try to be able to apprehend fully the least researched areas of the everyday subsistence, concerns and efforts of households. On the other hand, with regard to the relatively well explored areas, we used the most essential (background) variables only. We paid special interest to finding out how the practice of the household economy is connected to the above-mentioned welfare-producing institutions, and how they can be linked to the various social strata.

In compiling the inventory of the *tasks and problem situations* which emerge during the everyday practice of household economy we relied upon the Pahl-research; of course, we also took into consideration the characteristics of Hungarian society and the particularities of the area (Pahl 1984; Spéder 1995). Thus we considered the tasks of house and apartment maintenance and renovation respectively; we looked at domestic work, baby-sitting, and car maintenance. We could then put the question: who was the one who did most of the work *the last time*? When making the list of jobs to be done in the household, we took into consideration Ward's criticism—namely, Ward pointed out that Pahl's joblist preferred in advance the jobs that are, conventionally, done by the households anyway (*Ward et al.* 1989). We considered it especially important to explore the food production industry of the household, and, within it, the function of small-scale production. Other questions looked at the standard background-variables with regard to the distribution of labour within the family, as well as certain aspects of consumer behaviour, the career of the individual (i.e. the interviewed person) on the labour market, and the tensions which exist within the household economy.

In our preliminary conception we wanted to form indices characteristic of individual households—e.g. levels of self-sufficiency, dependence on the markets, and the commercialisation of consumption. Given these, it would be possible to carry out further analysis with the help of conventional demographic and socioeconomic indicators. However, it must be admitted that, so far, we have been unable to compose indices so comprehensive that, in using them, our preliminary hypotheses

could have been easily tested. Given the separate analysis of individual activities, it can be seen that our failure was primarily the result of the nature of the activities. In other words, individual elements of the household economy can each be explained with different variables. After these preliminary remarks follows a survey with regard to some of the domestic fields in which the Balassagyarmat households act.[4]

Food-production of households: gaining of income and lowering of expenditures

It is a commonplace that small-scale production within the family has been the subsistence basis of households for decades. Also it is common knowledge that the conditions for such production have been deteriorating during the economic transition (*Harcsa and Kovács* 1996). According to the mentioned survey, it is also obvious that recent years have been characterised by differentiation; this, in turn, has caused the concentration of agricultural enterprises. Another process, which is not so well-known, has resulted in something of a "renaissance" for self-sufficient production. It is shown by the fact that 34.4 percent of households in 1992, and 44.4 percent two years later, were carrying on "exclusively self-sufficient" small-scale production or horticulture (Spéder 1994b). These two structural developments draw our attention to the double function of small-scale production in household economy: the *earning of income and the lowering of expenditures*.

Within small-scale agriculture, we discerned two types: the "trucking type" (it would not be a mistake to see this to be close to the traditional peasant type), and the self-sufficient one, respectively. As can be seen from our table below, more than four out of every five families in the area of the sample population are involved in small-scale agriculture (*Table 1*). The majority cultivate crops but half of the households also deal with animal husbandry. Nearly one out of every five small-scale producers is involved in trucking; nevertheless, the majority deal with activities that are of a subsistence, purchase substituting character.

Specialised production is more characteristic of crop cultivation. The majority of the truck farmers (53.3 percent) specialise in potatoes, while a smaller group

[4] We are aware of the fact that sweeping changes in the structure of employment and the gaining of income had the same impact on the standard of living of families in Balassagyarmat and its neighbouring districts; this is now known from national surveys. However, as there has been much research done into this area in the past—let us only mention the research project of the Hungarian Household Panel. We did not make this a main point but we used it for background variables. It was our experience while analysing various ways of income gaining, that the practice of earning supplementary incomes had decreased, compared to the 1980s. It apparently remained true that "standing on several feet" is one possible strategy for successful adaptation (Spéder 1993). For a description of our sample see Spéder 1995. Sampling was confined to people between 18 and 65 years.

Table 1

Distribution of small-scale production types in Balassagyarmat and its vicinity, 1994 (percent)

Type of small-scale production	Crop cultivation	Animal husbandry	Together
truck farming only	16.0	4.1	18.2
truck farming	5.4	3.1	6.8
subsistence farming	59.9	42.7	58.4
no production	18.7	50.1	16.6
N=	556	557	556

concentrates on raspberries, black currants, and other kinds of crop cultivation (e.g. seedling), respectively. With respect to stockbreeders, it is worthwhile highlighting the ones who breed rabbits. Summarising the facts, we can say that *25 percent of the households in the area acquire revenue through small-scale agriculture.*

To survey the intensity of self-sufficiency, we tried several kinds of approaches. We left questions regarding quantities to the end; thus the priority question in the interviews sought answers with regard to the extent to which the individual saw himself/herself involved in vegetable and fruit cultivation, and self-sufficiency in meat, respectively (i.e. in the household economy). We are aware, of course, that meal habits can vary widely between individual social groups (especially between elderly and young people; but they can also depend on other social factors. For example, the same quantity of potatoes may mean quite different grades of self-sufficiency to different people. However, as we were interested in the grade of household self-sufficiency and of the dependency on markets, we decided to accept the relation to consumption as a benchmark. A quarter or a third of the crop cultivators and stockbreeders were only capable of reaching a very primitive grade of self-sufficiency, and thus we may consider them as "hobby" producers (*Table 2*). On the other hand, nearly half of the households do not need to buy goods—like their own produce—on markets.

We took into consideration the development of both variables when arriving at a complex variable of self-sufficiency.[5] Consequently 27.6 percent of households may be considered self-sufficient in both vegetables and meat. On the other hand, 33.5 percent of households are totally dependent on markets, and the remaining 39 percent are partly self-sufficient, and thus they also purchase on the market.

[5] We treated as dependent on the markets all those who carried on *no or hardly any* activities in crop cultivation *and* animal husbandry. On the other hand, we considered self-sufficient all those who were *nearly or fully self-sufficient* in both regards.

Table 2

Grade of self-sufficiency among cultivators/breeders in Balassagyarmat and its vicinity, 1994 (percent)

Self-sufficiency covers requirements of family in	meat	vegetables, fruits
a small part	24.0	21.9
a third	8.7	9.4
a half	20.4	22.1
most of it	22.2	25.9
totally	24.7	20.8
N=	275	448

Table 3

Self-sufficiency and dependence on markets according to social groups in Balassagyarmat and its vicinity, 1994 (percent)

	Grade of self-sufficiency in vegetables and meat*			Market oriented production**	All (N=)
	dependency on markets	mixed	self-sufficient		
type of settlement					
Balassagyarmat	53.5	39.2	7.3	14.5	296
villages	11.2	38.8	50.0	22.4	263
ages					
18–35	39.8	38.6	21.6	20.8	178
36–50	35.5	38.6	25.9	19.8	202
51–65	24.7	39.7	35.6	13.6	177
Total	33.4	39.0	27.6	18.3	559

*Together 100 percent.
**Percent of the housholds in the related category.

In examining the market orientation of small-scale production (especially its income-gaining role) or the intensity of self-sufficiency, there are two factors whose respective roles are obvious. Various types of small-scale production can be linked to the *nature of the settlement and to generations (i.e. years of age of the persons interviewed)*. All other factors can only be interpreted in the framework of the aforesaid. Both market-orientedness and intensive self-sufficiency are strongly connected to a rural way of life and household economy (*Table 3*). In villages, there are not many individuals who are not involved in one or other form of a small-scale

production; one third of households draw some income from these sources.[6] On the other hand, half of the households are also involved in extended self-sufficiency; at the same time, half of the town households purchase exclusively at the market. Town and village, as factors underlying the different conditions for everyday subsistence (and also favouring different ways of subsistence), are obvious factors of differentiation in household economies.

Another striking feature is the *age specific* nature of small-scale production, although correspondences are weaker. Most people carrying on extended self-sufficiency can be found among the older age categories; most of those dependent on markets can be found among young people and families. As for the market-orientedness of production, the latter are overrepresented. Therefore, younger people either do not carry on small-scale production, or they are involved in market-oriented production. If we consider the *rural subsample* we can confirm the aforesaid, as age is reflected in presence on the market: the older individuals (and middle-aged)—i.e. characteristic of traditional peasant smallholds—produce "for the market too"; on the other hand, youngsters carry out activities in specialised "trucking" instead.

With the help of some reliable variables of social stratification (e.g. educational level and a very much simplified strata variable[7]), a more tinged picture takes form before our eyes. Taking the whole of the area sample, we can see that a food-producing household economy among interviewed people with higher education or in white-collar jobs depends more on markets; in contrast, the lower someone's education, the bigger the chance that his/her household economy is self-sufficient. Nevertheless, we have to consider what decisive impact the type of settlement had, and we should then use this as a control variable!

With regard to the rural part of the sample, the *intensity of self-sufficiency* shows us a different pattern, as the whole sample indicate. In villages, people with middle- and higher education, and white-collar workers, respectively, who are involved in extended self-sufficiency have a participation rate which exceeds the average. This type of relationship is also characteristic of their financial situation (e.g. household incomes, savings capability; *Table 4*). Those who are better-off and have the possibility to put money aside, are more dependent on markets in the area, while the same groups in villages tend to be self-sufficient. Considering the area sample, we can see that inactive households are less characterised by living

[6]Producers trucking exclusively or partly trucking, taken together. It occurs in this study several times that we do not publish a table in full but just one row of data out of it. The tables can be found in the closing study already mentioned (Spéder 1995).

[7]Because of the sample-size, we distinguished only people doing "paperwork" (e.g. managers, employed intellectuals, office-clerks), and "manual workers" (e.g. skilled and semi-skilled workmen and labourers), respectively. We considered them in the context of this study as white- or blue-collar workers, respectively.

Table 4

Small-scale production types in Balassagyarmat and its vicinity according to individual social groups, 1994 (percent)

	Grade of self-sufficiency in vegetables and meat			Rural self-sufficiency*	Market oriented production**
	dependency on markets	mixed	self-sufficient		
educational level					
primary sch. 8th class	22.8	34.4	42.8	56.1	15.2
training sch.	28.4	44.8	26.9	37.2	16.7
sec. school	41.1	40.5	18.5	55.3	22.0
coll./univ.	54.0	36.5	9.5	(50.0)	20.0
strata					
white-collar	52.8	30.2	17.0	62.5	19.7
blue-collar	34.1	37.0	28.9	50.7	21.2
*income class****					
lower	28.3	43.9	27.7	41.0	12.5
middle	33.0	36.2	30.8	57.5	21.2
higher	39.0	36.7	34.3	56.3	19.7
*savings situation*****					
no savings	32.8	39.7	27.5	49.3	16.9
has savings	35.5	36.4	28.2	54.9	23.7
household finances					
perm. worries	39.5	39.5	21.0	40.3	15.5
rare worries	33.3	38.2	28.5	51.3	24.9
getting by	29.3	39.2	31.5	56.1	31.8
no. of activities					
0	26.5	46.4	27.1	40.9	15.9
1	33.3	40.3	26.3	49.5	19.5
2	40.3	33.8	26.3	60.0	19.5
3	35.9	23.1	41.0	63.2	17.1
Total	33.4	39.0	27.6	50.2	18.3

* Percent of those living in villages with given social groups.

** Percent of those living in the area with given social groups.

*** Terciles of household incomes.

**** Whether he/she could make savings in the three months.

"exclusively from markets"; on the other hand, in villages, extended self-sufficiency is more characteristic of active households.

With respect to *market-oriented small-scale production*, the factors examined do not illustrate any clear connections. However, we have established, on the basis of a more detailed examination, that in villages, people with middle- and higher education, those working in offices, who can save from their incomes, who have higher incomes, and who live in active households also carry on market-oriented

production with a higher rate of participation (Spéder 1995). In villages, income-gaining on markets may be linked to higher social status. Of course, connections can also be seen in another light: those carrying on market-oriented production are able to get into a favourable income position, and thus will be able to make savings with great probability. In other words, *we may suppose that market-oriented small-scale production remains a successful form of rural household subsistence.*

Within the food-production of households, preservation (i.e. of fruits, vegetables) was also a subject of our detailed examinations. Here, only the most important connections will be mentioned. With our analysis, we managed to demonstrate three effects. Big households were more active in preservation, so we may conclude that there exists a *scale effect*. The scale effect may be taken for granted, both from the side of requirements and from that of resources. Certain forms of self-sufficiency, in order to be "advantageous", require as a precondition that the household be "big enough". This is primarily because it is in these that circumstances that the *"en masse"* need for cattle emerges; secondly, it is then that sufficient labour is available for self-sufficient activities. The second effect again has its origins in the differences between country and town, in the opportunities for small-scale production, in food-production, and in deeper traditions. This means that villagers and the elderly preserve fruit and vegetables more frequently. Finally, households spend their increased incomes on goods available at the market. This does not necessarily mean that the traditions of preservation of fruit and vegetables has faded out. Thus we may discern two types of preservers: the better-off, who live in bigger households, who systematically preserve, but who also actively purchase on markets; and those in inadequate financial situations who make preserves in order to "avoid" markets.

The analysis of small-scale production made it clear that differences in the settlement type may not only alter but may even reverse the direction of the effects of other socioeconomic variables. It may then be concluded from this assumption that basic structures of subsistence in rural society differ decisively from those in the town (cf. *Farkas and Vajda* 1988; *Kuczi* 1996). Therefore, if our conventional variables seem to be oppositely directed in the two subsample connections (but at the same time they are of substance) it seems then small-scale production and the gaining of income and intensive self-sufficiency have a different function in subsistence. Thus they may play a different role in stratification. More precisely, in villages both income from small-scale production and intensive self-sufficiency are (pre)conditions of favourable social status. The (otherwise) more favourably situated townspeople are, on the other hand, presumably more dependent on markets with respect to food-supply. Furthermore, it can be remarked, that with regard to preservation, it is an important circumstance whether one is living in the town or in the country. This is why the scale effect must be considered.

Everyday household chores and the attraction of markets and self-sufficiency

Although small-scale production and certain services (e.g. painting, car repairs, laundering) can, in part, provide for the family (and it is done in the family sphere), they logically have the same function in the household economy (i.e. both necessary working hours and other household resources, and, in both cases, market substitutes are available etc). It is still advisable to handle each type of activity separately. This is because small-scale production—given its history over several decades and its impact on current economic behaviour—can be seen as a special feature within household economy. On the other hand, we were "forced" to take this approach because we could not analyse intensity scales which comprised every possible activity with a many-sided model. In our interpretation, the reason for this may be that many small-scale enterprises came into existence or were generated by different relations. Furthermore, there is a need to justify why we have dealt with certain work done on a house or with the reshaping of an apartment only (and not with house-building, albeit it is known that house-building with one's own resources has, traditionally, been the most far-reaching area of self-sufficient-informal work in Hungary (*Dávid* 1980; Farkas and Vajda 1988)). The motive lying behind our questions focused the *current activities* of households. We were aware of the fact that this distinction is operative; however, researchers must somehow confine their subject of inquiry within certain limits. Our stress was upon activities carried on everyday and in a systematic way (i.e. frequently routine-like); therefore "great projects" of household operation, such as house-building or marrying off of children, do not feature heavily in our investigations.[8]

As is well-known, various kinds of work and jobs for solving problematic situations have been standardised by a number of researchers. As a first step, we distinguished four kinds of work, each having a different logic. These are: self-sufficiency in the household economy; supply from markets; jobs done in a network (e.g. relatives and friends) either with (a) income or (b) done as a favour. Shares of the above-mentioned supply institutions according to individual tasks are shown in *Table 5*.

Certain everyday household chores are not indicated in the table (e.g. laundering, cooking, tidying up etc.) because these are done by households themselves without exception. On the basis of this table it can be seen that the importance of various institutions is very different for different households. With regard to the

[8] It is to be noted here that we can easily imagine the other approach that focuses on "great projects" of the household: that is, establishing the family economy, childbirth, getting an apartment or house-building, the parallel career of the married couple on the labour market (as well as their informal economic career), the shaping of connections of generations, and potential divorce and its consequences etc. However, in these cases it is probably more advisable to use another methodology (cf. Jessen et al. 1988). When we were completing our analyses we used further combinations of particular elements because of the small number of general elements.

Table 5

The use of individual institutions for producing welfare in carrying out everyday chores in Balassagyarmat and its vicinity, 1994 (percent)

Activities	Respective proportions of families doing jobs	Use of institutions				
		house-hold	inform. as a favour	inform. for money	market	other
painting-paperhanging	95.5	44.0	14.9	6.9	32.1	2.1
floor covering	58.6	31.9	11.9	5.5	48.0	2.7
oil painting	85.4	66.8	11.1	2.9	18.0	1.3
glazing	61.3	20.1	8.4	2.6	68.0	0.9
making a bathroom	54.0	26.1	9.9	5.6	53.8	4.6
building a garage	42.8	44.2	14.6	3.3	35.9	2.9
building a flat in attic	9.8	29.1	10.9	1.8	54.5	3.6
building a central heating system	40.6	10.5	7.5	5.7	75.0	1.3
extension of apartment	15.9	47.2	5.6	5.6	41.6	0.0
building a pantry	29.8	70.7	15.0	0.0	11.4	3.0
dressmaking/tailoring	56.1	48.6	18.7	1.3	29.8	1.6
knitting	57.0	77.0	17.5	1.3	0.8	3.4
clothes repair	98.2	87.1	36.0	0.0	0.4	8.9
car wash	50.1	95.4	1.4	0.0	2.8	0.4
lube check	45.3	92.9	2.4	0.8	3.5	0.4
bulb change	46.3	91.2	3.5	0.4	3.8	1.2
oil change	45.3	70.1	5.1	0.4	24.0	0.4
brake repair	47.3	39.8	6.4	1.9	51.5	0.4
tuning ignition	46.2	39.0	8.5	2.3	49.8	0.4
preparation for technical test	46.2	23.6	7.7	3.5	64.5	0.8

connections between self-sufficiency and markets, the extension of household economic self-sufficiency seems to be somewhat smaller. Moreover, it can be stated as a fact that one precondition for using market labour is the "existence of objects of great value", and the need for "skill" (Jessen et al. 1988). All the respective kinds of work done by network connections are done more frequently *as a favour* than for money. Therefore, work done through a network of connections can be seen more as an "extension" of household economic activities. What is more, it can also be stated as a fact that no single one of these institutions can be seen as exclusive. We have made detailed analyses of only two of the above services—i.e. oil painting and dressmaking/tailoring. In the following our analytic results are given for the former only.

Home maintenance jobs which occur systematically are relatively few. One job which is widespread is painting/wallpaper hanging. Another good reason for selecting this is that the relationship between welfare producing institutions and

socioeconomic features can be seen most clearly.[9] The distribution of "institutions" of oil painting according to type of settlement shows a difference, depending on whether this activity is based either on own resources or on a connections-network. In towns, households tend to do these jobs themselves (*Table 6*). Age may also be an explanation for the choice of two variations: young people do painting and wallpaper hanging themselves; older people prefer to get it done through a network. If we look at how individual institutions are used according to educational level, then one thing we can see is that the higher the educational level of the people interviewed, the more they make use of market institutions. On the other hand, those on the lowest level clearly "prefer" an informal network, while those on the middle level do the work themselves.

Examining the income terciles, it becomes clear that household self-sufficiency is positively related to income position, while the use of informal resources or markets is negatively related to income position. This means that the better the income position of a household, the more likely it is that its members do painting and wallpaper hanging themselves. The variable describing the household's financial position seems to have an opposite effect. With respect to financial tensions in the household economy, the following can be established: if troubles are frequent, household self-servicing is more widespread, whereas if financial headaches are rare, then market institutions are utilised. Thus we can suppose that those with good income positions resort to self-sufficiency if they feel narrowness in connection with the household budget. In painting/wallpaper hanging the presumed effect mechanism seems to "work": in the case of the "sensed" narrowness of a household budget, markets are changed to self-sufficiency. Finally, household self-sufficiency is more likely if the family is bigger and has a greater number of economically active members. This characterisation shows the importance of labour resources as a basis for household self-sufficiency.

Analysing painting/wallpaper hanging and dressmaking/tailoring, or having a dress made or clothes tailored, respectively, our research gave the impression that these activities are more widespread in town and among young people (Spéder, 1995). We could not see a clear link between different social strata. The supposition cannot be rejected that resorting to markets is becoming more widespread (but it does depend on financial positions); we may, at the same time, establish that the "urbane" activities examined are not done most frequently by those in the worst positions. Rather, it is those in middle and better positions who realise their clothing demands themselves or go to a dressmaker or tailor.

[9] Also, there have been connections in other fields (e.g. parquet laying, oil painting, renovation of bathroom); however, these were weaker. Therefore, it is not thoroughly justified to speak of painting/wallpaper hanging as a typical home maintenance activity.

Table 6

Painting and wallpaper hanging according to institutions of work done in Balassagyarmat and its vicinity, 1994 (percent)

	Institutions of work done through: household	connections-network	market	Total N=(100%)
settlem. type				
Balassagyarmat	48.0	18.1	33.9	277
villages	41.4	26.9	31.7	249
age group				
18–35	58.9	14.7	33.9	277
36–50	44.6	23.3	32.1	193
51–65	32.1	28.6	39.3	168
educational level				
primary school 8th class	37.4	35.1	27.5	171
training sch.	51.5	16.9	31.5	130
sec. school	47.3	16.2	35.9	167
coll./univ.	(42.4)	(13.6)	(44.1)	59
strata				
white-collar	46.6	16.5	46.9	103
blue-collar	41.2	24.4	34.4	131
income class				
lower	36.3	28.1	35.6	160
middle	45.6	21.7	32.8	180
higher	54.0	16.5	29.5	176
household finances				
perm. worries	51.7	22.4	25.9	143
rare worries	46.9	21.6	31.5	162
getting by	38.9	22.2	38.9	221
no. of family members				
1	(22.5)	(37.5)	(40.0)	40
2	31.4	26.3	42.4	118
3	52.9	14.0	33.1	121
4	51.0	21.0	28.0	157
5	(50.8)	(24.6)	(24.6)	61
6+	(50.0)	(20.0)	(30.0)	30
no. of actives				
0	35.8	25.2	39.0	159
1	43.7	24.7	31.6	174
2	51.3	18.8	29.9	154
3+	(60.0)	(12.5)	(27.5)	40
in the whole sample	44.8	22.2	33.0	527

Consumer behaviour: many-sided supply and the segmentation of utilisation

At the beginning of the nineties an excess supply prevailed on the commodity markets. This development meant and still means new opportunities for households. In the nineties the possibility and pressure of selection became a normal feature, in contrast to the previous situation, which was characterised by queues. Prior to the systemic change a household could decide whether it would buy a certain commodity or not; now it can compare quality parameters, guarantees, design and, perhaps most important, prices. Moreover, "searching and orientation" among trade institutions became a part of the overall subsistence strategy of households. What is characteristic of household behaviour on commodity markets in Balassagyarmat and its neighbouring districts? When forming our research concept, we supposed that preferences could be expressed according to trade institutions and the types of store in which households make their purchases. Consequently, we presented a very detailed list of business types[10] when asking people where they bought flour, coffee, detergents, underwear, books etc. While forming types, we took into careful consideration the differences between informal and formal institutions in order to be able to distinguish the more traditional and the "more modern" trade institutions, respectively. We identified four types of stores which we considered as traditional stores with regard to speciality and typicality in the context of the department stores which existed in Hungary in the later period of state socialism. During that period private trade was generally understood as meaning small stores with one or two sales assistants. Discount stores were characterised by a poor assortment and low prices. We ranked informal market places—formed in the late 1980s—as belonging to the category of COMECON market places.

In our research we found difficult to ascertain exactly what preferences belonged to particular business types. We have supposed that purchasing in a discount store means a lower price level and a somewhat narrower assortment. We consider that it would not be a mistake to state that purchasing in COMECON markets was characterised by low prices and poor quality standards; furthermore, there was no possibility for consumer protection (e.g. no system for registering complaints, no guarantees). Also it was one of our suppositions that private merchants generally have a more fashionable, more up-to-date choice of goods compared with other store types.

Furthermore, we examined whether households made use of price reductions, winter-summer sales, or took advantages of the opportunity to buy in bulk. In order

[10] Choice: 1. Slovakia; 2. supermarket; 3. department store (Ipoly, Centrum etc.); 4. boutiques, private merchants (indoors); 6. discount store; 7. an occasional vendor in the street; 8. market place, COMECON-market; 9. old clothes store, store selling old clothes by weight; 10. peddler, door-to-door salesman, ordering by catalogue, teleshop; 11. from an acquaintance as first hand; 12. other places.

Table 7

Distribution of various shopping places according to consumer goods (percent)

Goods	bought by interviewed %	store types					total N=(100%)
		"traditional" store	discount store	priv. merchant	COMECON informal market	other	
sweets	87.0	66.3	19.9	4.5	2.1	7.2	487
coffee	91.1	59.2	26.5	4.9	6.5	2.9	510
cigarettes	58.4	45.6	22.6	19.3	8.3	4.3	327
flour	99.8	50.6	41.7	4.1	0.7	2.9	559
meat	81.6	80.7	10.3	2.0	3.5	3.5	455
vegetables	52.7	15.9	1.4	8.1	71.2	3.4	295
detergents	99.1	52.2	38.6	3.8	2.5	2.9	559
cosmetics	79.6	58.7	19.7	7.8	3.4	10.3	446
underwear	96.1	56.3	–	4.6	35.3	3.7	538
shirt, blouse	92.0	47.6	–	12.6	36.1	4.7	515
coat	87.9	52.2	–	17.3	23.8	6.7	492
shoes	94.5	59.2	–	14.2	21.6	4.5	529
books	63.9	68.2	–	1.4	8.9	21.5	358
tech. goods	78.2	83.1	0.9	2.3	6.8	6.8	438
batteries	90.5	77.5	8.5	4.3	7.3	2.4	507
tools	58.6	53.4	0.3	1.2	32.0	13.1	328

to control subjective beliefs, we also put the question as to whether a purchase had actually taken place. We found that between a quarter to two-thirds of households pay attention to, and make use of opportunities to buy cheaper.

Another aspect of our inquiry was to find out if there was any connection between socioeconomic variables and the use of various types of store. Other investigations have so far found that the link between store types and other elements of purchase strategies, respectively, have an insignificant correlation with social groups. In other words, it seems to be taken for granted that all social strata use all kinds of stores (Ékes 1992; Harcsa 1994). Nevertheless, according to our inquires in Balassagyarmat, the use of the opportunity to make cheaper purchases can clearly be linked to certain social groups.

In examining the use of trade institutions, we were able to establish that *disadvantaged groups clearly prefer COMECON markets* (*Table 8*). This is true with respect to all those goods in which COMECON markets otherwise have a decisive share.[11] This preference does not depend on factors like settlement or age; however, there does seem to be a marked connection with educational level,

[11] In this study we show the data for buying shirts and blouses only. Data regarding the purchase of coats and underwear show a similar picture (Spéder 1995, pp. 44–47.).

Table 8

Use of trading facilities when buying shirts and blouses according to social groups in Balassagyarmat and its vicinity, 1994 (percent)

	Types of trading facilities			Total
	traditional store	private merchant	COMECON market	N=(100%)
type of settlement				
Balassagyarmat	49.3	15.3	35.4	268
villages	50.9	10.4	38.7	222
age ranges				
18–35	42.6	20.1	37.3	169
36–50	50.5	12.8	36.7	188
51–65	57.3	5.3	37.4	131
educational level				
primary school 8th class	45.9	4.1	50.5	148
training sch.	52.9	12.4	34.7	121
sec. school	50.9	16.1	32.9	161
coll./univ.	(50.8)	(29.5)	(19.7)	61
strata				
white-collar	46.3	25.0	28.7	108
blue-collar	46.6	13.0	40.5	131
income class				
lower	46.2	3.8	50.0	132
middle	52.0	10.3	37.7	175
higher	51.4	20.6	28.0	175
any savings?				
no	51.2	9.9	38.9	383
yes	44.3	25.5	30.2	106
actives in household				
inactives only	51.6	8.7	39.7	126
actives, too	49.4	14.8	35.8	365
household finances				
perm. worries	42.1	5.6	49.3	140
rare worries	49.4	11.1	39.0	154
getting by	56.1	17.9	26.0	196
Total sample	49.6	13.3	37.1	(100%)

income position, and the ability to save money. On COMECON markets, blue-collar workers are purchasers with lower educational levels, with lower incomes, and scarce possibilities for saving money. The variables which indicate tensions with respect to household budgets show that those households with narrow means partly solve their problems by purchasing on the COMECON markets. Moreover, the differences between those who prefer "traditional stores" and "private merchants or a boutique", respectively, are substantial. Young people, white-collar employees,

those in better income positions, and those with higher educational levels prefer private merchants (*Table 8*). This is especially true with respect to purchases of greater value (e.g. coats).

Can elements of segregation be shown in other features of household market behaviour—for instance, in making use of opportunities to buy "cheap"? It is well known that a commodity may often be cheaper (e.g. in a discount store), if one buys it in bulk or if one buys in (seasonal) sales and price reductions. It is obvious that it is of great help for those with narrow means if they can make use of these advantages. Thus it is to be expected that they will "search" for these advantages with special care and will try to "orient" themselves towards them. However, we are also aware of the fact that in both cases additional financial resources are needed, since buying these goods makes it necessary to advance consumption expenses, and to cover future consumption with today's income.

Those in better social positions (i.e. with higher educational and income levels) avail themselves more frequently of the mentioned opportunities than others (*Table 9*). There is, naturally, a difference between the realisation of respective purchase options. Purchase in "bigger batches" is solely connected with income positions. Making use of winter-summer sales and price reductions is in connection, beside income position, with educational levels, and even with age. No substantial difference can be shown between Balassagyarmat and the neighbouring villages. As it turns out, the proportion of those making use of cheaper purchase opportunities rises with the increase in the number of active earners living in a household, and also with the growth of the household itself. Thus in this case as well, scale effect is proved beside income effect.

After reviewing two areas of consumer behaviour, we were able to establish that a clear differentiation can be discerned in consumer activities. Different social groups buy at different places, and in a different manner. The well-off prefer private merchants, while the relatively disadvantaged are reduced to the assortment of COMECON markets. Most people still buy, of course, in traditional stores; what is more, for example, in the case of buying underwear, differentiation works between this store type and COMECON markets. Cheaper buying opportunities are theoretically open for anybody and everybody—in other words, the better-off can also use such opportunities. The effect mechanism is, presumably, as expected: to buy in bulk, to pay for consumption in advance and to be able to store goods, requires freely disposable (and a substantial quantity of) money and savings.

Summary: stratification, bonds to the settlement, and scale effect

After analysing individual fields of household economy, we may put the question again: what strata are most characterised by self-supporting household pro-

Table 9

Making use of opportunities to buy cheap goods, according to social groups (percent)

	Proportion of those making use of buying in bulk	in winter sales	in price reduct.	Total N=(100%)
type of settlement				
Balassagyarmat	62.9	50.7	59.7	286
villages	63.7	35.0	52.5	262
Age ranges				
18–35	69.2	54.5	68.8	172
36–50	63.8	46.5	56.5	199
51–65	56.6	28.8	43.8	175
educational level				
primary school 8th class	59.1	31.0	48.4	181
training sch.	65.9	42.8	56.9	138
sec. school	64.9	47.4	62.6	168
coll./univ.	(66.1)	(69.2)	(61.5)	62
strata				
white-collar	67.6	64.3	65.2	108
blue-collar	66.2	40.1	60.7	136
income class				
lower	54.3	29.0	43.1	173
middle	64.1	41.8	59.4	184
higher	71.7	58.5	66.5	180
has savings?				
no	62.1	41.0	52.6	114
yes	668.1	53.5	71.7	444
no. of actives in household				
0	57.5	27.6	41.4	167
1	61.3	47.4	59.3	186
2	66.2	52.8	69.4	157
3	(57.2)	(53.7)	(55.0)	39
household finances				
perm. worries	59.9	38.9	45.3	157
rare worries	62.2	49.4	65.1	164
getting by	67.0	42.4	58.1	227

duction? Or, to put it in another way: in what way does work done in the household for one's own purposes modify primary structural processes? Furthermore: who are present on markets, and how do they purchase?

The fact that the *role of markets* is differentiated, even segmented, can be proved in each field. It goes without saying that the better financial and social position one has, his/her household economy is more dependent on markets. On the other hand, people living among different circumstances use different aspects of markets; they go to "other places" to do shopping. The better-off prefer stores with

goods of higher quality and/or a more fashionable assortment, while the disadvantaged have no other option than to buy in COMECON markets which offer goods at lower price levels but of an unreliable quality. On the third count, occasional price reductions and rebates when purchasing in bulk can be made use of by the better-off having reserves and savings.

On the other hand, *self-sufficient* type production *done in the household economy* cannot be explained with a uniform logic. This activity may presumably be the result of the combined impact of various motives (Pahl 1984). After analysing individual activities, we experienced the effect of three explanatory principles. These are: bonds to the settlement, stratification effect, and scale effect.

"Town" and "country" indicate different respective conditions with regard to the everyday living of households. On the one hand, living and housing circumstances can be linked to settlement and they define "conditions of function". On the other hand, there are also patterns which are rooted in the past and which are connected to the "place" (Jessen et al. 1988; Kuczi 1996). It may be taken for granted that, in villages, an extended and intensive system of self-sufficient food production is carried on; self-sufficiency, exceeding the average in town, also exists in other fields. Contrary to the "rural" character of self-sufficient food production, dressmaking/tailoring and painting/wallpaper hanging might be called "urban" self-service activities. It looks like there is a difference between the motivation behind the respective systems of self-sufficiency in town and country.

It is not easy to formulate a final conclusion with regard to stratification and self-sufficiency, since the explored connections do not point in the same direction. Anyhow, it can be stated that it is not the households of the disadvantaged that are characterised by intensive self-sufficiency. Even the poorest do unpaid work at home, but in their case it is not so extended as it is in well-off households. Nevertheless, it cannot be said that intensive work done at home is characteristic of those in the best positions, since they—even if they do not abandon self-sufficiency—enter the consumer market as early as possible (to say nothing of the fact that urban, well-off households are clearly living from markets). Following this logic, we may not be far from the truth in supposing that unpaid work done in the household is the most characteristic of those in middle positions.

Finally, the scale effect needs to be considered. In a bigger household it is not only the needs that are bigger but, for them, a bigger and more differentiated wealth of labour is available. Consequently, it is not surprising that the apparent connections occasionally indicate a more intensive self-sufficiency among bigger households.

In the course of the analysis, we acquired a picture of the relations among the three effect mechanisms; this picture tells us that their significance may be ranked according to individual activities, but not with respect to the entire household. All this poses a range of questions, and we would like to consider one of these in concluding our article. If we can understand techniques of household economy only

on the basis of a separate logic, then this might also warn us to handle all the notions that try to describe techniques of everyday living on the basis of a uniform model. We cannot, of course, exclude the possibility that another explaining principle (i.e. not examined in the course of the research) lurks behind the mentioned self-sufficient activities. However, until the latter has been proved, for us the truth is the following: everyday living is formed as a result of combined effects of many kinds of motives.

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HOUSEHOLD ECONOMY: YESTERDAY AND TODAY (CONCERNING A PROBLEM IN CONNECTION WITH AN EMPIRIC STUDY)

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This study concerns a relatively less industrialised micro-region of Hungary. After the systemic change in 1989–90, plants which had been established in this micro-region about 20 years ago were closed down; due to this situation mass, long-term unemployment has become a dominating negative feature of the micro-region. Among other things, the study looks at the role of agricultural small scale production in the lives of the people of the micro-region. Historical circumstances help to explain the considerable role of this form of "second economy"; moreover, in the late period of state socialism different forms of household farming were created in areas involving commodity production and cooperation.

Since the systemic change, small-scale agricultural production has undergone a radical transformation and one of its aspects has been the breaking up, termination and change of the integrated aspects of the agricultural cooperatives. Another important point is that this sphere has also shifted towards the market economy (because it could no longer operate according to the previous methods which involved gaining income from employment and commodity production in the form of an "extra". Small scale production requires considerable—and very risky—capital investments; the strata of society which formerly were dealing with household farming could not allow themselves such investments due to lack of means. Consequently, there are less and less people who can successfully combine their employment in the "first" economy with part-time commodity production in household farming; furthermore, easy adaptation at any time into the commodity producing branch is something which no longer exists as a possibility.

About the examination

We can find unemployment in towns and regions which can look back to at least a century of industrialisation, to generations of industrial workers, to a culture of industrial labour, and to well-established urbanisation. Such unemployment is a consequence of a crisis in the backward (usually heavy industrial) branches (e.g. mining, metallurgy). However, it is quite another problem when mass unemployment occurs in rural settlements where industrialisation was set-up only a few decades ago. At the time of establishment (of the industry) masses were forced to become industrial workers, despite the fact they were living in villages. Thus there began for such workers a half-proletarian existence which rendered a peculiar way of life and culture of working. Unemployment in the latter situation requires a completely different kind of interpretation with regard to life-chances, resource acquisition, and possibilities emerging for those concerned. Perhaps more important

0001–6373/95/$5.00

is the way these people themselves interpret and evaluate their positions, as well as the alternative strategies they develop for continuing their lives.

Taking into account the above points of view we would like to describe the specific types of (dramatic) processes which have taken place in the Hungarian economy and labour market. Our quest was to seek an answer to a problem: namely, what happens to a region and its inhabitants—which until the seventies had mainly been of an agricultural character and then had been industrialised—when (i.e. in the nineties), due to crisis the industrial plants in the region have to be closed down and employees laid off? We considered such a region and the settlements concerned; in other words, we studied settlements which, in the nineties, began or were forced to take a new development course. Given the few years that have passed since the collapse of local industry, we were not able to draw a concrete conclusion. The process of industrialisation has obviously slowed down, its dynamic has been broken, and its nationalised status has come to an end. At present, it is not possible to recognise whether this standstill is temporary, or whether the stagnation will be long lasting; in other words, is it a halt in development or does it mark the beginning of the formation of a new development course? In fact, it can be assumed that people who became industrial workers and organised their lives, their way of living, and their careers according to these circumstances—after the closing down of the factories and their being laid off—have found a completely new kind of labour market, new employment and new living conditions. However, the question is: compared to the earning possibilities and development course offered by former industrialised circumstances, have the above-mentioned withdrawal of capital and subsequent mass dismissals, the high and permanent unemployment, and the privatisation of the land, been followed by alternatives and possibilities that enable local people to make a living? Do they still have the opportunity (and do they want it) to be industrial workers or employees, or is there a chance of orientation towards agricultural small scale production? Alternalively, can they continue with a combination of being industrial workers and agricultural small scale producers—i.e. a kind of half-proletarian existence? Or, is it the case that they have to live on state benefits and casual labour? Related to all this is the question of the available resources of those concerned. How do they realise and evaluate their existence and their possibilities? What personal and family values do they have? In what direction are they capable of organising their lives? How can they survive and what strategies do they have for breaking out of their situation?

We chose for our study, among the above-described type of industrialised regions, a site in the middle of Hungary. This was because of its peculiar historical development—it seemed to be ideal for conducting our examination. This micro-region (Kunhegyes, Tiszabura, Tiszaroff, Tiszagyenda, Tomajmonostora, Abádszalók) is situated between main routes of the macro-structure of Hungary's transport system, but lies at a considerable distance from these corridors—i.e. to the north of the Budapest-Hatvan-Miskolc route, and to the south of the Budapest-Szolnok-

Debrecen traffic corridor. (These routes refer to railway lines and road traffic.) The two main railway lines are connected with a lesser-used branch line. The beginnings of this infrastructure were constructed in the second half of the last century, during the course of capitalist development and the construction of the national railway network. The necessity and demand for connections with these main transport lines were always stressed by the local authorities and politically supported by them. However, over the past century these settlements have not been able to achieve a decisive break through with respect to this necessity.

Since the early beginnings of capitalist development, the possibilities and dynamics of these settlements and micro-region have depended more and more on the connection to the above-mentioned traffic corridors and main networks. The transformation and development of those rural areas where this connection has been achieved have been more dynamic with respect to links with rapidly developing towns and to vital traffic and transport corridors.

The micro-region—i.e. the target of our study—is a town surrounded by five villages. It is situated in a peripheral zone, with hardly any links with mainstream industrialisation, nor with the capitalist and infrastructural development processes which have taken place over the last century. The first significant capital investment was made in this region only in this century—in fact, only at the beginning of the seventies! A telecommunications factory employing several hundred labourers was established in a village; this was later developed into a big company with about a thousand employees (in the middle of the eighties). However, right from the start this industrial investment was backward and behind time by almost a century. The technology adopted was of a low level, and the end-product could be exported only to the Soviet Union. Twenty years later the whole investment, and the development based on it, collapsed.

The collapse occurred because this big company—and several smaller ones established in the seventies—were all closed down. The employees were made redundant and at those companies which remained in operation in these settlements the number of employees was significantly reduced. Thus mass long-term unemployment has appeared in this area and this is due to the lack of investments.

The data in *Table 1* illustrate an ominous picture of the employment situation, but the reality is even worse. In some settlements the proportion of registered unemployed has reached 42–44 percent, the *real* situation is considerably worse. For instance, the majority of registered unemployed—60–80 percent—were receiving an income supplement in some villages, indicating the persistent nature of their unemployment. Likewise, the serious situation is reflected by the fact that, according to the local employment office, the number of non-registered unemployed was around 2400; in other words, nearly the same number as those registered as unemployed (2600).

This study intends to reveal what has happened to the people made redundant from different industrial plants after they received their notice. The majority of

Table 1

The respective percentages of registered unemployed between 1992–1995

Settlements	Dec. 1992	Dec. 1993	Dec. 1994	June 1995
A[a]	33.4	29.8	23.0	19.8
B[a]	29.3	31.8	22.3	20.7
C[a]	23.7	26.2	27.3	24.4
D[a]	23.9	29.9	25.0	33.3
E[a]	28.3	41.6	36.8	31.3
F[a]	43.7	39.2	28.8	25.5
regional average[b]	29.6	29.5	24.6	22.9
county average[c]	12.3	16.1	14.5	13.4
national average[d]	12.3	12.1	10.4	10.1

[a]in the individual settlements studied;
[b]average percentage in this particular region of Jsz-Nagykun-Szolnok county;
[c]average percentage for the whole of Jsz-Nagykun-Szolnok county;
[d]as an average for the whole nation

their number were first generation industrial workers and workers in agricultural cooperatives. Some of them were involved in household farming activities, and some of them—as a result of the new land reform—were given back land which formerly had belonged to them. In our study we have placed stress upon showing the individual and family resources which have been used on the owned land, and the means available for agricultural production. Household farming activities which took place in the past are considered, and the production forms and experiences gained through experience have been taken into account. Future intentions and possibilities for production also received special attention. We have described some of the connections involved with these problems, based on the data of the people made redundant from local agricultural cooperatives, local industrial units, and other productive units.[1]

A breakthrough towards household farming activities

From the beginning of the seventies, due to the location of industry, the employment situation in the region improved considerably. In the life and income of

[1]We feel there is no reason here to differentiate between those laid off from agriculture and those laid off from industry. The random pattern taken of the list of those dismissed from agricultural and industrial plants included 290 and 450 persons respectively. Eventually, we received questionnaires worth evaluating from 271 agricultural and from 414 industrial workers.

several families the turning point was the employment of women—i.e. the spreading of the family model in which there are two wage-earners. The newly employed had jobs which secured a regular monthly income; although these incomes were not the same level as urban wages and there was no guaranteed social security, these newly employed were better off than those doing casual work. One of the beneficial effects of establishing industrial plants was the emergence of the necessity to raise the salaries of those who were employed in agriculture, local industry and services. This was in order to avoid fluctuations in labour force which could even endanger productivity. Similarly, with the introduction and spreading of a culture of labour, considerable beneficial effects were felt in local workplaces. These included: working hours were determined for a concrete period of the day; there was a transition from 5 and a half days to a five-day weekly working order; the working conditions in plants improved; the technological prescriptions and discipline were updated; the possibilities of washing oneself after work and having clean clothes became a reality; there was guaranteed annual leave, with a part of it guaranteed in the summer; work canteens became a normal feature; and there were premiums and awards for employees in connection with national anniversaries and holidays.

Altogether, from the seventies the income of these families considerably improved. This allowed the reduction of dependency on agricultural small scale production (albeit it continued to play an important role in their lives and in household management). Families were forced in this direction by the full-time employment of the wife or other members of the family capable of work. In other words, no "free" member remained in the household, and after an eight-hour working day or the changing shifts—which consumed a good deal of time—high level agricultural production was impossible. Young people, after finishing the obligatory general school, continued their studies in a secondary school or took jobs, whatever the case, their continued studies or their employment led them in a direction which was away from agricultural activity. Consequently, agricultural production could not be based on their motivation, and readiness to help in this area of labour. Meanwhile, with the spreading of industry and services, important elements of lifestyle and consumption habits changed. New values emerged—for instance, there was more time for leisure and more comfortable living patterns; all these elements had the effect of decreasing agricultural production. At that time, the size of building plots—due to administrative measures—became considerably smaller compared to the average 600–800 square fathom (1 sq. fathom=38.32 sq.foot) in the former peasant farming period. Later it became 400 sq. fathoms, and in the eighties 200 sq. fathom building plots became the average. This fact of decrease also showed the regression of household agricultural production because on this size of plot larger farm buildings (e.g. stables, machine-sheds, barns, stores etc.) could not be built; in fact, only vegetable and fruit production was possible and this for the satisfaction of household needs.

At that time cooperative and household farming were dominated by traditional farming principles and practice. The active influence of traditions meant

that the principle of standing on "more than two legs" was very much alive in the cooperative. This principle had been developed during the former manorial and peasant farming times; it refers to the subordination of plant cultivation to animal husbandry through self sufficiency in fodder supply. There was an almost unchangeable survival of plant cultivation: wheat, barley, maize, sunflower, rape, and where it was possible sugar-beet and orchards. Animal husbandry involved pig, sheep and cow. Industrial crops were grown as "remainders" and only when they did not effect these basic principles outlined above.

Household farming was ruled by the same principles: standing on "more than two legs" and self sufficiency. The demand for fodder needed for the pigs, hens, ducks etc. for household consumption determined the culture of plant cultivation on household plots. This meant that maize was mainly grown on these plots until the end of the seventies and the beginning of the eighties.

After the fusion of cooperative, from the middle of the seventies mechanization accelerated, closed production systems and livestock raising sites were established. In all this a significant role was played by young experts educated in the practices of large-scale farming. This modernisation and economic rationalisation co-existed with traditional farming and employment principles and practice for a long period of time. Naturally, they were gradually eroded and transformed by the appearance of the tractor and combine harvester drivers, technicians, truck drivers, masons, and lock-smiths employed in the auxilliary branches. These specialists had several trades and their respective activities and, professional knowledge, working hours, income, scale of values and aims could be compared with those of the industrial workers, rather than with the traditional peasant world of their parents and grandparents. Many of them worked a five-day week like their neighbours and acquaintances living in the same village but who were not employed in agriculture. The extra leisure time they now had was utilised for their individual or family growth and consumption and this helped to organise their spending possibilities and patterns in their leisure time, like those of other workers.

One of the most important changes was a shift towards production and monetary conditions. Management forms emerged and gained ground; these were based primarily on production considerations and calculations. The quantity of maize grown on 0.57 hectares of household plot satisfied the fodder demand for household poultry and pigs. If a family started to grow on the same household plot onions, poppy (for the seed), pumpkin or potato, their quantity considerably surpassed the demands of the household. The aim of production definitely became selling.

The specialisation which shaped certain production profiles moved in the direction of commodity production. Household farms fattening 80, 100 or 200 pigs annually, or small scale production in closed cycle units breeding 18–30 thousand poultry transgressed the cautious peasant mentality of "producing small and keeping small quantities of all kinds". Furthermore, these ventures required—compared to the then average incomes—significant investments, lending and credit proce-

dures; apart from all that, they were rather risky. The function of household farming which had evolved up until then was to help improve the living standards of the family, to satisfy certain needs of the household, to "redeem" incomes coming from the "first" economy, and to achieve some growth in the income of the family. Besides these aims, new operational goals and forms appeared and spread. Household farming was considered as an equal source of income alongside the "first" economy; later, it became the first and most important source of income. The agricultural experts at the beginning of the eighties earned the same amount of net income from a 0.57 hectares household plot as they did with their annual income in the "first" economy. Moreover, those who put together 6–7 household plots and were contracted to cultivate melons no longer regarded household plots as playing a supplementary, auxilliary role. For the poultry breeders who marketed a yearly 30 thousand poultry, household farming was their main occupation. This activity yielded an incomparably higher income than their former posts in the "first" economy.

A key role was played in this transformation by the cooperatives, especially by young experts and leaders. They collected information and forwarded it to different interest groups operating household plots. They were alert in looking around for opportunities and were cunning if needed. They kept an eye on everything; they made their opinions heard and they argued. They kept silent if necessary and accepted that, occasionally, "they were left to face the music". They continuously expanded their possibilities. They used their abilities to influence the authorities and if necessary they produced capital for the sake of development. Without this entrepreneurial mentality and business rationality in some villages it would have been impossible to develop household farming into an independent branch, or to establish combined units of poultry and pig breeding in part of an area or even the whole of it. The knowledge of secondary and highly educated agricultural experts was needed in order to get used to, and to spread production processes, methods and principles of—until then—unknown plant and animal cultures. Due to their professional knowledge they tried this "acclimatisation" process in the region and if they were successful, other farmers followed them. These rural layers had a network of connections needed for buying new propagation materials, animal breeding stocks, machines and technology, and for marketing their products. They developed their economic, political, professional network of connections in order to introduce—up until then—unknown vegetable cultures in these villages. It was in these villages that the buying and selling were carried out. They had information about market demand, about the price level of products and about the feasibility of what to produce. They found the buyers, and made bargains with regard to transport deadlines, prices and discounts.

A further important characteristic feature of the changes was the shift towards more labour intensive-products from the traditional peasant maize-pig household farming. In this particular area market gardening had no traditions. From the

beginning of the eighties the practice of growing poppy, onion, pritamin pepper, skinless pumpkin seed, cucumber, and hybrid maize spread. In these settlements new production knowledge and a new culture of working were introduced. Agricultural experts—including friends, colleagues and acquaintances—introduced and established a new form of household farming: in some cases 5 to 6 people were involved and in others 20–25 people; such groups formed an alliance and put together their household plots, and working as a team they grew potatoes, melon or sugar beet. This "household farming alliance" demanded organisational skills, investment and the taking of risks. Consequently, such undertakings would have been unimaginable without trust and the ability to cooperate.

The above-described forms of the agricultural "second" economy were open and accessible—not just for cooperative members, but for the whole population of a village. Employees working in industry, commerce or administration could join any integrational system of producers, just like the members of cooperatives. Many workers took the opportunity to double their income from the "first" economy. In this way it became easier to satisfy the demands of their family for more consumption and accumulation.

Over a period of time spreading of the different forms of the agricultural "second" economy—mainly large scale commodity production—showed a diversity with respect to geographical area and societal aspects. The differences in time and place could be measured by the appearance of the commodity producing household farming. Some forms appeared at the end of the sixties; in other places these forms occurred half a decade or a decade later. The real break-through began at the beginning of the eighties.

The different cooperative members, social layers of the village, and administrative and educated groups joined the process of household farming, albeit to varying degrees of involvement. This household farming comprised small-scale production and commodity production. It depended not only on the inclination or ability of an individual to initiate the undertaking, but also on the family and local traditions and resources. In the period of household farming a considerable differentiation took place in the villages studied. This differentiation depended on the extent of this income-gaining form, and the role it played in the lives and management of a family household.

The population which comprised the subject of this study was, in the nineties, laid off from industry (e.g. building industry, commerce, transport, and including public health) and from agriculture (e.g. cooperative auxilliary plants)—see *Table 2*. A large proportion of this population lived in households which, over the past decade, had been dealing to some degree with agricultural production. A "large proportion" means nearly three-quarters of the industrial labour force (73 percent), and more than four-fifths of the former cooperative members and employees (83 percent). Their families had animals and grew plants, if for no other purpose than their own consumption. According to our estimations, a figure of

three-quarters of the agricultural small-scale producers (i.e. dismissed from non-agricultural branches)—although it seems rather high—is realistic.

Table 2

The respective proportions of employees made redundant from industry and agriculture, according to their participation level in household and agricultural small scale production during the state socialist period (percent)

Commodity producing level of household and agricultural small-scale production	industrial redundancies	agricultural redundancies
not dealing with agricultural production	27.4	16.6
production only for own use	57.0	42.5
production for own use; the surplus sold	9.7	21.1
production for own use, but large part of products sold	3.4	5.2
production of own use, but there was a product that was *only* for sale	1.5	11.2
production only for a sale	1.0	3.3
Total	100.0 (N=414)	100.0 (N=271)

We regard it as a high level that three-fifths (60 percent) of those questioned had their main occupation in industry alone; one-fifth (19 percent) worked in industry alone and/or in other non-agricultural branches; roughly four-fifths of their number had no connection with agriculture on the level of the "first" economy. However, it is realistic because, with most of them, their breakaway from agriculture occurred on the level of their employment in the "first" economy. Yet the correlation is weak with regard to place of residence, standard of living, and lifestyle. They represent the first or second generation of industrial workers who, in most cases, did not leave their village and their family despite being employed in industry. In these families agricultural, industrial, building industrial, commercial, public health workers etc. were living together. They helped each other, whether they were non-skilled or skilled workers or professionals. Their respective places of residence or workplaces could be reached in one day and this offered possibilities for work outside agriculture. The plot belonging to the household, its adjoining buildings, the sties and other lots owned by the family, traditions, and low wages, increased demands for investments in order to raise the consumption of the family. However, the lack of opportunities in the "second" economy all pointed towards agricultural small-scale production and urged these households to acquire additional resources.

The daily 8 (or with overtime longer) working hours, the number of shifts, the time needed for commuting to the workplace, the level and quantity of equipment, the financial resources, the possibilities for the division of agricultural small-scale production labour among family members, and the availability of "free" labour in the household (e.g. a young mother on childcare leave or a pensioner)—all these factors influenced the method and extent of participation in household farming and small-scale production. It is hardly surprising that, among those laid off from industry, the most widespread form of production was that for their own demand (57 percent); those who started to produce commodities for sale (10 percent) remained at the level of the traditional "surplus principle" mentality of selling. A smaller proportion of their number could utilise the modern commodity production forms which had appeared in the eighties (6 percent); their number was smaller than those who were laid off from agriculture (20 percent). *Table 2* shows, at the same time, the considerable differences of their participation in household farming or household commodity production: about two-fifths of them (43 percent) produced only for their household use; one-fifth of their number was satisfied with "surplus principle" marketing. The data show that three-fifths of the former industrial and agricultural household farmers—60 percent and 56 percent respectively—were involved in production every day and 11 percent and 16 percent respectively during their time at home.

Systemic change, job losses, acquisition of land and the financial situation

After the systemic change, we began to study its effects on the population. On the one hand, this was with respect to opportunities for obtaining resources for agricultural (small) production (which, in principle, increased). The need for such resources also increased because of the closure of factories and loss of jobs. The different chances were determined by the size of the plot acquired from the break-up of the cooperative land, the share of ownership, and land ownership or ability to buy land due to compensation; the need presented itself because of the mass of industrial and agricultural workers who had been laid off, who were now unemployed, or who had been completely driven out from the labour market (e.g. forced into retirement). Due to low wages and a high inflation rate, those who could work could not give up the utilisation of the income increasing resources available in agriculture.

One of these resources was the plot where the dwelling house stood and which was suitable for agricultural small-scale production. If it was large enough the plot could be utilised for the production of vegetables, fruit and potatoes for the household, and for rearing poultry and pigs (the popular animals in Hungarian smallholdings). According to our data, at the examined villages or village-like

settlements, the proportion of families with no plots laid off from industry and agriculture was very low—12 percent and 6 percent respectively. Due to the changes in employment structure, income, lifestyle and building the proportion of those owing a rather small plot is very high, 45–47 percent (relative to usual village conditions). A small plot is approximately 100–200 sq. fathom (38.32 sq. foot). Knowing the usual customs of villages construction—i.e. a flower garden before the house, a courtyard large enough for farm wagons—on these plots, due to lack of space, it is not possible to satisfy household demands by production. If these people have no other pieces of land beside their household plots, it is not possible, or only partly possible to use the household plot for self-sufficiency.

There are rather big differences between workers laid off from industry and workers laid off from agriculture. Nearly four-fifths (78 percent) of the workers laid off from industry do not own any land and a further tenth (11 percent) own plots smaller than one hectare. These data show that they have been "irreversibly detached" from agriculture in recent decades. This observation is supported by the fact that a mere one-fifth of half of the landowners bought (30 percent) or inherited (22 percent) the land while only one-third gained ownership by auction. It is not surprising that about two-fifths (42 percent) of those concerned owned their land before 1989.

Table 3

The respective proportions of those made redundant in industry and agriculture, according to the size of the land owned by the family-household (percent)

The size of land	industrial redundancies	agricultural redundancies
with no land	78.4	40.2
below 1 hectares	10.9	11.1
between 1.1–1.6 hectares	2.4	14.4
between 1.7–3 hectares	3.9	20.7
between 3.1–5 hectares	0.7	6.3
between 5.1–10 hectares	1.7	3.7
above 10.1 hectares	1.3	2.5
unknown	0.7	1.1
Total	100.0 (N=414)	100.0 (N=271)

Although the proportion of landowners among those laid off from agriculture is significantly higher (60 percent), our data do not support the ideas (and wishes) of politicians involved in the social, political and economic transition. Nor does it uphold the notion formed in politics and public opinion in general about the landed property of a village population and former cooperative members. According to

Table 3 two-fifths of the members laid off from a cooperative had and have no landed property. One-tenth (11 percent) of landowners have property of below one hectare in extent; a further 14 percent have between 1.1 and 1.6 hectares; and about two-fifths (21 percent) have property of between 1.7 and 3 hectares. These land sizes are not suitable for the provision of a family if it has no other sources of income.

If the two kinds of lands suitable for agricultural production—i.e. the plot of the dwelling house and the arable land property—are examined together, it can be seen that, of those laid off from industry, one-tenth (11 percent) have no land, more than two-thirds (68 percent) have only their building plots, and a further one-tenth (11 percent) have their building plots and 0.57 hectares. This corresponds to the size of household plots in the era of state socialism. The line could be drawn here—which is not to say that we think that 1–5 hectare landowners can make a living from their land—such that we can declare that 90 percent of the workers laid off from industry have no more resources than they possessed before the systemic change.

If we examine the same types of resources with respect to those laid off from agriculture we gain a more favourable picture. 4 percent is the proportion of those who have no land; 36 percent have plots alongside their dwellings; 11 percent have dwelling plots plus 0.57 hectares; and altogether 51 percent have landed property which is the same size as before the systemic change. The growth of the size of landed property with regard to the other 50 percent gives no cause for optimism, because this growth has meant only a few hectares for the households concerned. Without exaggeration, we can state that the majority of those laid off, respectively, from industry and agriculture had the same size of landed property after the systemic change or a few 0.57 hectares more. The size of such property corresponds to the household and small production farms of the state socialist era. It can be assumed that these resources cannot play a larger role than they have played up to now and they have other functions in the lives and income of these families than they had during the era of state socialism. (It can be affirmed that 99.8 percent of those laid off from industry and 96 percent of those laid off from agriculture gained no property after the break-up of the cooperatives. Therefore, despite ownership changes, no significant change has occurred in the stock of machinery and equipment essential for land cultivation.)

The majority of families returned to the land in order to cultivate it and, generally, to supply the products of household farms. This fact cannot be doubted or discussed—see *Table 4*—because, at the time of the questionnaire, one-third (31 percent) of those laid off from industry had no job; slightly more than one-third (36 percent) of those laid off from agriculture had work. The majority were driven out of the labour market—in other words, they received a kind of state provision and in effect became inactive. Strikingly high among those laid off is the number of those who became long-term unemployed; their main source of living is unemployment

benefit. Among those laid off from industry the largest group (41 percent), and the second largest group of those laid off from agriculture (31 percent) respectively are those who get income supplement. Presumably, the majority of those receiving unemployment benefit at the time of the study do not expect much change in their prospects. Pension, early pension, welfare care-like pensions are the only ways out from their difficult situation. Many of them have no alternative but to become dependants or household members.

Table 4

The respective proportions of those made redundant in industry and agriculture, according to their present social position (percent)

Present social position	industrial redundancies	agricultural redundancies
employed	30.6	36.2
receives unemployment benefit	6.6	13.3
receives income supplement	40.0	36.6
takes part in public work	1.0	1.1
household member, dependant	4.9	4.1
on childcare leave	5.6	2.6
pensioner, early pensioner	4.9	4.5
receives welfare care similar to pension	4.4	5.9
other	1.0	1.7
Total	100.0 (N=414)	100.0 (N=271)

Half of those laid off from industry and two-fifths (41 percent) of those laid off from agriculture earn 7 thousand forints or less monthly. If the line is drawn at 10 thousand forints—which is not a high income—then two-thirds (69 percent) of those laid off from industry and nearly three-fifths (56 percent) of those laid off from agriculture belong to this group. The higher earning group—17 percent and 25 percent respectively—earns between 11 and 19 thousand forints, and a minority—between 5–8 percent—earns more than that.

One percent of the former industrial workers and five percent of the agricultural workers were able to find a job immediately after their dismissal. The proportion in both groups is 25 percent respectively, who, after being unemployed for a shorter or longer period, were able to find a workplace while registered as unemployed. The state of being employed was changed several times by 7 percent of former industrial workers and 20 percent of former agricultural workers (this latter number is high because in winter cooperatives sent their members to receive unemployment provision; when spring arrived these members were employed again for seasonal work. Thus the time of annuity prescribed by law was stretched out over

several years). The most populous group was that of the long-term unemployed; 47 percent of former industrial workers and 31 percent of former agricultural workers belonged to this category. The proportion of those who were not unemployed after their dismissal is extremely low (1–5 percent) and extremely high among those (31–47 percent) who became long-term unemployed. As a consequence of all this the majority of former workers are confronted with financial conditions which point towards some kind of agricultural occupation. They themselves deem it so: three-fifths of those laid off from industry think that the material-financial state of their families has deteriorated since become unemployed; a further one-quarter of them (26 percent) think that their situation has become considerably worse; only 9 percent thought that their circumstances have remained unchanged and 2 percent believed their circumstances had improved. The same proportions could be observed among those dismissed from agriculture: the situation of 50 percent has become worse; for 30 percent it has become considerably worse; 14 percent feel their circumstances are unchanged and only 3 percent believe their situation to be better. It is natural that nearly half of those laid off from industry (47 percent) characterised the state of their family as "we can hardly make ends meet"; 28 percent said their situation was "bad, we have financial problems"; a further 14 percent said their circumstances were "very bad, we have daily living problems". Those laid off from agriculture thought the following about the financial state of their family: two-fifths (39 percent) said "we just make ends meet"; 28 percent said "it is bad, we have often financial problems"; 19 percent thought their circumstances to be "very bad, we have daily living problems".

Household farming after the systemic change

The problems described above were dealt with in detail because the social state, and the financial and income position of those questioned were not only decisive with regard to their need to turn to agricultural small scale production, but also with respect to to the possibilities for doing so. Experiences during the era of state socialism showed a relatively strong connection between the respective economic, social and income positions in the "first" economy of those concerned and the extent of their "second" economy production with respect to the level of their commodity production. This is no coincidence because those individuals with a higher social position and income had, in general, more wide-ranging and better business connections, greater knowledge and general and professional skills. Furthermore, they had more capital to invest in the "second" economy and thus they could exploit and make good use of their advantages. Since the systemic change, a considerable transformation has taken place in the organisation of the "two" economies, and in the way in which they interweave with each other. In the

course of this process the mentioned "capitals"—i.e. connections, knowledge and financial capital—have been upgraded. The cooperative, productive and marketing forms have been abolished or considerably transformed. These had been offered by the cooperatives to their members, employees and generally to village inhabitants; they represented a type of household integration for poultry, pigs, poppy and hybrid maize. Poultry and pig breeding on commission and the required provision with food became things of the past.

It is a new element for those intending to participate in small-scale agricultural production that their activity begins with capital investments. In other words, they have to pay in cash in advance for seed grain, for cultivation of the land, sowing, harvesting, animals etc.; moreover, it is risky. There is no guarantee that the end-product of the invested capital and labour can be sold. It could happen—as some of the farmers learned from their own experience—that instead of gaining supplementary income they lost money. Many people recognised that they would not be able to sustain their organised, customary activities in the "second" economy alongside their salary or income gained in the "first" economy. If they had to acknowledge that, with the deterioration of their respective positions on the labour market and their income, their possibilities in the "second" economy had significantly worsened. Those driven "permanently" out of the labour market had even more bitter experiences. Their bitterness is verified because their "first" economy is a combination of income supplement and disability pension. Thus they are driven to seek some supplementary income.

The commodity production branch of agricultural small-scale production, being significantly profitable, has become more closed compared to the past (when admission to, and exit from this circle were free). Recommencement requires a large start-up capital investment in cash. However, the necessary capital could hardly be saved up with gross salaries of 15–30 thousand forints, or even less with the 7 thousand forints income supplement. Many people have to reckon with the fact that if somebody leaves, or is driven out of private agricultural production it is hardly possible, and only with great difficulty to reenter. Following the rearrangements which have occurred during the recent period, the individuals and groups who are most in need have been the least able to utilise this form of earning and thus supplement their income. The mass of people who have been permanently driven out of the labour market and who receive income supplement, have a low social position with a low income. They do not have good connections, they cannot find a job, and it is not likely that they will be able to take part in large volume agricultural commodity production. In fact, it is rather the opposite which is probable.

According to the data at our disposal, during recent years, production has decreased considerably in the "second" economy of agriculture, especially in the most dynamically developing fields: i.e. poultry and pig rearing. This reverse has been spectacular because the roosts of small farmers, suited for 3–6 thousand of poultry per shift, are empty. Formerly, up to 10 thousand pigs were fattened annu-

ally per settlements, but this figure has now drastically decreased. This spectacular reverse can mainly be felt in commodity production because—as an agricultural expert said—"the Hungarian peasant, the population in the country, tries to achieve autarchy".

The data we obtained for the groups examined support this trend. In rural households the most favoured domestic animal is the egg-laying hen. 36 percent of those laid off from industry and 30 percent of those laid off from agriculture live in a household where there are no hens. The majority of the rest have no more hens than 50; the share of those having 51–100 is 6 and 11 respectively, and only 2–3 percent have more. On the basis of the number of domestic animals, a conclusion can be drawn that all these families, without exception, produce for self-sufficiency. This was confirmed by 99 percent of those questioned, who stated that they do not sell anything on the market. A majority out of several commodity producers' sells only the surplus that is not needed in the household. Only one person was dealing with production for the market. The situation is similar with the other favoured animal of the eighties, the pig. Three-fifths of those laid off from industry (57 percent) rear no pigs, a further 28 percent 1–2 pigs, and 12 percent is the proportion of those who rear 3–5 pigs and sell the "rest". Over the last decade, on average 6–10 pigs were fattened in a household; however, only 3 percent of those questioned have stayed on this level; only two households were rearing at the least 50 pigs. The situation is somewhat better with those laid off from agriculture—44 percent have no pigs, 35 percent have 1–2, 14 percent have 3–5, 5 percent have 6–10 and 2 percent have more (i.e. maximum 50 pigs). The share of commodity producers among their number is not too high. This is confirmed by them: nearly nine-tenths (87–89 percent) said that they rear pigs only for the household, while the proportion of those producing mainly or totally for the market was around 7–10 percent.

This rate is the highest regarding commodity producers: most of the households are, even now, rearing pigs with the aim of selling.

We collected data showing the size of the lands cultivated by households. As *Table 5* shows, two-fifths (43 percent) of those laid off from industry are living in a family which has no cultivated land: two-fifths of their number (43 percent) have cultivated land below the size of one cadastral acre (6823.95 sq.yards). The former group is not even included in self-sufficiency production; on the other hand, the latter group is not able to participate in commodity production because the small size of the land is not sufficient for such production. The 0.6–5 hectare lands are not suited for commodity production. Only 3 percent have a larger estate, and only one family has an estate of between 10 and 20 hectares; two families have 21 and 50 hectares respectively and one family owns more than 51 hectares of cultivated land.

The proportion of those laid off from agriculture owning no cultivated land or owning land below one cadastral acre (6823.95 sq.yards) is lower than the previously

Table 5

The respective proportions of those made redundant in industry and agriculture, according to the size of land cultivated by their household (percent)

Size of land	industrial redundancies	agricultural redundancies
with no cultivated land	43.3	24.4
below 0.56 hectares	42.6	35.2
between 0.57–0.99 hectares	2.4	6.3
between 1.1–1.6 hectares	3.6	10.7
between 1.7–3 hectares	3.9	14.4
between 3.1–5 hectares	1.3	4.8
above 5.1 hectares	2.9	4.2
Total	100.0 (N=414)	100.0 (N=271)

described ones. "Lower" means that around one-quarter of them (24 percent) have no possibility for growing vegetables and potatoes for their daily consumption: more than one-third (35 percent) have a plot sufficient for only this type of production. The majority of this group can be considered as "dwarf holders" and they cultivate land below 5 hectares; those cultivating a larger area of land represent 4 percent.

The majority of family households—even those who own a larger area of land—is neither prepared nor equipped for farming. Only 3 percent of them have two-axled large tractors: this means 20 families. Two families have two-axled small tractors, 5 have engine-powered cultivators, 0.5 have combine harvesters, 0.2 have other harvesting engines. Of the buildings necessary for farming, the pigsty is the most common. Of those laid off from industry 64 percent have pigsties, while of those laid off from agriculture 72 percent have pigsties; only 5–8 percent have cowsheds or stables; 6–10 percent have buildings for storing crops. These details imply that farming is based on the manual work of the members of the family—except some households—and outside resources are not utilised. Two-fifths of those questioned (42 percent) said, for instance, that soil cultivation was carried out not by the family, but by someone who they hired. They had to pay for seed grain, chemicals, artificial fertilizers, animals and naturally for food and fodder. Half of those laid off from industry (47 percent) and two-thirds (67 percent) of those laid off from agriculture had the resources for financing the agricultural production of household farming. However, the range of the extent of these resources was considerable. The resources of some families did not reach the 3 thousand forint mark, while the expenses of those owning 10, 20 or 50 hectares surpassed the 100 thousand or 400 thousand forint level. The majority could afford only a moderate sum for this purpose. For instance, 25 percent of those laid off from industry could

afford a maximum of 3 thousand forints; a further 25 percent spent 4–10 thousand forints of household finances on items in connection with agricultural production. However, the expenses of half those laid off from agriculture did not surpass 20 thousand forints, although among them the share cultivating a larger area of land was higher than in the previous group.

Considering the fact that the area of land is small in the households examined, and that they are short of manpower and financial means, the agricultural production of these family households—see *Table 6*—is rather poor and shows a very mixed picture.

Table 6

The respective proportions of those made redundant in industry and agriculture, according to the type of household agricultural production (percent)

Type of production	industrial redundancies	agricultural redundancies
no animal rearing, no plant cultivation	22.3	11.8
only poultry rearing	6.8	4.4
only poultry and pig rearing	11.4	6.3
only vegetable (potato) cultivation	7.0	8.1
arable land plant cultivation but no animal rearing	1.2	5.5
vegetable cultivation and poultry rearing	8.0	8.0
vegetable cultivation and poultry and pig rearing	17.5	15.1
arable land plant cultivation only, poultry rearing	2.9	3.3
arable land plant cultivation, poultry and pig rearing	16.7	26.9
arable land plant cultivation, and besides poultry and pig rearing, cow and horse rearing	1.7	5.2
others	4.5	5.4
Total	100.0 (N=414)	100.0 (N=271)

By a "very mixed picture" we mean that the Table shows a rich variety of plant and animal cultures. We can find households with no farming, then those rearing poultry and only vegetable growers, then there are families farming according to the traditional peasant pattern; in other words, they grow wheat, maize, vegetables, and rear cows, pigs and poultry.

This mixed picture is in fact the mixed pattern of poverty. We refer to poverty because more than one fifth (22 percent) of those laid off from industry and one tenth (12 percent) of those laid off from agriculture are living in families in those villages where they are not dealing with animal husbandry and plant cultivation. Poverty is shown up by the fact that—under state socialism—a further 7 and 4 percent respectively were able to rear poultry, and 7 and 8 percent respectively were able to satisfy partly the vegetables needs of the household. These animal

and plant cultures do not require large investments—only a few thousand forints and a lot of labour. Pig rearing requires more financial means—the price of a piglet was 6–7 thousand forints at the time of our study; for fattening some maize and other foodstuffs are necessary—thus the data is meaningful which shows that nearly three-fifths (57 percent) of those laid off from industry and two-fifths of those laid off from agriculture do not rear a pig and 12 and 10 percent respectively kept only one. Interestingly, 36 and 28 percent respectively had no sties. Attempting to grow everything and small-scale animal husbandry—these reveal poverty. As with the maize growing, pig rearing household farming of the sixties (and even more so in the past at the time of "servanthood" or "dwarfholder" farming) the main factor has always been the lack of money, effectively the elimination of commodity and financial conditions, and the maintenance of autarchy. Naturally, nowadays, at the end of the century, it differs from the respective situations of the sixties and thirties. Thus today's situation is a different situation, with a different way of life and possibilities.

In this connection we emphasize that the generally accepted belief—i.e. that rural households are able to satisfy their needs for foodstuffs—is not true. According to our data many of them do not in fact deal with plant cultivation or animal husbandry. The majority of those who do are very poor, and their agricultural production is meagre. It is so meagre that 70 percent of those laid off from industry and 57 percent of those laid off from agriculture claimed that agricultural production plays no part, or plays only an insignificant role in the lives of their families. When they were asked "what role does agricultural production play in the family's financial household management", two-fifths (42 percent) of those laid off from industry answered that it plays "no role", while a further 47 percent said that "they spend less for foodstuffs". Those laid off from agriculture answered the above in the following order: 27 and 52 percent respectively. Around 80–90 percent of those questioned were of the opinion that the agricultural production of their family does not contribute at all to the incomes of the household. They felt it only helped to save money because, by growing potatoes, rearing poultry, ducks or pigs, it is possible for them to spend less on foodstuffs. (The proportion of those having a considerable income from these activities is 2 and 5 percent respectively.)

The present conditions are reflected by the claim of nearly nine-tenths (87 percent) of those laid off from industry and four-fifths (82 percent) of those laid off from agriculture that they do not intend to develop the agricultural production of their household. A large number of them expressed that, in reality, "they are not able" to do so. 52 and 57 percent of them respectively reasoned that their situation was due to a "lack of money" or "not being able to finance" any further development. 13 and 6 percent respectively said "they have no land, machines and sties". If there were hopes in connection with the minority 13–18 percent intending to invest, analysis of the data shows that we have to correct this idea. Of this minority 45 and 33 percent respectively have the aim of acquiring a "cheaper

supply of food" for the family—so the main fields of these investments are vegetable cultivation and poultry and pig rearing.

Instead of a summary

According to our data, the past three decades of small scale agricultural production in this micro-region can be divided into several periods of development.

The first period is that of the sixties when, in the villages of the region, commercial provision was at a low level, job opportunities were rare, and the majority of women worked in the household. In the cooperatives production was going on by the known traditional processes and distribution was carried out according to the "surplus" principle, mainly in the form of "allowances in kind". Household farming and small-scale production conformed to this "world" and could also be characterised as "traditional".

The next period is that of the seventies. Several fundamental changes occurred in the fields of production, employment, incomes and way of living. Following the establishment of industrial plants, many workplaces were created, masses of women from the household began to work, and the family model with two earners became general. In the cooperatives mechanisation started and quickly progressed, new production methods were adapted, company-like financial operation began and, in compliance with this switch-over, members received a regular salary in cash. The incomes of families increased, they received cash and the family division of labour (i.e. based originally on the wife working in the household), production, and consumption—and the way of living—were transformed. All these things influenced agricultural small-scale production, and new trends began. However, at that time the traditional "maize-pig" production form was still dominant.

According to our data the beginning of the eighties brought a decisive transformation in small-scale agricultural production with a breakthrough towards commodity production. Household farming and small-scale production had been given an impetus by the market orientation of the whole of agriculture, by the adaptation of modern production processes for small farms, the growth of market demands, the changing of the political trend, the spreading of new production methods, a new division of labour, and new forms of interest among members of cooperatives and, indeed, the whole village population. During previous decades efforts to achieve commodity production had been latent but now they tried to break political limits and a large number of commodity producing small-scale production farms were established. Among them were farms the owners or members of which made their living exclusively by this production. A breakthrough was not only indicated by the above processes but also by the spreading of vegetable cultivation which up until then had no traditions—for instance, the cultivation of onion,

pepper, poppy, pumpkin seed and cucumbers. Moreover, there were cooperative forms which could be qualified as being of small volume compared to that of the previously existing cooperatives. We think that, according to West European standards, small-scale producers selling annually 30 thousand poultry and 200–300 pigs are not so small producers; nor are household farmers growing sugarbeet and hybrid maize on household plots of 11.4–14.25 hectares. An important characteristic feature of this breakthrough was the role of knowledge; furthermore, connections and financial capital were upgraded in this sphere. The participation of small-scale agricultural production and commodity production had a different meaning for the respective villages, social layers and families. A considerable differentiation took place in the eighties and this created different conditions for the subsequently emerging entrepreneurship and the ability to stay on the market.

The breakthrough indicated above brought a perceptible improvement for the majority who appeared on the market in the traditional way with a "surplus". This was because they could combine favourably their part-time small-scale production with their main employment (which secured an income from the "first" economy).

Since the beginning of the nineties and the systemic change a new period has started in agricultural small-scale production. The industrial plants established 20 years ago have been closed down; in other economic branches and also in agriculture many employees have lost their jobs. The situation of the cooperatives has become insecure: some of them have disintegrated, and their lands have been taken in private ownership mostly through compensation, albeit the new properties being only a few hectares in size. A large proportion of the population of the region has become unemployed and some have been permanently ousted from the labour market. The luckier ones receive income supplement, the less luckier ones do not get anything and are even "falling out of the view" of the labour administration. In these circumstances many of their number really need the income supplement of household farming and small-scale agricultural production (operating in the smooth way it did some years ago). However, such production is a thing of the past; Hungarian agriculture has been ousted from various external markets, the internal market has become tighter, and the former capital transfer and production integrations have disintegrated or are not functioning. A new element has appeared: production has to be started with considerable investments by those dealing with small-scale production—for this they either have the money or they do not. Yet these investments do not guarantee an income or a certain standard of living. Furthermore, it is not at all sure that the products can be sold. This indicates that in recent years the small-scale producers who survived have to take on considerably increased risks. Other layers of small-scale producers do not have to deal with this problem but this is because they have not got the minimal amount of capital necessary for the "surplus principle" commodity production. Those who are in employment are confronted with the same problem because their earnings are insufficient for financing small-scale production with the necessary means.

The problems described show that the commodity production part of small-scale agricultural production is decreasing. There are ever-decreasing numbers of employees who are able to combine successfully their main position in the "first" economy with part-time, commodity-producing household farming. The occasional participation in commodity production and the free accession and leaving possibility are things of the past.

Acta Oeconomica, Vol. 49 (3–4), pp. 461–463 (1997–98)

OBITUARY

In memoriam: Tamás Lipták

An outstanding figure in the field of Hungarian econometrics, *Lipták Tamás* has tragically died in an accident at the age of 64.

Let me start by recalling the years we worked together. In so doing, I cannot help but speak about myself as well (which the reader will, hopefully, excuse).

After the 1956 revolution was crushed I buried myself in work and started, for the first time in my life, to build mathematical models. Being an absolute beginner, I clutched at straws for help. It was then that András *Bródy* and Alfréd *Rényi* told me that there was a highly talented young man working at the Research Institute for Mathematics who might have a talent on problems related to economics as well. I met this person and soon we were working together. At the time I was interested in the first attempts of profit-oriented ventures in Hungary and we tried to describe their various alternatives in the form of models. After months of rather painstaking work we managed to compile a longer study. However, just before we deemed it ripe for publication, Tamás was arrested.

Tamás' arrest did not surprise me. Ours was more than a simple working relationship: we not only discussed profit orientation and cost curves but we had fierce political debates too. We analysed the events of 1956 and the anomalies of the communist system and we spoke of the fate of mutual friends who had taken an active part in the revolution. Tamás himself participated in the events—not in the first echelon of power but as a reliable and tireless foot soldier in the struggle for freedom. After 4 November 1956, with the revolution crushed, he duplicated leaflets urging people to go on fighting. He was first arrested in 1957, together with György *Krassó*. Krassó was kept but Lipták released ... for a while. He went on fighting against the Kádár restoration. Soon, in 1959, he was summoned again but this time he was not released. He was sentenced to two and a half years detainment in one of the so-called "intelligentsia suits".

Tamás was a colourful and sophisticated character. Just the few facts above from his life indicate that he was always ready to court danger for his convictions. If the cause he wanted to serve called for the turning of the handle of an illegal mimeograph, that is just what he would do. Nevertheless, he did not play at being a professional revolutionary, nor was he an ascetic obsessed with some ideology. No, he was an intellectual to the core; he even looked like Don Quixote. He was a master of abstract theoretical thinking in the same way as he had a vast knowledge and a sharp wit in everything, be it politics, history, literature or philosophy. He radiated warmth, vitality and charm; he had lots of friends who thoroughly enjoyed his company.

Now back to the study we wrote together: it was impossible at that time to print or publish the study in Hungary since one of the authors, i.e. Tamás, was in prison. So we agreed with Alfréd Rényi that it should at least be duplicated and the co-author's name should read "Research Institute for Mathematics".

Once Tamás was free, we decided to publish the study in a Western periodical. In those days one needed the permit of an authority to publish anything abroad. We—that is, Tamás, a mathematician fresh from prison, and I, an economist fired from the Academy—resolved not to ask for any permit. We simply put the study in an envelope and mailed it to *Econometrica*, the leading periodical of econometrics. Let me mention that we did not know any of the editors nor had we had any previous contact with the periodical. *Econometrica* accepted the study without changing a word and they duly published it.

I had already learned a great deal from Tamás, even in this early phase of our cooperation. He taught me more than mathematics: he set me an example as of how to think and compose in an accurate way. He had what was almost a mania about precision. His handwriting was perfectly clear and legible: if he found an error on the tenth page, he discarded the whole manuscript and started afresh.

Our next collective venture was the elaboration of the model and algorithm of "two-tier planning". The finished study embodied innumerable days spent together, many debates, drafts and revisions; even so, our respective contributions were more or less discernible.

It was my idea that the procedure of the well-known Lange-Taylor model of socialism should be "reversed". In this new procedure the national planning office was to set the prices and lower-tier units (i.e. the companies within them) would minimize costs at such prices. If demand and supply were to differ, the office would modify the prices in accordance with the sign of excess demand. The process would then repeat itself, resulting in convergence towards balanced prices and allocation. In the Lange-Taylor model, the centre acts a type of substitute for the market's role in setting prices. I wanted to set up a model that would imitate not the market but central planning (more exactly, its "idealised replica"). Here the centre, in line with the practice of planned economies, distributes quantities (i.e. input quotas and output tasks). Organisations ("sectors") at its lower tier then report back the shadow prices of quotas and make plans for the tasks assigned to them. Taking the latter into account, the centre can then revise quantitative allocations. This is repeated again and again, with the process getting closer to a favourable allocation.

For this theoretical conjecture, Tamás worked out an algorithm which proved that convergence was in the direction of an optimal solution. This in itself was quite a feat and one which Tamás accomplished with great inventiveness and with the precision that was so characteristic of him. This alone would have been proof of his rare talent, but he went much farther than that: he incorporated the model into the framework of the theory of games. He interpreted the task of planning as a game between the respective teams of the centre and the sectors. Let me emphasise

that this was well before the renaissance of game of theory. Tamás was one of the few people who, even at that time, were seriously interested in that theory. It is no exaggeration to say that Tamás Lipták was a genial pioneer of the upsurge in the popularity of game theory. He would still be regarded by the profession as a pioneer even now, had he been able to continue on along the road upon which he started out.

Unfortunately, Tamás's spirit faltered following the brilliant building of the mathematical model of two-tier planning. Peaks were followed by depressions, his creative periods got shorter and shorter and he never again reached his former heights. At the same time, he found it increasingly difficult to find his place in society.

His friends in Hungary and abroad arranged for him to work in one of mathematical economics' most prestigious schools, at Churchill College in Cambridge, Great Britain. He emigrated to England and returned only for occasional visits to Hungary. His radiant intellect, charm and polite manners remained but he was no longer able to produce significant scientific results or to find his feet. The sad irony is that this is literally what caused his death: he stumbled on a staircase, fell, and later died of the injuries he suffered. With his passing away we have lost a brilliant thinker and a man loved by many.

J. KORNAI

Acta Oeconomica, Vol. 49 (3–4), pp. 465–473 (1997–98)

BOOK REVIEWS

SCITOVSKY, T.: *Egy „büszke magyar" emlékiratai* (Memoirs of a proud Hungarian). Budapest: Közgazdasági Szemle Foundation. 1997. 253 p.

This book is fascinating to read. The first chapters paint a rich and lively picture of a period that is mostly known from fiction or history books. How did the elite of Hungarian society—and within it a prominent family of historic name—live in the years before, during and after World War I? What was their social life like? What were their weekdays and feasts like? What sort of relations did they have with their servants? How did the traditional upper class mingle with the world of clerks and bankers? What ties did they maintain with the outside world? We learn about all these things from thorough descriptions of the best literary quality. What we have here are brilliantly drawn human characters and complex and controversial relationships.

The subsequent chapters are no less interesting. There is a lively account of the world-famous London School of Economics in the exciting months when the turbulence of the Keynesian intellectual revolution was stirring the minds of many progressives. We are drawn into exciting events during World War II and scenes of British and American campus life.

Scitovsky brings events, friends and colleagues and their social environment closer to the reader but at the same time says little about himself. However, by the end of the book the reader has the feeling that he is getting to know the author. His is a unique mix of shy withdrawal, especially at times when he should stand up for his own interests, and a courage when he feels he should act in a way that might not be expected. His attitude shows that, at an early age in the feudalistic Hungary of his childhood and youth, he started to differ from the expected behaviour of his own class. This is manifested in his later years just as markedly when, in his soft-spoken way, he daringly turns against the fashionable trends of his profession and marches stubbornly along his own path. He was born into riches but from the very moment of his intellectual awakening he always felt empathy for those in need or the less privileged. He never shows snobbery or arrogance. As a child, he easily made friends with the poor, and as an adult he always selected friends and acquaintances according to their charms, and intellectual and moral values and not because of their birth or rank. Scitovsky's father—whom Scitovsky deeply respected and loved—had seen the world from the view of an enlightened conservative; he himself was at all times attracted to liberal thinking—that is, the other side of the dominant political trends of that time.

It is amazing the extent to which this man—whom we get to know (and admire) from the pages of this book—stands out from the narrow-minded specialist economists of our time. In him there is not a trace of the intellectual one-sidedness that characterises many researchers. His analytic skills have been enriched by his versatility in philosophy, literature and psychology. For Scitovsky music, a good read, a beautiful painting or a stylish building are as pleasing as, say, a well-written academic paper. His education and cultural heritage have helped form his taste and have brought joy to his life.

One more difference (in contrast to many other economists) can be seen in the fact that self-importance and officiousness are completely missing from his writing. Instead, it is inspired with humour: it is never meant to hurt but rather to bring understanding and a large amount of self-irony. This latter is a rare virtue in academic circles.

There is only one major deficiency in the book: people who do not know how important an economist Scitovsky is will not learn this from this biography either. His modesty, and the afore-mentioned self-irony have ensured this. Only here and there does he give us an idea of how enormously he contributed to international economic science. This bookreview can-

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not close that gap but let me add some information to enrich the contents of the book.[1]

One of Scitovsky's interest is welfare economics and he became a classic expert on the subject. One citation can prove this point: i.e. fair distribution is expected to ensure the satisfaction of *basic* needs. If this is accomplished, society will be able to accept a larger grade of disparity in incomes. If, however, certain groups of the population cannot satisfy even some of their basic needs, then even a smaller grade of disparity in incomes would trigger moral uproar. This is a statement especially valid for today's Hungary, with the reform of the welfare state which is underway.

I myself, and presumably many of my colleagues, have for long used the notion of price-maker versus price-taker without knowing that this was Scitovsky's brain child (until he himself almost apologetically mentioned it). He fared like many other great men: his thought had become common knowledge, part of the collective memory, and its origins were forgotten. Obviously, there is pride and glory for the spiritual father, but it certainly hurts if his name is not mentioned. With his work Scitovsky put a large question mark after the theses of the—up until his time—indisputable theory of balance. He questioned the widely accepted symmetry of seller-buyer. He realised the problems caused by the information backing up the decisions of sellers and buyers and he was the first—or among the first—to formulate the phenomenon of information asymmetry, although he himself has never used the term. It is true (and he says so in his autobiography) that it is bad when a thought comes late, but it is just as bad if it comes too early, when scientific society is not yet ready to absorb it, and trust in the prevalent concept is still firm.

All these observations apply only too frequently to Scitovsky's findings. He cut paths in dense forests and in places where others opened up broader, more easily passable roads only much later. I wonder if scientific society is ready to absorb the powerful train of thought he expounded in his book *The joyless economy*. In this, Scitovsky makes an attempt to integrate psychology and economics. The book criticises the utility theory of mainstream economics as well as the reality of our world, with special regard to the average American way of life. He calls the attention of economic theoreticians to the fact that the greatest joy is actually found not so much in the maximum of satisfaction but rather in stimulation, excitement and the expectancy of satisfaction. He throws light on the role of variety and novelty in human joy and happiness. Meanwhile he directs his criticism, with much dignity and a touch of subdued irony, towards those who are unable to protect themselves from boredom; while such individuals chase material welfare, they fail to find the numerous simple and lovely instruments of gaiety and happiness; Scitovsky points out that these things are not necessarily a matter of money.

For people who are familiar with Scitovsky's *oeuvre*, this autobiography provides a rare insight into the labour of intellectual creation. "Already as a child I made an observation when my parents dragged me along to their shopping sprees in antiquity shops in all European capitals: it was always the dealer who set the price." There must have been many children dragged along to antiquity shops, but it was Scitovsky later in life, who used the observation to formulate the price-maker-price-taker theory. Here the starting point was an event that happens to millions of children every single day. However, it needed a scientific mind to generalise and see here a phenomenon of importance and place it in the context of professional thinking. It is just as interesting to learn from the autobiography how *The joyless economy* was conceived, how the philosophy expressed in the book is embedded in the author's rich and educated way of life, how the empirical observations (and self-observation) of

[1] A study by Peter E. *Earl* gives a summary on Scitovsky's economic work (published in: *New Horizons in Economic Thought*, editor: Warren J. Samuels. Elgar, Aldershot, 1992). Biographic details about Scitovsky are available in: *Great Economists since Keynes* (Harvester Press, Brighton, 1985). In a short autobiographical writing, "Hindsight economics" published in the *Quarterly Review Banca Nazionale del Lavoro* (No. 178, Sept. 1991, pp. 251–270), Scitovsky gives a rare insight into his own research work.

the author compare with recent findings in relation to modern psychology; such observations eradicate many a white spot on the map of consumption theory. Scitovsky is an example and a living proof that a professor of economic sciences should rather be a social scientist, not simply an economist.

Tibor Scitovsky is not a revolutionary who would radically break with earlier concepts. Nor is he one of those who are happily drifting in the mainstream and all they want is to stay there. He stands with one leg in the mainstream but with the other he keeps on testing white water. This is enough for open-minded thinkers like Arrow, Sen or Hirschman to hail his works with unconditional enthusiasm. However, the rest view Scitovsky's work with respect albeit some with a little aversion. Although he is officially recognised as one of the century's greatest economists his thoughts have still not reached as many people as they ought to have done. He is very much aware of the limited scope of the effect of his ideas and achievements, but this has not stopped him from sticking to his own concepts, theories and style.

When the editors of the book asked the author what title he would like to give to the Hungarian edition of his memoirs, he chose a reference to his own childhood saying: "Memoirs of a proud Hungarian". Let me add—Hungary too can be proud to have a son like Tibor Scitovsky.

J. KORNAI

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.

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 pri-

vate 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 institutional 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..."

A. HERNÁDI

COOPER, R. N.–GÁCS, J. (eds): *Trade growth in transition economies. Export impediments for Central and Eastern Europe*. 1997. 363 p.

The authors of the book point to the fact that after 1990, but especially in and around 1994 and 1995, the countries under review produced a 30 to 50 percent export expansion, as compared to 19 percent in the OECD countries and 23 percent in the developing world. This was quite a performance, even if various statistical discrepancies make such comparisons slightly less reliable. (One thinks of statistical data "massaged" by the former regimes, the trustworthiness of statistics dated before the birth of some countries, and the dependability of growth estimates based on such data, whether referring to exports or GDP.) Such exports, the editors argue, played a pivotal role in alleviating the crisis in small transition economies and in building up their respective GDPs.

Is it then a success story? We who live in Central and Eastern Europe do not think so. The authors emphasise that policy-makers are largely responsible for providing the condi-

tions for export-triggered growth. Even if an interrelation between economic growth and exports cannot always and everywhere be proved by statistical data, the long-term truth of economic philosophies declaring the primacy of exports may hardly be challenged.

There are of course many differences between the countries—i.e. with regard to consistency, dynamism, obstacles and difficulties with their export processes. For instance, export growth in Romania, Bulgaria and Latvia started with a considerable delay. In Hungary, Romania and Latvia (and later also in Bulgaria) the imbalance of foreign trade has meanwhile become a serious problem. The growth rates of exports in transition economies show wide variances and their bases are still unstable. The elimination of administrative and tariff obstacles have likewise been a controversial process on both sides: Western markets maintained some of their restrictions and due to this the transition economies have partly backed off from their liberalisation. It is rather the exception than the rule that trade relations are based on long-term comparative advantages. In some cases, the economic position of exporters had been shaken by problems in financing. Similarities and differences in growth, and decisive factors and insignificant ones (taken in their complex entirety) nevertheless indicate that the period under review brought a social and political turnabout for the transition economies. Moreover, it is a period that was special and well definable if seen from the angle of global trade integration.

Yet with these countries their economic "fate" and export trends are all different. From among Romania, Bulgaria and Hungary—the countries that already existed before 1990—only the economy of the latter was capable of increasing the volume of its exports between 1990 and 1995. In order to solve its debt problem, Romania forcibly sustained its export drive in the second half of the 1980s but by 1990 this drive had dwindled. Due to its deep integration in Comecon Bulgaria was hurt by the transition even more than other ex-members of the CMEA. (In spite of spectacular export growth by 1995, neither Bulgaria nor Romania were able to repeat their respective export performances of 1989.)

Some of the countries were adversely affected by the 1993 slump in global trade. Some were entangled in the task of creating their new statehood. Looking at the huge differences in their respective export performances, as shown by the graphs of the book, it is difficult to discover any regularity. For the outsider, these statistics tell hardly more than a general trend of export growth and the increasing importance of Western markets. It is quite an achievement on the part of the authors that they have proved that the repolarisation of political power relations in trade had run similarly in all small transition economies. Furthermore, they have been able to point to a number of export obstacles which, in all cases, have operated behind the screen of export success.

However, the resultant force of counter-effective factors had resulted in the growth of exports by the turn of the 1990s. Even so, the success of foreign trade, as the authors see it, is vulnerable. At the same time their opinion may indicate that they believe that the transformation of markets is irreversible but there is no guarantee that good export performances will be there forever: for the sustainable development and the prospects of transition economies, their most important tasks are exactly the elimination of obstacles in the way of exports and preventing the erosion of their competitive edge.

In summarising the 20 to 40-page country studies, the authors state that it was the exchange and real interest rates that had the greatest effect on the development of competitiveness. Back in the mid-1990s, no two systems of exchange rates in the CEE countries were identical, but by the time of transition they had started to show more similarities. With respect to the latter, the editors cite early efforts to achieve stabilisation, attempts—that were often successful—to curb inflation, and the real revaluation of national currencies almost everywhere. They ask: could a real revaluation of national currencies have been avoided? How was the export competitiveness of companies affected by the stabilisation policy pursued by national banks, the level of real wages and the possibility of wage increases?

With regard to supply-side obstacles, the authors think that relatively high or rapidly growing labour costs (but also energy and credit costs, as well as political and market risks) are among the most important. As a result of stabilisation policies which applied sizeable devaluation at an early stage, CEE countries could, relatively quickly, increase the export of labour-intensive products. However, the overall tendency was that comparative advantages gained this way quickly evaporated if there was no sizeable, or only slow growth in productivity: as a result of the real revaluation and/or increase of real wages, wage advantages (measured in USD) disappeared (or will soon disappear) in most transition economies. CEE countries that based their competitiveness on low raw material and energy prices did not fare better either, since their domestic energy prices soared and the production of energy-intensive goods grew more costly. The analysis concludes that the deterioration in the competitiveness of exporters happened mainly in cases in which wage costs were relatively high, there was space for their further growth and there was no sizeable devaluation. They add that this is exactly what happened in Hungary.

At this point, however, it should be noted that there were two opposing views prevalent in the interpretation of the Hungarian macroeconomic processes of the 1990s, especially with respect to disturbances in the external balance and the level of real wages and their impact on competitiveness.[1] At that time many experts held the opinion that "overly high wages and personal incomes, and excessive consumption, were to blame for ...the huge deficit of the current balance of payments". The other view, published in a report by Kopint-Datorg, and based mainly on research by Gábor *Oblath*, was that "behind the external imbalance there are supply problems... of competitive sectors". In analysing the nature of the latter, Oblath wrote that "... stabilisation policy based solely on cutting back real wages may actually hurt the international competitiveness of the competitive sector... that is, it paves the way for the maintenance or even the growth of the external imbalance".[2] Ironically, the debate was abruptly ended by the Bokros package, devised to cut back real wages and to introduce sliding devaluation.

Referring back to obstacles confronting the exports from small transition economies, the problems of export financing must be mentioned. These were caused by abnormally high credit interest rates. (In 1994 the real value of credit interest rates varied from 4 percent in Slovakia to 30 percent in Latvia; it was between 13 to 16 percent in Hungary.) In their summary, the authors state that in spite of differences in their monetary and budget policies, all countries had troubles with the gap between interest rates on deposits and credits. This gap was caused by financial difficulties and banks with a high proportion of bad debts, and the weak infrastructure of banks with respect to trading activities.

Looking at the demand- and supply-side factors of export expansion, all managers interviewed felt that inherited conditions and domestic obstacles were more serious than barriers raised by foreign markets. This was, in spite of the fact that liberalisation had taken place differently, the extent of openness had varied, the prevalence of joint ventures was different, and every country interpreted privatisation in its own way. These managers believed that domestic (supply-side) obstacles to exports were more troublesome than demand-side (external) barriers. The authors, admitting that this is a subjective judgement and not a proven fact, regard this as quite remarkable in the light of the general opinion that Western markets are overly protective.

For people living in CEE, these findings are perhaps less surprising than for the editors who live abroad. Successful exporters are slightly overrepresented in the sample (this is natural, since the research focused on exports), and there are, presumably, an above average number of fully or partly foreign-owned companies and foreign managers among them. Thus the findings with respect to managers is understandable if one compares everything to

[1] The essence and theoretical and empirical treatment of the debate can be read in Gábor Oblath's study "Exchange rate policy, wage costs, competitiveness and economic development", *Kopint-Datorg Workshop Studies*, No. 25, December 1997, p. 112.

[2] Citations see Oblath *op. cit.*: pp. 10 and 11.

the markets they are used to and the comfortable background—offered by their mother companies while in the CEE they have to cope with underdeveloped segments of fledgling markets economy, a weak institutional network, bureaucracy and confused pricing systems. Meanwhile, they themselves often do not take note of trade and tariff barriers in Western Europe, the existence of which is quite obvious for others despite the existence of association agreements.

When evaluating the importance of domestic factors, the authors point out that fluctuations in exchange rates have often created situations in which the domestic market has been temporarily more profitable for exporters than foreign markets. This was partly due to the fact that as a result of the keen import competition which followed liberalisation, the quality of products has been significantly improved in a period when the domestic industrial output fell by nearly 40 percent; less, but better products were sometimes more saleable even in a shrinking market. Hence the export expansion observed on the surface was, also in this regard, in certain places and at certain times, the resultant force of two counter-effective processes: due to idle capacities domestic and external markets alike grew more attractive, while relatively high profitability in the domestic market has sometimes weakened the incentive to export.

With regard to domestic obstacles in the way of export performance, the authors cite the underdeveloped state of economic institutions, the problems of financing, the scarcity of capital and credits, uncertainty caused by privatisation, and the crumbling of the network of former commercial relations. Over and above these, the export activity of companies has also been hindered by a general lack of information and practical knowledge of marketing and law, problems related to language skills and foreign trade techniques, imperfect knowledge of technical directions, norms and consumers' demands, poor services and slow or no reaction to market changes. The superiority of Western partners is evident here. Although the authors think that the level of internationalisation is low and it does not have a significant effect on the economic growth of the small transition economies (Hungary is not mentioned here as an exception), there are already new and modern forms of inter-company relationships and cooperation which include joint appearance in third markets.

Another very interesting study, of the so-called mirror type, is that by Vladimir *Debentsow*. This analyses the prospects for trade between Eastern European countries (this time with the Czech Republic among them) and asks whether transition countries that have been forced out of each other's markets have any chance of reaching the pre-transition level of their internal trade turnover. András *Köves* wrote as early as in 1994 that "Irrespective of the economic policy's possible intentions and in spite of the existence of powerful groups interested in the maintenance (renewal) of trade the strategic reorientation of Central and Eastern Europe can no more be reversed".[3] Nevertheless, the question is still topical.

The study analyses the reasons for the supply structure of the Eastern European countries, their concentrated and less diversified product structure and the predominance of investment goods. This more or less explains why this supply could not be reconciled with the slump in demand. The changes in the respective structures of small transition economies have only alleviated these tensions; the Russian market, getting the sweet taste of Western consumption goods, turned a cold shoulder to "friendly" supplies which could not be sold elsewhere.

As the CMEA's trade and financing mechanism fell apart, the Warsaw Pact ceased to exist and with it the trade in military goods decreased significantly. This fact led to a regress of trade relations, as did the liberalisation of the Russian market. In the latter, Western competitors overwhelmed CMEA exporters and their products, and these exporters were unable to stay their ground in advertising, marketing and services. Another obstacle was Russia's industrial policy which favoured import replacement as against the increase of export ac-

[3]Köves, A. 1994. „A ≪nagy ugrástól≫ a hétköznapok felé: a kelet-európai átmenet gazdaságpolitikájának néhány kérdése" (From the big leap towards weekdays, a few aspects of the economic policies of Eastern European transition). *Külgazdaság*, No. 8.

tivities. According to the author of the study, the future NATO membership of CEE countries is going to have a similar effect since it has crushed long-term hopes for the increase of military trade. As Debrentsow sees it, the shrinking of regional trade is the result of artificial economic ties that were very much characteristic of the CMEA. Upon analysing the product structure, the author concludes that the export of some groups of products may, or could have better chances in the Russian market, but the old patterns of trade will never return. Companies exporting to successor states may have to cope with special conditions and serious obstacles, but they should keep in mind that the difference between the competitive environment and the technical conditions of markets will become less and less discernible.

Looking at all these well-known phenomena, perhaps the only surprise for the Hungarian reader is the extent to which they coincide with our own experiences. If this is the case, and it seems to be despite special political variances (even the analysis of the respective Estonian and Latvian trade shows the same results), then the tendencies are not product- or country-specific but system specific; in other words, the quality and structure of the one-time "socialist" internal trade has gone forever.

Finally, it is necessary the study of the editor, János Gács. This represents a kind of synthesis, being a thematical re-thinking of thoughts expounded in the country studies.

When evaluating government policies with regard to export promotion, the author is primarily interested in instruments which are still available for state intervention. In doing this he deals with practically all aspects of trade policies from import regulation to exchange rate policies. Gács deals with the trade policies of the 1990s as part of a complex transformation process and breaks the latter into four basic components: transition to market economy, reform of trade, macroeconomic stabilisation and change of structure. He proves that the transition period is chaotic and cannot be described by using the usual concepts of a market economy—neither with regard to state intervention nor to market operation. However, trade liberalisation in the respective CEE countries has shown some similarities with reforms introduced in developing countries (e.g. moving from direct state intervention towards a more general assertion of price mechanisms, and also the weakening of protectionism); even so, it has been basically different and the main difference has been that the governments of post-socialist countries lifted administrative import barriers much quicker than developing countries. In this way import-replacing activities were pushed into the background. However, following liberalisation exports received no additional promotion. Moreover, their position deteriorated, for the slump caused by the transition weakened the whole domestic production basis, and exports were no exception. Macroeconomic stabilisation affected trade policies through the regulation of exchange rates and the ending of the shortage economy, while the change of structure influenced these policies by stopping the CMEA orientation and launching integration into the EU and EFTA, respectively.

The analysis indicates that respective trade policies were not devoid of errors, mistakes, excesses and inexperience. In many cases hasty liberalisation—introduced without temporary protection—had a backlash and with the mass bankruptcies of companies suddenly left without shelter. This situation could have been prevented with temporary state subsidies, import quotas and stringent foreign exchange rules. The application of legal (horizontal) methods of export promotion was hampered—apart from inexperience and lack of institutions—by fears deriving from old intervention reflexes as much as it was by the scarcity of budgetary means. Furthermore, what is just as familiar: while companies in all small transition economies realised that their market power was insufficient in the Soviet successor states and in Western markets alike, and there was a fierce debate everywhere about the competitiveness of the various industrial sectors, none of the countries managed to devise an industrial policy suited for the prevailing conditions.

With respect to the instruments of state intervention, the study details exchange rate policies and export regulations, and the presentation of the latter includes tariff and non-tariff barriers to exports; this is a field which is only

rarely examined. At this point let me make a digression.

Since export booms in practically all the countries under review have been accompanied by a spectacular rise in import demand, payments (or rather their lack) have become a major obstacle to export expansion. Due to problems in the balance of payments, besides and in spite of free trade agreements there has been another process going on in several countries which has been parallel with liberalisation but has worked against it. Although its intensity has been much less in space and time, its essence has been to seek limitations, after the opening up of the economy, that are legal, and to introduce market protection measures that are acceptable to the outside world but which narrow the inflow of imports. These endeavours impeded the cooperation of CEFTA member countries just as much as the external (most-favoured) trade of CEE countries, and even East-West trade has been affected. It would be naïve to assume that such driving forces have ceased in the region when customs surcharges and similar barriers have been lifted according to agreements. Consider the vague role which companies with foreign participation in their capital are playing in the development of import volumes on the one hand, and in lobbying for various case-by-case preferences on the other (special tariffs, municipal and government preferences etc.).[4]

Analysing export subsidies, economic diplomacy, the system of export financing and the way governments have handled changes in company structure, Gács stresses that in the mid-1990s there had not been much state intervention in the region and even that was of an *ad hoc* nature. However, the factors which might trigger intervention are still there. In his view, this is because export-based production has no stable foundation nor does it have an advanced infrastructure. Consequently, in Eastern and Western markets alike it has been forced into disadvantageous competitive positions and thus needs support. This support may be in the form of foreign capital investment or state subsidies. Paradoxically, the possibilities of internationally accepted export promotion may provide a much greater scope for action than the CEE countries are able to use.

It must be stressed that this is the very first comprehensive analysis, based on market economy norms, of the region's post-transition foreign trade. Within the pages of this book, and thanks especially to the country study written by Ágnes *Csermely*, known processes of the Hungarian economy are put into a broader system of interrelations. They often are subject to a novel interpretation and in this way room is provided for novel and more general conclusions. The general message sent by the studies to home and abroad is just as important: developments have been rapid and stormy in each and every small transition economy, but the factors working against them were not negligible either. Now, with integration into global trade in sight, it is crucial to recognise and consciously avoid obstacles that still stand in the way of export activities.

ZS. BORSZÉKI

[4] On the trade policy of CEE countries and the latest protectionist tendencies see the article of Patrick A. *Messerlin*. 1997. „A közép- és kelet-európai országok kereskedelempolitikája: Genfen át vezet a legrövidebb út Brüsszelbe" (The trade policy of CEE countries: the shortest way to Brussels via Geneva). *Külgazdaság*, No. 9, p. 4.

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*We acknowledge the receipt of the enlisted books. No obligation to review them is involved.

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The following acknowledgement was omitted from the study by Szabolcs Kemény entitled "Flexibilities and trust: production markets and role production in the Hungarian economic transformation" published in Acta Oeconomica Vol. 49, Nos 1–2.

"Comments by Ronald L. Breiger, István R. Gábor, David Stark and especially Anna Bentley on an earlier version of the paper are gratefully acknowledged."

ACTA OECONOMICA

PERIODICAL OF THE HUNGARIAN ACADEMY OF SCIENCES

VOL. 49

AKADÉMIAI KIADÓ, BUDAPEST
1997–98

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EL TRIMESTRE ECONOMICO

Vol. LXV (3) México, Julio-Septiembre de 1998 Núm. 259

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EL TRIMESTRE ECONÓMICO aparece en los meses de enero, abril, julio y octubre. La suscripción en México cuesta $180.00. Número suelto $60.00. Número suelto atrasado $40.00. Disquetes con el índice general (por autores y temático) de los números 1-244, $26.00 (4.49 dls.)

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EL TRIMESTRE ECONÓMICO

REVUE TIERS MONDE

n° 154 Tome XXXIX Avril-Juin 1998

Revue trimestrielle publiée par
l'Institut d'Etude du Développement Economique et Social
Université de Paris I Panthéon-Sorbonne

Les transformations du travail

(Amérique Latine, Asie)

sous la direction d'Helena HIRATA, Bruno LAUTIER et Pierre SALAMA

Rédaction et administration : Institut d'Etude du Développement Economique et Social
58, Bd Arago 75013 Paris - tel : 01 44 08 73 07 - fax 01 47 07 81 75

Abonnements et ventes : Presses Universitaires de France - Département des Revues
14, avenue du Bois de l'Epine B.P. 90, 91003 Evry Cedex - tel : 01 60 77 82 05 - fax 01 60 79 20 45

Prix du numéro : **145 F** - Abonnements pour l'année 1998 : France **480 F** - Etranger **530 F**

Publié avec le concours du Centre national des Lettres

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Composed by F$_{ON}$T Ltd., Budapest
Printed in Hungary
Akadémiai Nyomda, Martonvásár

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HU ISSN 0001-6373