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BUDAPEST COLLEGE OF MANAGEMENT

ON THE WAY TO THE EUROPEAN UNION

Issues of Business, Economy and Society in Hungary around the Century Turn

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ON THE WAY TO THE EUROPEAN UNION

Issues of Business, Economy and Society in Hungary around the Century Turn

BUDAPEST COLLEGE OF MANAGEMENT

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MANAGING EDITOR:

Balázs Hámori (Ph.D.) Professor of Economics,
Scientific Advisor to the General Director of Budapest College of Management

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GREETINGS FROM THE EDITOR

"Training is everything. The peach was once a bitter almond; cauliflower is nothing but Cabbage with a College Education."
"Consider well the proportion of things. It is better to be a young June-bug than an old bird of paradise."
(Mark Twain)

Sometime in the middle of the 90s of the last century, Hungary experienced the worst of the so-called transformational crisis. It had mostly pulled down the institutional system of the command economy, established the most important forms of the democratic societal institutions, and made steps forward on the bumpy road of privatization. However, all these changes were yet uncertain concerning the way of operation and the effectiveness of the new institutions. The country's economy was in a deep crisis, partly because of the collapse of the institutions of the former command economy, partly because of the disintegration of the Soviet Union – to whose requirements the country had adapted to in the preceding decades –, not to mention the difficulty of birth of the new institutions. The private enterprises that had been newly founded beside the older ones and had had a promising start went bust one after the other.

At that time, some people, reputed experts and famous public figures thought it would be useful to establish a modern private institution of higher education, aiming first of all to support the development of the small and medium-sized enterprises, that would transmit the most up-to-date entrepreneurial knowledge. Looking back, we can assert that establishing a college in the midst of a crisis involved a great deal of risk. However, the really great risk was involved in that the acceptance of the existence of private institutions of higher education was very remote from both the mentality of the Hungarian public administration and that of most families and parents.

The program conceived has proved appealing; it has filled in a gap in Hungarian higher education. The number of applicants for the College has been continuously increasing, today around 3000 students attend this institution. We are also glad to see that our alumni are offered outstanding jobs, they have taken the first steps on promising carrier paths up to now. Quality is the key, providing education that also respects the needs of budding personalities. The leadership of the College has always found it very important to value and support the creative and useful individual initiatives of both the faculty and the students throughout the whole education process. This innovative atmosphere attracts an increasing number of prominent and recognized professionals. Thus there is a continuous improvement of the quality of education and research, and the recognition and reputation of the institution grows all the time.

The researches done under the auspices of the College keep on widening and show greater and greater promises. The themes of research range from various examinations in behavioral science business and management as well as macroeconomics international economics and European studies. Besides that, several works and books on information technology, mathematics, and statistics have been born in the past years. The scientific periodical of the College, the "Scientific Proceedings" – under the headline "21st century" – gives publicity to the professional reports and arguments.

In order to give a picture also to our partners and the broader professional public of the hard quality work done within the premises of the Budapest College of Management, we have prepared a review of the studies created in the past period and already published in Hungarian. We now present this in English to the readers, the colleagues here and all over the world, as well as to anyone interested. At the same time, we also encourage researchers both at home and abroad to join the articles published now with their comments. We naturally welcome for publication independent works within their fields of research.

Balázs Hámori
managing editor

András Inotai*

COMPETITIVENESS AND ACCESSION TO THE EU

Central and Eastern European countries have been facing a **triple challenge** concerning the relationship between competitiveness and joining the EU in the past ten years:

- On the one hand they endeavor to comply with the politico-economic and institutional tasks arising from the change of regime;
- On the other hand they strive for membership in the European Union in the background of which there is already an element of competitiveness, as without a dramatic improvement in competitiveness, it is hardly possible for them to catch up with the more fortunate and advanced part of Europe that had historically been developing in better circumstances;
- Answering the challenge of globalization is the third issue.

These three features – that is transition on a national economy level, seeking membership in the European Union and giving answer to global challenges – have been developing in the course of half a generation and provide a historically unprecedented challenge and opportunity for this region.

Competitiveness is ever less connected to individual national economies. We can add, moreover, that it is also ever less connected to individual companies. A huge number of new features – thinking here not only of global systems and huge multinationals – have emerged that entirely change the measurability of competitiveness. Having mentioned multinationals, we note here that it is very interesting how much the national economy's sensitivity to economic cycles has changed in Hungary that joined global division of labor through European markets.

10 years ago we knew as everyone had learned the lesson: when Hungarian export to the West flourished, economic growth accelerated. If there was a recession in Western Europe, the Hungarian economy also stalled. It is interesting, as statistically 76% of Hungarian export goes to the EU, the country's dependence – put in quotes – on Western markets is much bigger today. Another question is how much of this 76% remains in the EU and how much of it is re-exported from Western Europe outside the EU by the companies that have those products manufactured in Hungary.

There could simply be a the case when there is a recession in Western Europe but America or some part of the developing world is booming. When there is a recession in Western Europe, for example, and capacities cannot be fully employed, the West European companies operating in Hungary face a strategic decision as to in which country to stop production. Earlier, the classical decision was – naturally – that the foreign subsidiary had to be shut down while the parent carried on. Today, in the midst of global competition, this would mean suicide that no company could afford. Let us assume, for example, that a given company has 30 different subsidiaries all over the world – from Brazil to Ireland and from Germany to Poland, etc. It then has to consider, as it produces in a global network, which branch's operation is the relatively most expensive. And if it is the German one's, it will be the branch the parent company will close, else it will fall out of the global competition. **This is the reason why Hungary's dependence on the western economies' business cycles has not grown in such a measure as the proportion of its export shipped to Western Europe.**

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* *Doctor of Economic Sciences, director, Institute for World Economics of the Hungarian Academy of Sciences*

The second thing that should be noted already in the beginning is that international competitiveness has been influenced by three factors in the past:

- Technological or information technology revolution;
- Large-scale liberalization of the flow of factors of production on a global level – later we shall return to this;
- The radical change in corporate organizational structure not dealt with here separately.

As far as trade liberalization is concerned, **we have been able to experience clear differences between the classical Western European liberalization and the late Central and Eastern European one.** In particular, while the former had been taking place much slower and more gradually, in countries that had been economically, financially and technically prepared to give up some instruments of protecting the domestic market, liberalization in Central and Eastern Europe could be sensed as an overnight, one-shot, large-scale market opening. This was one difference.

The second, not less important difference is that the Western European trade liberalization took place in such a way that parallel with the decrease of tariffs, the so-called non-tariff barriers to trade such as technological and health regulations, etc. increased.

At the same time, under the former regime, first of all within the framework of co-operation in the COMECON, Central and Eastern Europe did not build up this so-called secondary tariff protection as it was unnecessary for exchange of commodities took place through barter on the basis of quotas. Thus trade liberalization took place in the form of an immediate and complete market opening, as those secondary protectionist measures that had been being developed in the advanced countries for decades did not exist, they were not operating in the Central and Eastern European countries and could not have been employed in a sophisticated way.

A second note concerns the liberalization of the trade of factors of production. The free international flow of products, services, capital and labor involves a great contradiction. Within regional integrations, the liberalization of the movement of products is practically complete. In Hungary's case, all the European Union's products can enter the country without tariffs and quotas as of December 31, 2000. As far as the Hungarian export is concerned, the same had been put into effect several years before. At the same time, there are still some barriers regarding agriculture that will continue to exist until the country has become a full member of the European Union. The trade of services has also undergone a large-scale liberalization, and further liberalization can be expected at the international trade rounds hopefully beginning next year. The really basic contradictions concern the movement of capital and labor.

The flow of capital is practically completely liberalized on a global scale, together with all its advantages, disadvantages, opportunities and threats. At the same time, **the mobility of labor is largely restricted from administrative and legal points of view**. The reasoning that labor is lazy and unskilled, they would not like to leave their homeland etc. does not fully account for its immobility. Brussels's authority does not extend to this area while there has been community decision-making concerning trade policy since 1974. The result is a contradiction that is also present at the Hungarian accession negotiations and can gain an extraordinary importance in the first years following accession. Hungary's aim is that free movement of labor, as one of the four freedoms of internal market, should start immediately when the country has entered the Union. In the case of Western Europe, however, this is the area where the demand for barriers is articulated most strongly. There are enormous fears of migration, that East European labor may flood West European markets.

These fears would not be realized because Western Europe will put protective measures into force, which can be welcome. If we consider the relationship between the movement of labor and capital we can see that **in our region, Hungary has been the greatest beneficiary of this: in the past years, foreign capital has flowed not only to the cheap but also to the skilled, educated, flexible part of Hungarian labor force.** Foreign capital of approximately $ 5-6 billion came to Hungary solely for exploiting this advantage. If we are put the question what we would prefer to do in the next 8-10 years: see a further $ 10 billion in foreign direct investment coming into the Hungarian market together with the resultant creation of workplaces or send 150000 Hungarian employees to Western Europe thus part with a not negligible part of capital import, we would choose the second alternative. It is not sure whether the overnight liberalization of the Western European labor market would be in our interest.

My third note is that competitiveness is much more than an economic category. It is very important to draw attention to this. Now we will immediately turn to three considerations that will determine competitiveness both in the 21st century and in the European Union.

- **The quality of administration becomes an ever more important element of competitiveness.**

Let us take a simple example: someone in Hungary produces a good that is absolutely competitive, and having passed the door of the factory, it is also competitive on a global scale. When it has reached the market, it turns out to be incompetitive because in the meantime tariffs, legal and administrative barriers, paper work and red tape simply erode the competitive advantage it managed to gain within the premises of the factory. In the 21st century, a society, national economy or factory operating under incompetitive circumstances cannot be competitive.

■ **Adequate social cohesion** is a basic requirement, especially in the case of small open-structure economies. If a country is torn apart, becomes fragmented, different groups do bush-fighting along different lines, this basically, and in particular negatively, affects the international competitiveness of the given country. For a small open economy to be internationally competitive or remain such in the international market, **a high level of social cohesion, social consensus concerning the basic development issues is necessary.**

■ The importance of innovation and flexibility gains more weight. We can add to this that the second and third issues are connected to each other. No matter how innovative someone is, they cannot win the Nobel Prize by themselves, with individual initiative in the 21st century. A team of one or several hundreds of or several thousands of researchers backs those who are granted Nobel Prizes today. That the head of the research team happens to win the Nobel Prize is one thing but he gets it not solely for his own merits. The romantic innovations of the 19th century have no ground in the 21st century. Only that innovative ability can turn into increasing competitiveness that is backed by strong cooperation. Social co-operation together with innovation are determinant.

* * *

In what follows we will focus on how the Central and Eastern European countries succeed in the competition in the European Union's market. The macroeconomic data of the past period show a clearly **historically unparalleled and sharp shift in markets** that took place within 10 years in practically every country of the region. In Hungary's case, 76% of total export goes to the EU; this ratio is 70% in Poland, and is practically already above 50% in all Central and Eastern Europe's accession countries.

This geographical shift presented itself in the form of greater competitiveness if the given country was able to increase its share of the European Union's total import. This was characteristic of nearly all the countries referred to but it can be best shown in the cases of Hungary, Poland, the Czech Republic and Slovakia.

Geographical shift and the growth of market share were in most cases accompanied by a large-scale structural change. This structural change, however, differed across countries, and today structural difference exist not only between the classical four areas of Soviet influence, that is Central and Eastern Europe, the Baltic region, Balkan and the republics of the ex-Soviet Union but the performance and the capability of structural shift of Central and Eastern European countries proved to be different in the first decade of transition.

These differences are expressed first of all in that **the unit prices of export of individual countries are largely deviated**. One ton of export measured in dollar or euro – that is the unit price of export – represent very different orders of magnitude in the cases of the individual countries. We examined these figures concerning both the European Union and the German market: we show some data as an illustration in order to be able to draw some farther-reaching conclusions from them.

One conclusion concerns the relationship between **the Central and Eastern European countries' export dynamics and the growth of their market share**. This shows how the European Union's total import was growing between 1995 and 1999 broken down by countries. A four years' time series is adequate for measuring the relative competitiveness of individual countries. **During these four years, the European Union's total import, expressed in euro, grew by 42% while the share of its export coming from the ten Central and Eastern European countries grew by 70%** – this shows the growth of these countries' market share was greater than that that of the European Union's total import. Import coming from Hungary, which nearly doubled, grew by the prominently greatest measure in all the Central and Eastern European countries. What is more, **Hungary is the only country that was able to more than double its export to the European Union in the four years referred to.** In terms of numbers, the growth of Hungarian export during these four years amounted to almost € 10 billion, which is unparalleled compared with the country's total export of € 25 billion in 1999.

Table 1

Dynamics of trade between the EU and the 10 accession countries (1995-1999)

Country 1999/1995 (1995=100)	Growth of export to the EU € bn	1999/1995 (1995=100)	Growth of import from the EU € bn	1999/1995 (1995=100)
All countries outside EU	184.9	132.3	141.6	226.7
CEE (10)	38.6	172.9	170.3	31.2
Estonia	1.0	176.0	210.2	1.0
Latvia	0.7	171.6	124.2	0.3
Lithuania	1.0	199.8	164.6	0.6
Poland	13.1	185.7	142.2	5.2
Czech Republic	6.3	154.6	185.8	7.7
Slovakia	2.2	170.0	193.0	2.9
HUNGARY	9.6	**211.1**	227.7	9.7
Rumania	2.4	164.7	169.9	2.4
Bulgaria	0.6	128.9	121.9	0.4
Slovenia	1.6	131.0	124.5	1.0

Source: Eurostat. External and Intra-European Union Trade,
No. 6. 2000 and the author's calculations

The structure of export is even more important. Group 7 of Standard International Trade Classification is in fact the most important, which contains machinery, electric devices, computers and vehicles. We classify them, together with some other products such as medicine and precision instruments, into the groups of the so-called technology-intensive and knowledge-intensive products. We can see that the structures of the individual countries' export to the EU are very different. While in Hungary's case, the "machinery and transport equipment" group accounted for 63% of export, this ratio was 53% in the case of Slovakia, 47% in the case of the Czech Republic, 45% in the case of Slovenia and only after them follows Poland with 35%. Every other country was specialized in the "miscellaneous manufactured articles" group to a greater extent (in Hungary's case, here is the smallest ratio of specialization), which is unquestionably connected to the multinationals' production structure in Hungary.

On the basis of what was said above, a very interesting model can be outlined, a model of how the specialization ratios rank concerning export to the European Union. It clearly shows that while the "miscellaneous manufactured articles" group can be found above the 100 mark almost everywhere; Hungary is the counterexample, where the group of "machinery and transport equipment" was the anchor of specialization. We examined this in the case of export to Germany, too, and these tendencies were even more pronounced there. In this case, a slightly differently constructed model (labor- intensive, material-intensive, technology-intensive products and agricultural products as well as the so-called sensitive products) shows that in 1999, 72% of Hungarian export to Germany consisted of technology intensive products. The same ratio was 62 % in Slovakia, while it was below 50 % in the cases of all other Central and Eastern European countries.

All this means that while the European Union tries, for political reasons, to make the region seem homogeneous when it considers the timing and conditions for its countries ' accession to the EU, the differences are becoming even wider, even within Central Europe.

Not to mention the fact that if we try to construct a specialization matrix for the candidate countries, the special strengths of specialization describing the economic and political development of the different countries can very clearly be seen. Furthermore, **Bulgaria and Rumania as well as the ex-Yugoslavia** (including Croatia but not Slovenia) are to a great extent specialized in textiles, apparel and footwear. This commodity group makes up approximately half of their export to the European Union. And a second pillar that can take over the dominant role of textile and apparel industry in export does not exist or does not seem to exist.

Table 2

Commodity pattern of the European Union's import from some Central and Eastern European candidate countries (1999, % of total import)

	0+1	2+4	3	5	7	6+8
Import of EU from all countries outside EU	6.4	5.2	10.0	7.5	39.1	28.8
Poland	6.3	3.3	4.7	4.1	30.4	49.5
Czech Republic	1.6	4.8	2.1	4.7	46.3	39.1
Slovakia	1.0	3.5	1.9	4.1	53.0	35.6
HUNGARY	**5.4**	**2.3**	**1.6**	**3.7**	**62.5**	**23.7**
Rumania	2.4	5.5	0.5	2.3	15.6	73.2
Bulgaria	8.8	7.1	0.7	6.0	11.6	65.0
Slovenia	1.3	2.5	0.1	4.5	40.8	50.0

Source: Eurostat. External and Intra-European Union Trade,
No. 10. 2000 and the author's calculations

Baltic countries belong to the next group: their export is built upon two pillars, apparel and wood manufactures. These two commodity groups account for 70-80 % of their export of manufactured goods. Machinery is practically absent in their export to the European Union, while certain types of electronical products are now starting to appear.

The third "group" is comprised by only one country, **Poland**, that shows partly the features of the Baltic group in that export of apparel and wood manufactures is also dominant here (40% of the international export of wood manufactures to Germany arrives from Poland). At the same time, other products: iron and steel castings, forgings and stampings, machinery, electronics and for the time being in a small amount, vehicles start to catch up with the existing two dominant commodity groups.

A separate group is formed by the Czech Republic and Slovenia. Both countries' export is built on many pillars but their structures follow a classical industrialization sample, even in the areas of machinery and electronic equipment. They are strong also in areas like apparel, rubber products, glassware, wood manufactures and paper and paperboard, etc. The Slovak export represents a very unique and bizarre but probably not sustainable direction of development, where one single commodity group, namely vehicles, make up more than 40 % of export to the Union.

Besides that, practically other commodity group that could be the anchor of development, suggesting a more diversified export structure in the middle run, cannot be found on the Slovak export palette. The question is how sustainable this one-sided export structure is and whether the export of vehicles can generate the production of other export commodities.

Hungarian export is specialized in technology intensive products, which means machinery, vehicles, electric devices, precision instruments and computers.

The most decisive argument for the difference in structures is that they represent various unit prices of export. **The price of one ton of Hungarian industrial end product to Germany was about DM 1.5400** (the inclusion of only end-products is justified on the ground that industrial end-products make up 85-93% of the export of all Central and Eastern European countries to Germany). **This neared the price of one ton of all German import**, which was DM 119.000. Much more important than that is that as opposed to the Hungarian export unit price of DM 15.400, the unit price for Poland was DM 4.000, that is 26% of the Hungarian unit price. In plain English: Poland had to export 4 tons to realize as much revenue as Hungary was able to attain by exporting 1 ton of commodities. If the average price of one ton of German import had been 100, then the unit price of export would have been 79 for Hungary, 21 for Poland, 30 for the Czech Republic, 46 for Slovakia and 50 for Slovenia, which, concerning unit price of export, ranked above Hungary five years ago. It is also interesting that the average price of Hungarian export of industrial end-products was about 18 % higher than the same export figure for Austria.

Table3

Unit prices of German import from some countries (1999, 1000 DEM/t.)

Country	Total import 0-9	Manufactured products 7-8	End products 8
Total import	**1.925**	**7.761**	**19.452**
of which:			
Poland	910	2.844	4.022
Czech Republic	1.376	3.947	5.920
Slovakia	2.527	5.323	8.893
Hungary	6.487	10.799	15.357
Rumania	5.377	7.350	9.636
Slovenia	6.582	7.409	9.683
Bulgaria	3.206	5.932	10.525
Austria	3.650	5.471	12.916
Ireland	18.151	70.599	125.005
Portugal	8.152	18.172	22.133
Spain	4.868	8.480	12.620

Source: Statistiches Bundesamt Fachserie 7 Aussenhandel, Reihe
3. Aussenhandel nach Landern und Warengruppen (Spezialhandel) 2. Halbjahr und Jahr 1999. Wiesbaden, April 2000 and the author's calculations

We can try to guess what is the basis for this outstanding performance: that Hungary imports commodities of very high value which it then further processes naturally plays a role in this. Analyzing import-export (or in general input-output) interrelations is even statistically problematic, because adequate number of new data is not at our disposal in the required depth.

Table 4

Unit prices of German import of end products in international comparison
(The unit price of Hungarian import from Germany in the given year=100)

	1989	1993	1998	1999
Total German import	291	177	111	127
of which:				
Poland	65	41	29	25
Czech Republic	55	48	43	39
Slovenia	–	107	74	63
Austria	219	142	95	84
Spain	227	159	93	82

Source: Inotai (1999)

In the end, we have to talk about the most important issue: **what to do next?** The basic requirement of the issues relating competitiveness, as of all kinds of economic policies is that it should be sustainable. The question is **under which circumstances it can be and continue to be sustainable**. When talking about competitiveness, the basic issue is articulated as **whether Hungary's current competitiveness is sustainable and what is to be done in order that it could be kept sustainable.**

We can see that in the past years – especially in the past five years – **the Hungarian production and export structure was sharply divided from the export structures of other countries in the region, mainly for two reasons: the privatization practice pursued in Hungary and foreign direct investment.** Today, however, we cannot answer the question whether this is a periodic difference, whether the other countries but at least the Czech Republic, Slovakia and Slovenia will be able to catch up with the Hungarian structure, '**the Hungarian model**', with a few years' delay, or there is such a deep structural rift, that the current way of thinking in terms of different models will take root. This dilemma will be resolved only in 4-5 years.

The next issue is that given the current pace at which wages are increasing in Hungary, is there a threat of foreign capital flying to other countries where wages are relatively low. Concerning Central and Eastern Europe, this threat is currently not realistic. The largest part of foreign capital that was invested in the Hungarian light industry in the early 1990s, first of all by medium sized Italian, Austrian and German firms, has already left, it is not operating in Hungary but in Ukraine, in Croatia, partly in the Baltic countries or Rumania. There is no chance that technology intensive production will be taken out of the country to other countries in Central and Eastern Europe, either because these countries are not prepared for that. Not to mention the fact that the existence of motorways and a secure environment is so vital for just in time production that this production culture cannot be planted beyond a boundary, that is further to the South, Southeast of the Hungarian borders.

The threat is if an economic policy undermining the sustainability of competitiveness gained power in Hungary, a part of this production could go away, it could flow back to Western Europe. Theoretically, there is a chance today of a substantial part of production to be repatriated to Western Europe, but such amount of institutional and labor market elasticity would be needed for this in Western Europe, including the possibility of downward movement of wages, which is unrealistic at the present for socio-economic reasons. In 20 years' time it may not be entirely impossible.

A further question is what Hungary should do to make foreign working capital not only stay but to be deeper rooted in such a way that a clustering, region and group formation can take place, and newer and newer companies go into the lunar orbit around multinationals in such a way that in the meantime, the added value of production can increase. A very consistent, predictable economic policy is needed for this. One type of economic policy or set of instruments is needed for the involvement of foreign capital in the framework of privatization, another type of policy is needed when strategic investors work with 5-8 years' foresight and decide whether they enter the country or not, or they just walk out of it.

* * *

How does membership in the Union affect competitiveness? One basic issue is the same as the key question of the accession negotiations: how Hungary can adopt the 'acquis communautaries' necessary for joining the Union that is the elements of community law making and legal system without which it cannot become a member in the EU. A the same time, which are the elements of the legal system of the Union the adaptation of which would strongly deteriorate Hungarian competitiveness at the time of entry – for example social, environmental and other elements of law – their adaptation is mandatory today and continue to be mandatory for some time after the entry. **We have to balance over a very narrow boundary at the negotiations,** which could be followed up at almost every chapter, at all 29 chapters that have so far been opened.

A second question is to which degree to comply with the Maastricht criteria that is the criteria concerning monetary union before entry? The answer is unambiguous: **we don't have to overreact**. Hungary won't be a member of the monetary union immediately on entry because it is not allowed to according to the EU legislation. It will have to wait at least for two years in the parking orbit called European Monetary System (EMS), in which all countries that did not enter the Eurozone in 1999 have by all means to stand for two years, like Greece had to not long ago. As Hungary will have to spend two years but maybe more outside the European Monetary Union, the country will be able to keep its independent or partially independent exchange rate policy. **Exchange rate policy plays a key role in competitiveness**. It can score an own goal, too if it devalues too drastically to improve price competitiveness. (We saw this at the beginning of the 1990s when the Czech Crown was devalued by 90 % and partly as a result of this, topped with the chosen privatization model, the competitiveness of the Czech economy was improving for a long time solely on the basis of price competitiveness.) In Hungary, at the same time, a slight appreciation of the forint could be witnessed in the latest years. **The big issue is how long this can go on without threatening competitiveness.** The answer is relatively simple: **so long as the substantial increase in productivity can counterbalance this appreciation effect.**

In Hungary the issue has been that so far but it does not mean that this practice can be continued forever. At any rate, for some years after entry to the Union this will be a feasible arrangement, but it requires a very farsighted and reliable economic policy that lacks all kinds of opportunistic and ideological elements.

The question arises whether in an era of globalization membership in the EU puts a threat to Hungary's competitiveness. We can be in a very comfortable position within the EU but if the EU is not globally competitive, it will carry Hungary along with it, and in the end, the country's global competitiveness will decrease. This theoretical possibility can be ruled out, though. However, we have to see that the companies operating in the Union are subject to such a great level of competition that they cannot afford this luxury. Higher wages that will naturally arise in Hungary after entry into the Union do not in themselves have necessarily to deteriorate competitiveness. Let me add that in the past years it has been exactly for the appreciation of the forint that Hungarian wages expressed in dollars, deutschemarks or euros have grown to a great extent. Foreign investors are not interested in how many forints they have to pay first of all but they are interested in what it means in terms of dollars and/or euros. **Higher wages in themselves are not enemies of competitiveness.**

Fist of all, they are not because higher wages can go together with higher productivity. In the Hungarian vehicle industry, which is practically fully foreign owned, productivity is higher today than in a non-Western European country, while wages reach at most 20-25 % of those in for example Germany. There is great a contradiction, a source of great tension here, that will be eased gradually by the membership in the European Union.

Higher wages do not necessarily lead to the deterioration in competitiveness for the reason that wages mean only a part of production costs. If it is possible to bring down other elements of production costs (social security charges, taxes, the additional costs of red tape, etc.) than the total cost of production can be decreased even with higher wages. But this requires a very well defined economic policy.

We have to mention yet another thing, which cannot be repeated enough times. This is information society or knowledge based society. It is clear that **human capital will be a key element of competitiveness** in the future. Educating human capital is not an easy task; it generally means long-term investment. One source of threat in Hungary is exactly that on the one hand there is or has been inflow of foreign working capital, which could be noticed in that the real profit was not meant by employing Hungarian textile workers but by employing highly qualified labor including those working in research and development. It is not by chance that such investment and development activities have increased in Hungary in the past years. We have seen lately, however, that skilled labor can simply run out; Western Transdanubia is a good example for that. So it turns out that what we have been so proud of for 10 years and even before: that Hungary is a country that is rich in human resources is not true today. As a result of a very fast and dynamic development, today the dilemma is that sufficient amount of foreign capital would come to Hungary but it does not find sufficiently qualified labor force.

It is true that in Eastern Hungary there is still such labor force at disposal but its mobility is restricted for different reasons. For this reason capital would start for Eastern Hungary that still offers skilled labor if there were motorways there. And it will go there in the minute when motorways have been built or when there are definite plans for them. It even anticipates the construction of motorways in its decisions if it knows that in two years motorway construction will reach where it plans to set up some kind of operation. **We have to realize how much the regional, geographic distribution of foreign capital and motorway network coincide with each other in Hungary.** Foreign capital has gone so far as the motorways reach. The problem is that even in that event it is probable that the lack of skilled labor has to be taken into account. The strengthening of higher and vocational education the strengthening of the system of indoor training can serve to ease this problem. On the contrary to this, very easily and in a relatively short time, Hungary can face the problem that it has to and can only buy sufficient quality and quantity of workforce in some 'trendy' professions like information technology, computer technology, biotechnology in the world market.

Germany announced the 'import' of 30.000 IT professionals in a kind of green card system. The American system has been known for a long time. It is less known that according to a strategic plan prepared in Portugal it well need the involvement of 1 million foreign professionals, a Portugal that has 10 million citizens, the same number as Hungary. Although government support of the three children family model is very important from the view of family policy, the country cannot wait for 20-25 years for foreign capital to come into Hungary and to employ human capital and added value into its operations here in an increasing degree, which is basic for the further development of the country. Namely the three children family model that thinks in terms of children born today, creates sufficient supply in the Hungarian labor market only in 20-25 years. The country does not have 20 years for this. Even if not only the number but the quality that is qualifications of graduates from higher education increases (knowing that there are considerable contradictions between qualitative and quantitative education), it seems unavoidable to fill this temporary 5-8-10 year gap by starting a very conscious immigration policy that will solely be based on professional qualities.

If it does not happen, **there is a threat that Hungary will loose a part of its potential advantages because a sufficient quantity or quality of workforce will not be at disposal. I consider this the greatest challenge of the years ahead whether inside or outside of the European Union, both before and after the entry.**

György Csáki*

FROM TRANSITION TO INTEGRATION: FDI-INFLOWS INTO HUNGARY, A SUCCESS STORY OF THE HUNGARIAN TRANSITION**

Foreign direct investment plays a decisive role in international factor movements. To attract as much as possible FDI inflows is of a predominant importance for emerging market economies. As far as transition economies are concerned, a real race for FDI is taking place among them. It is interesting to see, that their capacities to attract FDI are not depending on their macroeconomic performance but much more on their general economic policy and especially their privatization policies and practices.

Since privatization plays a decisive role in FDI inflows of the transition economies – and privatization is such a type of acquisition when the seller is the state, Dunning's well-known eclectic investment theory becomes manifest in a special manner. Hungary has always been in the vanguard of FDI inflows of the Central European transition economies but its position has changed *vis a vis* the other countries of the region – especially compared to Poland and the Czech Republic. The research question is, what is the determinant factor of attracting FDI and how Hungary's position has changed from this point of view.

The paper describes three phases of FDI inflows in Hungary:

An early phase occurred in 1988-1992, which was based upon Hungary's early legal and regulatory advantages: *till the end of fiscal 1992 about USD 5 billion FDI* were attracted which was by far the largest amount of FDI inflows among the Central and Eastern-European transition economies.

In *the second phase* of FDI inflows, *between 1993-1998, Hungary's inward FDI attraction was characterized by the dominance of privatization* – since in Hungary about 70 percent of privatization incomes were generated by foreign investors.

Since 1999 Hungarian FDI entered the third phase, that can be described as a period which is no more dominated by privatization but it is characterized by the hopefully close date of the country's EU accession.

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* *(Ph.D.) Professor of International Relations, Head of Department, Budapest College of Management*

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Some theoretical considerations

Some modernization theories have viewed for quite a long time FDI as a main engine of capital formation, market enlargement and the diffusion of knowledge which all lead to a significant development of many Third World countries. (See for example *Lewis, 1948, Rostow, 1960 and Apter, 1965*). Other theories, namely the dependency school and the World System doctrines (See for example: *Frank, 1967, Galtung, 1971 and Wallerstein, 1974*) theory took international capital movements, and namely FDI flows as the major tool of the neo-colonial system of asymmetric dependency, therefore, an international phenomenon of increasing poverty.

In the 1980s and 1990s a "pro FDI" assessment became widely accepted – parallely with the spread and dominance of the neoliberal mainstream economics. (*Lall, 1995*) The shift towards a globalization of market-based liberal economic policies became overwhelming, consequently governments in the developing world considers foreign direct investment, that is, the activity of transnational corporations as the most effective way of capital accumulation, technology transfer as well as the increase of exports.

As far as the Central- (and Eastern-)European transition is concerned, in its early phase the so-called "Washington Consensus" played a decisive theoretical/ideological role in the establishment of the macroeconomic and economic policy framework in the development *"From Plan to Market"* (*World Bank, 1997*). In the framework of the "Washington Consensus" FDI inflows are playing a crucial and decisive role in restructuring of the outdated industrial structures, corporate governance and management methods (*Sachs, 1994, Aslund, 1995*). Although left-Keynesian criticisms (see for example *Andor-Summers, 1998*) have been formulated concerning the fact that profits made by foreign investors are much greater than the host countries' advantages of direct capital imports, foreign direct investment are most welcome in practically every Central- and Eastern European transition economies. Really hostile behavior against FDI are formulated only by – extreme right and extreme left – populist political forces.

The Central European context of the Hungarian FDI attractiveness

The above mentioned economic theories about foreign direct investment flows were mostly based upon the fact, that in terms of world trade, the growth in foreign direct investment has been almost unbroken for four decades. Following stagnation between 1989 and 1991, the increase in foreign direct investment exceeded the expansion of both world production and world trade throughout the 1990s as a whole. In 1998, despite the crises in southeast Asia and Russia and the uncertainties in Latin America, foreign direct investment increased dynamically to approach USD 650 billion. According to preliminary statistics there was no change in this trend in 1999, with total annual foreign direct investment approaching USD 800 billion. The 1990s were dominated by a wave of company buy-outs and company mergers – a tendency in fact so consistent that it can scarcely be called a "wave". The majority of foreign direct investment – between two-thirds and three-quarters of total foreign direct investment exports – are traditionally realized among developed countries. Furthermore, as a result of the recent economic crisis, the developing countries' share fell in 1998 to 25.8 percent, the lowest level for a quarter of a century. In 1999, however, investors' confidence in the developing markets began to return, but it is likely that developing countries will return only very slowly to the 1996-7 figure of 37 percent of the total inflow of foreign direct investment.

In fiscal 2000 the total amount of FDI inflows was equal to 1,271 billions of dollars (while the FDI outflows amounted 1,150 billions of dollars), so that the FDI inward stocks achieved 6,134 billions of dollars (while the outward FDI stocks became equal to 5,976 billions of dollars). In the year 2000, the value of cross border mergers and acquisitions was 1,144 billions of dollars - which is equal to exactly 90 percent of the total FDI outflows. The value of foreign direct investment outflows in fiscal 2000 was about 18 percent of the yearly total exports of goods and non-factor services.*(WIR 2001 p. 10.)*

The most significant change in the 1990s was the fact that the transforming economies of Central and Eastern Europe managed to "put itself onto the map" in terms of the international flow of foreign direct investment. Although the share of the region in terms of total foreign direct investment inflows is still fairly modest – 3.5 to 4 percent between 1994 and 1997, and since then less than 3 percent – it can be hoped that, with the integration of these countries into the world economy, these levels will rise dynamically, even in the medium term. As far as capital exports are concerned, the transforming economies of Central and Eastern Europe realize less than 0.5 percent of the total foreign direct capital investments in the world economy. Although it can justifiably be supposed that a very limited number of major national corporations in the region will be able to embark on the path towards transnationalization following the successful privatization process, it seems clear that this region, even in the long term, will play a role in the world economy predominantly as a net capital importer.

In Central and Eastern Europe the wave of company buy-outs was mainly realized through privatization. The most frequent form of company merger is for two foreign-owned daughter companies to be merged in the given transforming economy following the merger of the mother companies.

As regards the attraction of foreign direct investment into the transforming economies of Central and Eastern Europe, the growth in 1998 was only 6 percent, while portfolio investments dramatically fell due to the Asian and Russian crises and, above all, the collapse of the Russian financial system. However, total foreign direct investment of slightly less than USD 24 billion mean that, relatively, the region's capacity to attract foreign capital significantly decreased in 1998. Almost two-thirds of the USD 24 billion total – that is, USD 16.5 billion – flowed into the ten associate members of the European Union. When analyzing the ten EU associate member states' capacity to attract capital, the years 1995 and 1998 can be regarded as particularly significant. In 1995 foreign direct investment inflow by the ten EU associate member states in the region doubled compared to the average over the previous years. Ninety percent of this sudden growth was realized in two countries – Hungary and Poland. In the case of Hungary, privatization revenues represented the largest proportion of the extremely high foreign direct investment inflow totaling USD 4.65 billion. Following a comprehensive rescheduling of debts, 1995 was the first year that Poland – the largest country in the region with a population of almost 40 million, and the only country with geo-strategic significance for Western Europe – became open to investors. Compared to the 1995 peak, the years 1996 and 1997 saw a certain decline; however, the capacity of these two countries to attract capital remained significantly more dynamic than in previous periods. Bearing in mind the fact that privatization in Hungary was apparently almost complete by late 1997 and that macroeconomic growth in Poland was likely to see a significant acceleration, it seemed that a new phase had begun in terms of the region's ability to attract foreign direct investment. According to widely accepted expert analysis, among the transforming economies of Central and Eastern Europe Poland has finally taken the position due to it as a result of its geographical location, its extensive domestic markets, and its highly qualified and enterprise-oriented workforce. However, the figures for 1998-99 show that Poland has not been able to increase its performance in terms of attracting capital as might have been expected after 1996-97.

The "spurt" in Czech foreign direct investment inflow in 1998–99 can be seen as an interesting new development. Up until 1997, and especially before 1995, it had been unclear why so little foreign direct investment was flowing into the Czech Republic; today it is just as difficult to tell what lies behind the improved 1998-99 performance. In 1998-99, significant restructuring within the region shook Hungary's previously unchallenged leading position. Firstly, Poland's capacity to attract capital increased significantly and appeared to stabilize, following levels of USD 4 to 5 billion in 1996-97 and, since 1998 at almost USD 7 billion annual capital imports. The Czech Republic's capacity to attract capital also rose significantly in 1998-99 compared to the modest performance of previous years: the country that was regarded as the "star pupil" of the region attracted between USD 650 and 900 million in 1993-94, and levels barely exceeded USD 1.4 billion in 1996-97. (The figure only rose to USD 2.5 billion following Skoda-related investments.) In recent years, Czech capacity to attract foreign direct investment seems to have stabilized at around something more than USD 4 billion. An analysis of the statistics for foreign direct investment inflow into Central Europe (that is, CEFTA countries) during the past ten years leads inevitably to the basic conclusion that *there is no correlation between the given country's macroeconomic performance – that is, economic growth, balance of payments and budget deficit – and its ability to attract foreign direct investment.* Even in absolute terms, Hungary attracted by far the largest amount of foreign direct investment compared to its regional competitors up to 1995–96, when the country's macroeconomic performance was perhaps the worst in the region.

Table 1

Foreign direct investment inflow in Central and Eastern Europe end-of-year balance, USD million

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Czech Rep.	72	595	2889	3,423	4,547	7,350	8,572	9,234	13,457	17,552	21,095
Slovakia	-	-	-	453	762	1,066	1,361	1,558	1,888	2,817	4,892
Hungary	569	2,107	3,435	5,585	7,095	11,926	14,668	15,882	18,255	19,299	19,863
Poland	-	-	1,125	2,840	4,715	8,374	12,872	17,780	24,780	26,475	36,475
Romania	-	40	117	211	552	971	1,234	2,449	4,480	5,441	6,439
Slovenia	-	-	-	954	1,325	1,760	2,052	2,285	2,863	2,684	2,865
Central Europe	-	-	-	*13,255*	*18,444*	*30,476*	*39,525*	*46,739*	*61,243*	*74,268*	*91,629*
Albania	-	-	20	78	131	201	291	339	384	425	517
Bulgaria	4	60	101	141	247	337	446	951	1,352	2,403	3,404
Croatia	-	-	13	109	222	324	857	1,344	2,217	4,028	4,927
Macedonia	-	-	-	-	24	33	44	60	177	210	380
S-east Europe	-	-	-	*539*	*1,176*	*1,866*	*2,872*	*5,143*	*8,610*	*7,066*	*9,228*
Former USSR	-	-	*187*	*3,105*	*5,360*	*9,833*	*15,865*	*26,824*	*34,541*	-	-
Baltic States	-	-	-	836	1,369	1,884	2,662	3,461	5,022	6,299	7,255
Estonia	-	-	-	419	696	955	1,026	1,148	1,822	2,441	2,840
Latvia	-	-	-	163	394	577	936	1,272	1,575	1,795	2,081
Lithuania	-	-	-	254	279	352	700	1,041	1,625	2,063	2,334
CIS (Europe)	-	-	*170*	*1,613*	*2,434*	*4,799*	*7,894*	*15,032*	*18,191*	*20,942*	*24331*
Russia	-	-	-	1,211	1,851	3,867	6,346	12,589	14,772	16,541	19,245
C-E Europe	-	-	-	*16,899*	*24,980*	*42,175*	*58,262*	*78,706*	*104394*	*108,575*	*132,443*

Source: Foreign Direct Investment in Central and East European Countries and the Former Soviet Union. **WIIW-WIFO DATABASE** (Vienna) 1999/258/L/2196. September 1999 and WIR 2001 p. 305.

During the same period the Czech Republic scarcely attracted any foreign direct investment, in spite of the fact that the Klaus government was at the time the favorite of the entire Western world – although this favoritism was based on a misunderstanding, investors might believed what they heard on a daily basis from their governments and their media. Nevertheless, the amount of Czech foreign direct investment inflow rose rapidly in 1998 and remained at the same high level in 1999 once it had become obvious that "the emperor had no clothes" and that the Czech national economy was struggling with serious macro- and microeconomic problems. Also difficult to understand is why, especially following the extremely successful year 1995, Poland's popularity decreased in the very years when the country produced economic growth of 6 to 7 percent and when the growth of the region's largest market exceeded even these high levels. A really accurate answer will doubtless only emerge with time. However, an approximate idea is probably to be found in the investment strategy of certain major international corporations. In any case, it remains puzzling that macroeconomic performance and the country's image were much less attractive to foreign investors than might have been expected. At the same time, ***the effect of a given government's economic policy might be found to be more significant than supposed – perhaps because in the main it determines the economy's liberalization and the regulative environment.***

In consequence of all the above mentioned facts and figures, till the end of the year 2000 about USD 91.6 billion of FDI stocks have been accumulated in Central Europe, approximately USD 7,2 billion FDI have flown into the Baltic States. Taking into consideration FDI in the former USSR, about USD 132 billion FDI have flown into Central- and Eastern-Europe: this amount does represent no more than 2 percent of the total FDI inward stock in the whole world economy. *(WIR 2001, pp. 10 and 305)*

FDI inflows in Hungary: a real success story of the transition

Table 2

Foreign direct investment inflow in Hungary (USD million, 1972–1999)

	In cash	Privatization income	Investment in kind	Total
1972-1989	387	-	783	1,170
1990	311	20	589	900
1991	1,459	435	155	1,614
1992	1,471	492	170	1,641
1993	2,339	1,163	142	2,481
1994	1,147	103	173	1,320
1995	4,453	3,370	185	4,570
1996	1,983	618	57	2,040
1997	2,085	1,827	22	2,107
1998	1,935	485	11	1,946
1999	1,651	295	6	1,657
2000	1,600	0	0*	1,600
2001**	822	0	0	822
1972-1988	17,570	8,814	2,222	19,789
1972–2000	20,821	8,814	2,222	23,046
1972-2001	21,643	8,814	2,222	23,868

Source: Ministry of Economic Affairs (IKIM – NGKM), Hungarian National Bank,
State Privatization and Holding Company (ÁPV Rt.).

* *According to ÁPV, in fiscal 2000 this figure was equal to about USD 280,000 – which is 0 while rounded to millions.*

** *Preliminary figures issued by the National Bank of Hungary (www.mnb.hu/fizetési mérlegek/2001. December)*

In Hungary, foreign direct investment inflow has always been a key issue from several points of view:

- FDI was the basic way to have *real owners* and a state of the art *corporate governance*
- FDI, that is foreign-owned companies played a key role in the (re-)*integration of the whole national economy into the world economy* as well as the Hungarian corporate sector into the global corporate networks
- *management know-hows, that is modern corporate managing, organizational and marketing skills and experiences*
- Statistics provide unquestionable evidences that*FDI was the engine of the geographical reorientation of Hungarian exports*: through FDI the Hungarian economy transformed half of its exports from the eastern markets to the western ones in a very short period of time
- FDI played a decisive role *meeting Hungary's heavy debt repayment obligations*: at the moment of the change of regime, Hungary had about USD 14 billion net foreign debt which was an enormous amount compared to the then USD 12 billion worth yearly exports. In fiscal 2000, Hungary's USD 7 billion foreign debt could be compared to about USD 27 billion of exports – and more than 80 percent of the Hungarian exports were realized by foreign-owned companies
- One can not underestimate the importance of FDI in*financing budgetary deficit*: since privatization incomes were used practically totally for financing debt, the USD 8,4 billion hard currency privatization incomes decreased substantially interest burdens financed through the budget.
- As a conclusion, we can esteem that *important FDI inflows have fastened very much the shift from plan to market, that is the transformation of the former command economy into a modern social market economy.*

* * *

In terms of foreign direct investment inflow, the past decade has been an undeniable success story in Hungary: prior to the stabilization of 1995–96, this was probably the only success story in the Hungarian economy.

It is a success story in the quantitative sense, since out of all the countries of the region the highest level of foreign direct investment flowed into Hungary – per person, as a percentage of the GDP, and compared to domestic fixed capital formation. During the 1990s, foreign direct investment significantly mitigated the economic decline. Hungary's share of the total direct foreign investment in the world economy has been permanently – over the past decade – at least double Hungary's share in world trade (0.8 to 1 percent compared to 0.3 percent).

Hungary's FDI import performance was especially attractive in the early nineties: in the early period of transition, Hungary had had an initial advantage over its regional 'competitors' as it is clear from *Table 3*.

It is also a success story in terms of quality. The significant transformation of the geographical orientation of foreign trade transactions in an incredibly short period of two to three years; technical developments; the rapid development of the corporate economy; and the general promotion of marketing attitudes – in short, the rapid and successful corporate transformation that has taken place – would have been unthinkable without the appearance and activity of foreign capital. Hungary's export performance has undeniably had, and continues to have, a favorable impact on the trade balance. At the same time, it provides a primary source for financing the current account balance of payments deficit. The branch distribution of Hungarian foreign direct investment inflow is particularly favorable: the processing industry, and within this sector the machine industry, attracted/attracts the most foreign direct investment in Hungary. At the same time, the proportion of investments in services – telecommunications, financial services, transportation, trade and real estate development – is also extremely high compared with elsewhere in the region.

Table 3

FDI inflows in selexcted transition countries, 1992-1999

Country	1992-1995 USD millions	1992-1995 Percentage of GDP	1996-1999 USD millions	1996-1999 Percentage of GDP
Central Southern Europe and the Baltics	21,091	0.5	50,558	3.3
Czech Republic	4,821	2.9	10,104	4.6
Estonia	647	3.9	1,050	5.2
Hungary	9,399	5.7	6,979	3.8
Poland	2,540	0.6	17,096	2.9
CIS	8,272	1.0	22,001	2.5
Russia	3,965	0.3	8,412	0.7

Source: TRANSITION newsletter. January-February 2002 p. 14.

Locational advantages of Hungary

Hungary's early advantages over its regional competitors in terms of FDI attractiveness was due to several different factors, such as:

- *Early establishment of the legal and regulatory environment* adequate to a modern market economy (In fact, the basic legal and regulatory reforms had been established prior to the change of regime, as early as in 1987-88.)
- *Early liberalization of both commodity, service and capital inflows* – even without a fully convertible currency (full convertibility has been established only as of March 1, 1996 but the Hungarian currency – the forint – was made step-by-step convertible for foreign investors since 1987)
- *Important tax allowances* were provided to foreign investors since 1988
- *Hungary has a fortunate geographical position* in Central-Europe – on the one hand, the country is historically in a transit position between North and South as well as East and West, on the other hand, Hungary is geographically close to some very important potential investors, such as Germany, Austria, Italy
- At the time of the change of regime *Hungary had*, at least in regional comparisons, *relatively high standards of entrepreneurial spirit* – which was, certainly due to the relative corporate independence introduced in the fremawork of the so-called "new economic mechanism" in 1968
- In the framework of the legal and regulatory reforms in 1987-88, relatively *early reforms of financial intermediation* was also taken place: a two-tier banking system was established as early as in 1987, foreign banks and insurance companies were authorized to set up their affiliate companies since 1988.

Three phases of FDI inflows in Hungary

In Hungary, three distinct phases can be distinguished in terms of FDI-inflows (*see figures in table 2 and regional comparisons of table 3*):

1.) An early phase occurred in 1988-1992: based upon Hungary's above described early advantages, *till the end of fiscal 1992 about USD 5 billion FDI* were attracted which was by far the largest amount of foreign capital attracted by one single central and/or Eastern-European country. Early investors were fairly differents from the ones in the successive phases.

Those *who had well known the Hungarian market* (former foreign trade partners or/and traditional investors from and of the region) who set up joint ventures in order to penetrate to the Hungarian market.

A lot of *early market takeovers* were also taken place in retail trade, in the production of consumer goods – including food processing, as well as in some services (insurance industry, for example),

Some, in fact very few but very important foreign companies which can be taken as *extremely early strategic investors* also made important investments in Hungary in the late 1980s and in the first years of the 1990s (see for example the very first car plant set up by Suzuki and the takeover of Tungsram by GE Lighting Europe as early as in 1989),

Extra-EU (North American and Asian) "bastion builders", wanting to establish a stronghold took the opportunity to invest in such a low wage country which seemed to be an adequate market place and production basis for getting access to the EU markets.

It is interesting to see, that *Hungary's capital attractiveness was so spectacular*, at least in regional comparisons, *when* certainly *Hungary had the worst macroeconomic performance*.

2.) In *the second phase* of FDI inflows, *between 1993-1998, Hungary's inward FDI attraction was characterized by the dominance of privatization*.

The *Hungarian privatization was always based upon market methods*: in Hungary there was no voucher privatization or any other kind of free of charge asset provisions. In Hungary, even preferential privatization methods, such as compensation vouchers, existence credit facility, start-up credit facility, privatization leasing, etc, all could have been used exclusively on the market (as a bid) and must have compete with bids in cash. With a very few exceptions (mostly in case of medium-sized state-owned companies), when foreigners were excluded, Hungarian must have compete with foreigners – and this letters always had a much stronger capital position. That is why *foreigners dominated the Hungarian privatization process: not less than 71 percent of total FDI inflows was carried out by foreign onvestors! (See Table 4)*

Figures of *Table 2* and *4* show clearly that USD 7,956.3 million out of USD 8,814 million, that is about 90 percent of 'privatization FDI' was actually realized between 1993-98.

Yearly differences can be easily explained: while *1991 and 1992* were 'normal' years of the early phase of the privatization, fiscal *1993* was marked by a breakthrough – especially because of the first step of the privatization of *Matáv* (while having sold 35 percent of the equities with the totality of management rights), the Hungarian national telecommunication company, and this single transaction represented USD 1,163 million alone (it was equal to 68,8% to the total FDI inflow of that year). The extremely poor performance in *1994* was due to the then macroeconomic crisis as well as to the uncertainties related to the second free Parliamentary elections. In *1995*, the newly elected socialist-liberal coalition government made great efforts for the macro-economic stabilization as well as to decrease dramatically the country's foreign debts – the privatization of public utilities and energy providers was unique in that time. It was the real breakthrough both in the Hungarian macro-economic situation and in the history of the Hungarian privatization. The privatization performance of *1996* was quiet good but not outstanding. The USD 1,827 million privatization FDI in *1997* meant another peak: this time several successful stock exchange introduction generated a new exceptional privatization income, which was based, in this year too – as in every year between 1991-1998 – on privatization FDI. In *1998* and *1999* privatization "slowed down" and was prematurely stopped by the new right-wing government elected in 1998.

Table 4

Privatization revenues of the State Privatization Companies

1990-2000, HUF billion

	Sales and asset management	Cash revenues	Of which, hard currency	Hard currency/ Cash (%)
1990	0.67	0.67	0.53	79
1991	30.43	30.35	24.61	81
1992	66.91	65.90	40.98	62
1993	164.50	133.63	110.67	83
1994	148.87	46.36	10.95	25
1995	471.93	437.80	411.48	94
1996	162.63	119.46	92.73	77
1997	340.61	317.70	208.60	66
1998	104.80	98.70	38.62	39
1999	114.95	99.23	70.00	71
2000	21.13	19.83	0.00	0
Total:	**1,628.2**	**1,369.6**	**970.6**	**71**

Source: ÁPV Rt. (State Privatisation and Holding Co.), the author's own calculations.

2.) Since 1999 Hungarian FDI entered the third phase, that can be described as a period between privatization and EU accession. As it is obvious (see, for example *Table 2 and 4*) privatization has ceased to be the main source of Hungarian FDI inflows. Therefore, on the one hand, then yearly FDI inflows decreased significantly, on the other hand, nowadays, *inward FDI is fueled* mostly by the *multiplier effects of earlier investment and reinvested profits*. In 2002 it is more obvious as any time earlier, that in Hungary "investment breeds investment." *(Csáki-Sass-Szalavetz, 1996)*

A couple of years ago one could easily be optimistic, having said that the end of the Hungarian privatization would be so close to the country's accession into the European Union, that the to process would almost coincide, therefore, the relatively high level of foreign direct investment would "easily" finance Hungary's current account deficit. *(Csáki, 1997/b)* Nowadays, such illusions have been definitely lost: although *January 1, 2004* can be taken (in an optimistic view) as the official date of Hungary's EU accession, *this nearly perspective has obviously not attracted too much new FDI into Hungary*.

The place and role of foreign-owned companies in the Hungarian economy

The role played by foreign-owned companies in the Hungarian economy is well illustrated by various statistics drawn from the balance figures and tax declarations of partly or entirely foreign-owned joint enterprises. These figures are taken from the publicly accessible data of APEH (Tax and Financial Control Administration), the Central Statistical Office, and the Court of Registration. The following figures are taken from *(Csáki–Pitti, 2000)* and have been updated by data for fiscal 2000 issued by the National Tax Authority.

Foreign ownership exceeds the national average of 46.7 percent in industry (it is especially high in the food industry and in the production of machine and car components, it is relatively high in other services (especially real estate services), in trade and in financial services. However, foreign ownership is below average in agriculture, in the construction industry, in transportation, and in other services (excluding real estate).

There is a clear tendency for*foreign capital investors to aim to achieve complete, or at least majority, ownership*: minority foreign ownership is becoming more and more the exception that proves the rule. It is no surprise, therefore, that 86 percent of the total capital of partly or entirely foreign-owned companies is in the hands of foreign owners.

The marked concentration of foreign direct investment inflow in certain areas of the country is a commonly recognized problem: the image of the "two Hungaries" divided by the Danube is confirmed by an analysis of the targets of foreign direct investment inflow (in terms of region or county). *(Pitti, 1997 and Hamar, 1999)*

In 1999, out of the 25,244 registered partly or entirely foreign-owned companies, 59.5 percent (14,520 companies) operated in central Hungary, 11.4 percent (2,886 companies) in Western Transdanubia, and 6.6 percent (1,681 companies) in central Transdanubia. The combined share of the three regions out of the total number of foreign-owned companies was therefore 77.5 percent.) The concentration is even higher with respect to registered capital, with 65.5 percent (HUF 2,017 billion) of the HUF 3,078 billion total registered capital of foreign-owned companies having been concentrated in central Hungary, 6 percent (HUF 186 billion) in central Transdanubia, and 9 percent (HUF 278.5 billion) in Western Transdanubia. Altogether this represented 81.5 percent (HUF 2,481.5 billion) of the total.

Nevertheless, it would be wrong to overemphasize the negative impact of the regional distribution and concentration of foreign direct investment inflow. Foreign direct investors follow the logical principle of, on the one hand, obtaining through privatization the best Hungarian companies, and, on the other hand, establishing themselves "in the place of" those former socialist large corporations that went bankrupt in the whirlwind of the change of system – or, more exactly, in the transformation crisis – and after the collapse of COMECON. In the unparalleled *wave of liquidations* in 1992–93, *a one-off opportunity opened up for a mass of "brownfield" investments: new production equipment, which was often dismantled and moved from another plant, could be set up in existing industrial buildings that had a suitable infrastructure, and operated by the skilled labor force that had formerly worked in those locations. Audi's* first plant in Győr and *Opel's* investment in Szentgotthárd were typical of such moves – both started their operations *in the former Rába works using former Rába employees.*

Investment motivations are not always clear, although Dunning already classical eclectic paradigm can be used fairly effectively. (*Szanyi, 2001 p. 27.*) Because the pretty large overlap between market seeker privatization FDI and foreign greenfield investment based upon the same investment motivation, even a new category emerged in describing and analyzing FDI inflows into the Central and Eastern European transition economies. Mayer and Estrin (*Mayer – Estrin, 2001*) speak about brownfield entry mode as a special case of acquisition, in which the resources transferred by the investor dominate over those provided by the acquired firm. In this case, the investor do take over a company in an emerging market in order to get market access, to have an important market share through acquisition – but the investor will replace all production facilities with its own, therefore, investor will take over, at the end of the say, the real estate (that is the workshops and office buildings) and the labor. Earlier, we used the same term of "brownfield investment" (*Csáki-Sass-Szalavetz, 1996*) to describe those cases when, in Hungary foreign investors bought a workshop building and recruited labor from a large state owned company with the same motivation pointed out by*Meyer* and*Estrin. (Mayer – Estrin, 2001)*Even special industrial parks had been established in Hungary on the basis of the real estate assets of a former state owned company this real estate linked with the relatively highly skilled labor force attracted quiet a large amount of foreign capital: characteristic examples of this type of capital attraction could have been distinguished in Győr (using the greater part of the real estate of Raba Works) and in Székesfehérvár, based on the real estates of the former state owned electronic giant, Videoton.

The regional characteristics of the establishment of foreign capital simply reflect the process whereby the foreign foreign direct investment that began to flow into the country in 1998 were almost entirely unaffected by any economic-political influence. More exactly, in spite of the inevitable impact of the general economic political liberalization and, what is more, the obvious role it played in turning the country into a popular investment target, it was unable to influence the inflow of capital in terms of either sector or region. The situation – a change of system in politics and a transformation crisis in the economy – is easy to explain and to understand. With hindsight it can also be explained that, in the interests of the acceleration and irreversibility of the economic change of system, the Antall, Boross, and Horn governments deliberately followed*Dunning's "non-interventionist scenario". (Dunning, 1993 p. 565))*

In 1997–2000 the economic characteristics of companies with foreign interest moved in parallel with those of the national economy, although the rate of increase in performance was significantly more rapid in this sphere. The increase in net sales revenues was about 40 percent, within which the already high export sales showed an approximately 55 percent increase. It is particularly interesting that *88 percent of the total export increase was provided by foreign-owned companies.*

It is increasingly important for the future of the Hungarian economy to watch the changes in trend in the gross domestic product (added value). The way the ownership-related characteristics of these behave is especially interesting.

The figures given in Table 5 suggest that the market results of companies with foreign interest represent a significant force in the country's economic performance. This driving force could be bigger if the domestic enterprises acting as suppliers were better able to meet the requirements of the joint ventures (in relation to deadlines, production capacity, quality, market prices, etc.). The optimum exploitation of this capacity is temporarily hindered by the fact that domestic companies, due to their lack of capital, are unable to keep pace with the development of companies with foreign interest.

The net turnover of all firms operating under company-tax regulations, at current prices, more than doubled from HUF 11.8 trillion in 1995 to HUF 27.7 trillion in 1999. Contributions to this average current-price increase in turnover of 38– 40 per cent a year came from almost all segments of the economy, although the rates of growth ranged between 15 and 70 per cent. The main contributions to the growth in absolute value were made by industry (including manufacturing), trade, transport and telecommunications, and other services. Rates of growth considerably above average occurred in financial services, industry, and transport and telecommunications.

A marked correlation of business results with ownership attributes and stronger concentration can be discerned. Aggregate indicators suggest that the turnover index (at current prices) of firms in majority domestic ownership almost doubled over the period, while that of firms in majority foreign ownership more than tripled. The former just managed to keep ahead of inflation while the later managed a substantial measure of real growth. Deeper analysis shows that a declining number of big companies are capable of determining the overall performance of the economy to an increasing extent.

Firms with foreign ownership perform much better than the national average, but industry-level analyses also reveal hectic movements over time and by industries. Upward trends in turnover can be seen in financial services (53.2 per cent), other services (46.5 per cent), agriculture (43.6 per cent), telecommunications, and the industrial categories (including industrial activity in customs-free zones).

The figures for 1995–2000 show that the change in added value 'follows' the change in net turnover, where ownership-related attributes can be seen. The aggregate added-value performance of domestic business associations rose by 32–3 per cent between 1995 and 1997 and 34–5 per cent between 1997 and 1999. Over the same periods, firms with foreign ownership showed an increase of 48–50 per cent in the first period (the first two years of an economic stabilization program) and 36–7 per cent in the second.

The difference of performance can also be shown in another way. *The per capita value added* in 1999 averaged HUF 4.3 million in firms in majority foreign ownership and only HUF 1.6 million in firms wholly in domestic ownership.

The performance of companies with foreign interest is increasing more rapidly than average, and their financial policies are stricter. This, along with the benefits provided by the Hungarian state, means that they perform better. This can be measured by the growth in the enterprises' net worth. *Their operating ratios are more favorable than the average for Hungarian enterprises, and due partly to this and partly to their economic background, they have a greater impact on the Hungarian economy than their actual ownership share.* Besides the direct impact, companies with foreign interest play an important indirect role through their commissioning of domestic companies, which significantly influences the Hungarian economy's market opportunities.

Table 5

Characteristics of the economic activity of companies with foreign interest and their proportion within the Hungarian economy, percentages

	1994	1995	1996	1997	1998	1999	2000
Number of companies	11,2	12,8	10,9	10,6	9,2	9,8	9.2
Staff	24,4	25,8	26,8	28,4	27,8	29,2	28.8
Net turnover	38,3	63,3	43,2	47,8	48,9	51,7	52.2
Out of: exports	*58,8*	*63,3*	*69,4*	*74,0*	*77,2*	*82,0*	*82.8*
Domestic sales	*35,3*	*37,6*	*38,8*	*41,7*	*41,6*	*43,3*	*43.2*
Gross value added	39,4	45,0	47,4	49,6	52,1	52,4	52.7
Total costs and fees	38,7	42,3	44,0	47,9	48,2	51,3	51.7
Out of: materials	*41,5*	*44,3*	48,4	55,3	57,0	61,8	63.9
Wages	*32,8*	*35,7*	*39,9*	*41,3*	*42,7*	*44,6*	*43.8*
Social security	-	-	-	*42,9*	*44,3*	*47,5*	*47.9*
Amortization	*49,1*	*51,5*	*50,5*	*53,5*	*53,7*	*56,9*	*57.1*
Investment	81,5	80,2	79,1	75,2	84,6	88,2	67.5
Pretax profits	41,5	43,2	53,7	57,1	60,1	52,4	57.4
Pre tax losses	-36,1	-41,8	-42,2	-43,9	-49,4	-53,1	-54.5
Tax in book value	48,8	43,6	53,7	76,4	61,0	62,4	63.5
Tax allowances	27,8	92,5	95,6	96,0	95,5	96,4	92.6
Corporate tax paid	26,8	36,2	39,0	44,9	45,7	49,1	45.8
After tax profits	46,5	44,4	56,2	59,2	63,1	63,9	60.1
After tax losses	-36,1	-41,7	-40,1	-42,6	-52,5	-52,9	-54.5
Dividend paid	64,3	60,7	69,4	73,7	69,2	61,5	64.7
Revenues in the balance	36,1	40,1	57,1	59,1	60,5	64,9	65.6
Subscribed capital	38,7	40,5	45,2	46,9	46,6	58,0	54.7
Out of: foreign	*59,6*	*65,9*	*70,6*	*75,3*	*80,0*	*85,7*	*85.2*
Total equity capital	38,1	41,5	45,8	48,8	50,6	57,8	56.2
Share of the increase of equity capital	70,2	69,7	78,5	64,1	62,2	78,7	105.2

Source: Csáki, 2000/b and the author's own calculations for fiscal 2000.

Comparing firms in total or majority foreign ownership with domestic firms (the figures in brackets), the following could have been observed in fiscal 2000:

1. The average net turnover per foreign firm was HUF 656.608 million (HUF 61.237 million).
2. The value of exports per firm reached euro 969,064 (euro 108,534). According to the preliminary figures for fiscal 2001, the per firm value of foreign-owned companies was equal to euro 1,078,866 compared to euro 120,750 per domestic firm.
3. The GDP figure per firm was HUF 121.291 million (HUF 11.143 million) and the GDP figure per employee HUF 5.072 million (HUF 1.844 million).
4. Although foreign firms receive 92.6 per cent of the tax concessions provided in the economy, the tax paid per foreign firm was HUF 8.666 million (HUF 0.108 million), since the pre-tax profit per firm averaged HUF 43.639 million (HUF 0.796 million).

Higher pay: The more efficient and profitable business activity of firms with foreign ownership is also reflected in higher pay to their employees. The average pay level of wholly foreign-owned firms stands at 126.9 per cent of the overall pay level in the corporate sphere. In wholly foreign-owned firms employing 51– 1000 persons, the pay level is over 30 per cent higher than average. Here the branch structure is interesting. Firms in total or majority foreign ownership pay particularly well in transport, warehousing, postal services and telecommunications, where they exceed the branch average by 52 per cent and the corporate-sphere average by 80 per cent. Firms in total and majority foreign ownership also pay much more than average in chemicals, commercial services and trade. Foreign-owned firms do not typically employ unregistered labour (or if they do, they conceal the fact well). Furthermore, they pay most of their tax and social-security obligations promptly.

Table 6

Budgetary contribution by the foreign owned companies. Billion forints

		1996	1997	1998	1999	2000
1.	**Corporate tax** (18%)	35,3	50,0	70,2	93,3	102,8
2.	**Local tax** (1-1.5%, net turnover)	40,1	56,3	93,0	98,0	101,0
3.	**Social security**[a] (33%, wages)	149,0	208,0	228,2	252,7	288,3
4.	**Employers' contribution**[b] (3%, wages)	10,4	16,5	19,5	23,1	26,1
5.	**Training Fund** (1,5%, wages)	5,2	8,3	9,8	11,6	13,0
6.	**Contribution to the "Rehabilitation fund"** (HUF 25,500 per employee)	13.1	14,0	14.9	15.2	15.9
7.	**Employees' Fund**[c] (1,5%, wages)	5,2	8,3	9,8	11,6	13,0
8.	**Social Security contribution** (11%, wages)	41,0	63,2	71,7	84,2	96,1
9.	**Personal income tax** ()	99,8	166,2	195,6	214,8	254,2
	Total	**399.1**	**590.8**	**712.7**	**804.5**	**910.4**

Notices:

1. It is important to understand, that item 1-5 are paid into the budget by the employers and the other ones are paid by the employees of the foreign owned companies.
2. The above figures can be taken as lower limits, since they are calculated on the averages and not on the separate data.

[a] 40% in 1996, 38% in 1997, 35% in 1998 and 33% since 1999.
[b] Fund for unemployment benefits – contribution of the employers.
[c] Fund for unemployment benefits – contribution of the employees.

The aggregate relations of business associations with public finance have changed favorably in recent years. There has been a steady decline in the value of the budget subsidies applied for (and received). Meanwhile the direct and indirect payments into the budget have risen fast, against stable levels of taxation. The public-finance relations of firms with foreign ownership present a mixed picture. They do not receive direct subsidies, but they remain the recipients of 92.6 per cent of the tax concessions. Their contribution to tax revenues is rising. GKI Economic Research Co. estimates that 45.8 per cent of the corporate taxes (HUF 102.8 billion out of HUF 224.4 billion) was paid in fiscal 2000 by firms in majority foreign ownership. Foreign-owned firms paid in the same fiscal year about HUF 101 billion of local taxes. The increasing employment that they provide and the higher-than-average earnings of their employees mean that they paid a total of HUF 288.3 billion into the social security budget in fiscal 2000. Foreign owned companies have a further fiscal obligation: they paid in fiscal 2000 HUF 39.1 billion into the 'Employers' Contribution ("Solidarity") (that is unemployment risk) fund' and their employees paid about HUF 254.2 billion of personal income tax and were contributed about HUF 117.8 billion into the social security funds and paid a further HUF 13 billion into the 'Employers' Contribution ("Solidarity") Fund (that if for covering the that is unemployment risk, since 'Employers Contribution Fund and 'Employers' Contribution Fund' adds up). Employers are paying 1.5 percent of the wages into the 'Professional Training Fund and contribute with HUF 25,500 per employee to the "Rehabilitation Fund' which partly covers the costs of the employment of handicapped people. These items (102.8 + 101.0 + 288.3 + 39.1 + 15.9 + 13.0 + 96.1 + 254.2) in fiscal year 2000 added up to a *total contribution of foreign-owned companies and their employees' to the public-finance system of HUF 910.4 billion..(See table 6)*

Although statistics speak for themselves, it is still worthwhile summarizing the main points in relation to the operations in Hungary of companies with foreign interest:

- In every area of the ever more globalized world the role of foreign capital is increasing, and Hungary cannot be an exception to this rule.
- The change of ownership structure has become dramatic; while state ownership decreases, foreign ownership is steadily increasing.
- The improvement in Hungarian enterprises' ability to accumulate has not been able to keep up with the increasing volume of foreign capital, and if no change for the better takes place there may be a further fall in the percentage of domestic ownership.
- The appearance of foreign investors initially mitigated the degree of economic recession, and later on it played an active role in setting the economy on a new track towards development.
- The sensitivity of companies with foreign interest to costs and incomes (and, along with this, their management efficiency) is much keener than that of domestic enterprises.
- The profits of companies with foreign interest — apart from the outstandingly high level of repatriation in 1998 of profits earned in 1997 — justifiably remain in Hungary and are used mostly for extending the resources of the economy (which will naturally have an impact on future changes in ownership relations).
- Companies with foreign interest have not so far changed their practice with respect to the distribution of dividends and stakes in proportion to their performance. Bearing in mind that an ever-increasing number of enterprises belonging in this category are being launched on the stock exchange and that the stock market price is influenced by, among other things, the distribution of dividends, an increased willingness to pay dividends can be expected.

According to certain assessments *(Hunya–Stankovsky, 1999)* "in the more developed CEE countries, and especially in Hungary, the motivation of the new FDIs has shifted from market takeovers to export-oriented, efficiency-oriented investments". In our opinion this process started much earlier in Hungary and was reflected in the complex multiplier effects of FDIs. *(Csáki–Sass–Szalavetz, 1996)*

1. It is frequently the case that smaller companies will only take risks abroad, especially in an entirely unfamiliar market, if large corporations known to them have already made investments there.

The first investors, paradoxically, inspire their major competitors to invest as well. *(*Coca Cola might soon be followed by Pepsi Cola, UTC Otis by Schindler, Schöller by Eskimo (that is, UNILEVER), or vice versa.*)*

2. Major investors very soon attract their regular subcontractors and service providers. *(*"The French banks are ready to accompany their domestic clients to Hungary", was the reply given by Dominique Chatillon, the president of the French Bankers' Association, when asked why French banks are not more active in Hungary. The answer is clear. The French banks' daughter companies limit their activities

almost exclusively to serving their domestic clients in Hungary. One of the few exceptions is BNP-Dresdner, which, employing a type of cooperation with which it experimented first in Hungary (involving, for instance, the financing of bus maker IKARUSZ's exports to Russia), has created joint daughter banks in several CEE countries.*)*

3. The majority of profits from successful investments are reinvested in the country in which the profits were made.

4. Successful operations – resulting from Hungary's favorable (from several points of view) geographical location and the related transportation opportunities – may inspire investors to establish regional or sub-regional production, services, and/or logistic centers. *(*This was how Opel Hungary Ltd. was transformed into Opel Southeast Europe and became a regional dealer in nine countries. Similarly, Ericsson's software development center became the regional development base for twenty-nine south, east, and southeast European countries.*)*

*The consequence of the combined "multiplier effects" (h*ere we are naturally not taking into consideration the multiplier effects of foreign-owned companies spreading company organizational, business ethical, technical, organizational, and marketing methods at the level of the national economy*)* is that *"investment breeds investment"*. The greatest accolade for the Hungarian economy is the fact that earlier investments have created further investments, producing greater added value, with foreign investors integrating their Hungarian daughter companies more closely into their global network. General Electric's more and more recent developments *(*GE represents a special example, since besides the USD 800 million invested by **GE Lightings Europe** in Tungsram, of which about USD 300 million was the cost of the acquisition, **GE Aircraft Engines** has invested USD 15 million in Veresegyháza; **GE Power Systems** has put USD 27 million into another greenfield investment in Ózd; and **GE Medical Systems** has recently acquired a majority stake in MEDICOR Röntgen Ltd. As is well known, **GE Capital** has been the main owner of Budapest Bank since 1995, thus five out of the thirteen divisions of GE are already present in Hungary.*)*; Audi's engine assembly plant producing 6 percent domestic added value, as well as their DM 700 million major factory assembling two types of car; the realization of the production in Hungary of increasingly large and complex computer units by IBM, which has become the largest Hungarian processing industry exporter; foreign telecommunications companies investing hundreds of millions of dollars in Hungary every year; Philips, TDK, Sony, Temic, Siemens, etc., which are putting into operation new processing industry plants almost every year – all of these illustrate that whoever has once invested in Hungary will carry on investing, will reinvest profits made in Hungary, and will, in addition, realize new investments. This short list of companies also clearly reflects the fact that multinationals have made an increasing number of strategic investments in Hungary since 1995-96, which undoubtedly indicates a new era of foreign direct investment inflow in Hungary.

* * *

Hungary has successfully come through the first two quantitative and qualitative phase of the inflow of foreign direct investment. Today, foreign direct investment does not flow into Hungary in relation to market takeovers. As a result of the multiplier effects of earlier investments, and now that investors have become familiar with the opportunities that exist in the running of Hungarian enterprises and companies, the time has come to make investments that increase efficiency and realize strategic goals. (To use the categories of *Dunning*'s well-known eclectic investment theory.) This can be achieved partly by reinvesting profits produced in Hungary, and partly by directing additional resources to the country.

The quantitative decrease over the past two years is, at the same time, a warning sign. The "dream", in which the completion of the privatization process coincided with the official declaration of Hungary's membership of the EU, has not come true. Despite this, efforts to finance the current account balance of payments deficit using the inflow of foreign direct investment cannot be given up. Maintaining the country's capacities for attracting capital must remain one of the fundamental aims of economic policy. The positive image that is painted by international comparisons must not obscure the fundamental tasks that lie ahead for the national economy. Keeping up Hungary's ability to attract capital should also be an integral aspect of the country's accession to the EU – the conclusions are obvious.

If, so far, the Hungarian national economy – for constantly changing reasons – has been able to attract foreign investors without any serious state activity, in the second phase of foreign direct investment inflow it will be essential to carry out goal-oriented state and government activities. However, individual benefits are not primarily what is needed here.

It is a **professional commonplace** – which, on the basis of the experience of developing countries has been included in every handbook for decades – that **tax benefits will not attract foreign direct**

investment into a country into which capital would otherwise not flow. It is also a fact that in the predominantly working-capital importing countries investment support offered to foreign investors has been inflated to such an extent that offering such benefits has become almost "compulsory". Investors can easily blackmail the government of the target country, claiming that "We are negotiating in three countries and have received ten years' exemption from corporate income tax from the governments of the other two...". The case of **BMW** is a good example: they openly declared that if they did not get the required tax benefits from the British government – within the EU! – they would relocate their production capacities to Hungary. It is hard to tell to what extent such threats can be taken seriously – that is, to what extent Hungary will have to be prepared to take such enormous investments – and it is even harder to decide what concessions could or should be made to gain such investments...

In terms of individual concessions – on the basis of international experience – it is more sensible to provide support that is related to the real estate required for the investment, such as providing public utilities or infrastructure (e.g. service roads).

In the future, further foreign direct investment should be attracted by the development of the educational and vocational training systems, and by the development of infrastructure, especially transportation infrastructure, so making the country truly accessible. From this point of view it is extremely important to enlarge the country's motorway network as quickly as possible, regardless of how realistic the government's recent objectives might be and regardless of the less than encouraging achievements in this area so far. It should not be forgotten, however, that the railroads still represent the weakest link in the transportation infrastructure "chain". Not to mention the failure to exploit the full capacities of water transportation on the Danube Only on such a basis can investment-supporting projects be built, aimed at the attraction of well-defined groups of investors to specific regions of Hungary.

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Foreign direct investment in Hungary have really played a crucial role in the Hungarian transition process and *have made development from command economy to market economy fast and effective*.

On the macro-economic level, FDI have played *a decisive role in Hungary's integration into the world economy, have generated dramatic changes in Hungary's export structure (both in terms of geographical orientation and industrial composition), created a practically fully synchronized business cycle with the European Union* – while Hungary's growth performance is continuously 2 percentage points higher than that of the EU.

On the micro-economic (corporate) level FDI have created *real owners and, therefore, promoted the development of state of the art management, organizational and marketing skills, have made international technical and quality standards spread* throughout the whole national economy.

The main achievement of massive FDI inflows have been the promotion of the guaranty of EU-conformity as well as the implementation of EU-standards in every sphere of the Hungarian national economy. By this way, *foreign direct investment played a central role in the preparation of the Hungarian economy to the accession into the European Union, that is to achieve the country's first and foremost political and economic ambition*.

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Pál Vastagh*

THE MAIN TENDENCIES OF CONSTITUTIONAL DEVELOPMENT IN HUNGARY AFTER THE CHANGE OF REGIME WITH SPECIAL REGARD TO THE EU ACCESSION**

I. The characteristics of the transformation process of the constitutional order, the Hungarian experience

As a result of the political changes in 1989-90, the constantly evolving constitutionalization in the Central-Eastern European countries concurrently meant a new period in the European constitutional development. In each country, the main content of the changes was expressed by rejecting the institutions and solutions typical of the former political system, by returning to the regulatory principles and institutions typical of modern civic societies. This general trend was supplemented with the peculiarities *determined* by the specific circumstances of each country. This process can be considered the third great historical milestone of European constitutional development following the ones after World War I and World War II.[1]

These years most countries of this region elaborated new constitutions, while Hungary and Poland amended their constitutions to the extent equivalent to elaborating a new one. Latvia had her own way: after gaining independence in 1991, she reintroduced the constitution of the year 1922.

These general tendencies were present in the Hungarian transformation process as well, but this transformation was supplemented and enriched by several unique features.

The Hungarian transformation process was mainly defined by its peaceful character. The great majority of the players in the change of the regime considered this peaceful way to be the most important requirement and this peaceful character prevailed in every essential momentum of the political transition, which took place on the basis of the principle of legality, within the framework of the rule of law.

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* *Associate Professor of Law, Budapest College of Management. MP, former Minister of Justice*

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1 *Sári János: Közép-európai alkotmányok 1994: A tagadás tagadása. Jogtudományi Közlöny. 1994. July-August p 275*

Later, in spring 1992 the Constitutional Court, analyzing the constitutional transformation process, came to the conclusion that Act XXXI of 1989, expressing the agreement of the different political forces, and, which was promulgated on October 23, 1989, though by its form it was a constitutional amendment, it was in fact a complete constitutional revision in its content. The provision of the Act that "the Hungarian Republic is an independent democratic state based on rule of law" in terms of constitutionality expresses the political content of the change of the regime.[2]

The Constitutional Court understood the essence of legal transformation insofar that the whole legal system should be aligned with and kept in harmony with the new constitution. The new constitution, the fundamental laws were irreproachably passed in terms of formality, by observing the legislative rules of the old legal system, by originating their binding force from the old ruling. The former law remained effective, the new constitutional structure was built on the old legal system, but it reflected the political values of the new democratic constitutionalization process.[3]

Legality first and foremost means stability. We must agree with the generally accepted consideration: there is no school, from natural law through legal positivism to legal sociology which would not accept that one of the most important values of law is certainty; stability first of all manifests in predictability, general implementation, transparency and legal certainty.

Nevertheless, these values can only relatively be effective in the extraordinarily dynamic period of transformation. At the same time, the Hungarian development and transformation did have and did retain the peculiarity of maintaining the stability of law and order in both political and legal dimensions.

II. On the conditions promoting "the Constitutional Revolution"

The favorable conditions in the years preceding 1989/90 greatly contributed to the exclusively peaceful character of the economic, political and legal transformation, that is to the change of the regime. These antecedents blended the society and added considerably to the fact that the radical changes resulting in the historic turning point took place without very serious conflicts and confrontation.

We must mention here the conditions having developed in the economy. The Hungarian economy carried the germs of market economy already at the end of the 1960s. In foreign trade relations the trade with EEC countries assumed great proportions. So Hungary was the first to conclude a comprehensive agreement with the European Communities on July 30, 1988, 5 days after the agreement on the cooperation between the EC and the COMECON had been signed. Already in 1986, the European Parliament formed a view that the European Communities had to treat Hungary individually, in conformity with the country's peculiarities. The fact that Hungary joined the GATT already in 1973 is worth mentioning as well.

These important contacts had not only economic significance but also greatly contributed to the adoption of market economy attitude and the related legal solutions by Hungary. The real breakthrough in the creation of private sector and market conditions was the passage of Act VI of 1988 on economic companies. Taking into consideration its real impact on the transformation process, many experts compared the significance of this Act to that as if a new (so to speak) "Economic Constitution" had been adopted; since the Act created the up-to-date legal forms of economy, made it possible to join world trade and to invest free funds in the production, and prepared the privatization of state owned properties.[4]

At the end of the 1980s, the economic reforms and political changes in Hungary were in tune, which opened the road to the comprehensive and qualitative changes in the political system. Besides the formation of the new constitutional order, the legal conditions of a peaceful transition and the legal framework for political activities had to be established. In this process, the regulation of the right of

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[2] *The Constitution of the Republic of Hungary Article 2 paragraph (1) Korona Kiadó Budapest p 13*

[3] *Resolution No. 11/1992.(III.5.) AB of the Constitutional Court. Resolutions of the Constitutional Court. Budapest, 1992. p 77*

[4] *Ágnes Kaló: A short presentation about the Hungarian legal system from practical point of view. Ünnepi tanulmányok. Miskolc, 1991. pp 162-164*

assembly and the right of association had outstanding importance. Both bills were created in liberal spirit, the political rights were broadly explored in them. The Act on Assembly passed on January 11, 1989 explicitly provided for the right to found a party, besides the freedom of organizing trade unions and the freedom of establishing civil organizations. The enactment of these bills formally abolished the one-party system indeed. The Act on Strikes, Acts on Assembly and Association created the basis for the democratic constitutional order. Most of these acts have remained durable and are still in force without essential amendments in ten years' perspective. In the same month, the amendment to the constitution made it possible to set up the Constitutional Court, thus creating the most important institution and guarantee for the constitutional transformation process.[5]

When we are listing the factors influencing the character of the transformation, me must touch on the continuity prevailing in the Hungarian legal development. Despite the radical changes after World War II, the Hungarian legal system did not completely break off the dominant factors of the previous era.

We can similarly assess the impact and revival of the idea of constitutionality in the Hungarian legal thinking. The Constitution of 1949 was modeled on the Soviet one. The document simultaneously broke off the Hungarian constitutional development and the European constitutional values, in this way enfeebling the idea of constitutionality. Nevertheless, some surviving traditions helped find our way back to the enforcement of constitutional requirements.[6]

In the decades preceding the change of the regime, the workshops of Hungarian jurisprudence accumulated sufficient knowledge without which the "constitutional revolution" could not have been carried out. At the end of the 1960s and beginning of the 1970s, in the framework of comparative legal studies, researchers had collected a great deal of information on the well-functioning institutions of Western-European constitutional systems and they had examined the possibilities of their domestic adaptation.

III. Building up a democracy based on the rule of law

The Act XXXI of 23 October 1989 enacted the fundamental principles and institutions of the rule of law. The amended constitution laid down a classical parliamentary system. The Parliament became the center of power, having great authority to supervise the government. The Parliament elected the Head of the State, whose executive powers had been greatly restricted. The institution of ministerial responsibility was reintroduced. This parliamentary system was built on the primacy of representative democracy, although stipulating the institutions of direct democracy, the system assigned only a secondary part to them.

In general, the checks and balances were weakly constituted in this structure. The principle of the separation of powers was primarily vested in the activity of the Constitutional Court, the independence of the judiciary and the establishment of the State Auditing Office. One of the milestones of the constitutional reform was to determine the "acts of constitutional importance" that is the circle of acts to be passed by a two-thirds majority. In fact this constitutional regulation meant a restriction of power of the existing ruling majority. The revision of the constitution in fall 1989 fulfilled its two main tasks: it stabilized the multi-party system and created the constitutional framework for a moderate parliamentary system.[7]

As a result of the first free general elections (March-April 1990), the new parliamentary majority made a political pact with the strongest opposition party in order to significantly modify the political structure having established in 1989. Subsequently to the pact, the governmental dominance strengthened vis-à-vis the position of the Parliament. By then the government became the center of power; the Prime Minister gained greater authority. The "constructive motion of censure" was introduced in order to

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[5] *Géza Kilényi: Hungary's Road to a Democratice State of Rule of Law. Democratic Changes in Hungary. Public Law Reserach Centre of Hungarian Academy of Sciences Budapest, 1990. p 27*

[6] *Kulcsár Kálmán: Alkotmányosság és kontinuitás. Valóság. 1991/8. Pp 8-9*

[7] *György Szoboszlai: Constitutional Transformation In Hungary. (Flying Blind. Emerging Democracies in East-Central Europe) Yearbook 1992. Hungarian Political Science Association pp 322-326.*

ensure the stability of the government. This way the ministerial responsibility was practically abolished in Hungary. The circle of two-thirds majority acts was reconsidered. Matters of great political importance were granted absolute majority requirements (election of officials like Ombudsman, President of the Supreme Court, election system, regulations concerning the most important institutions like the Constitutional Court, human rights, etc,) while the questions of governance have come under the need of a simple majority. Ministers are appointed and dismissed by the Head of the State on the proposal of the Prime Minister, their political fate is at the discretion of the Prime Minister. The amendment to the constitution in the Act LX of 1990 practically based a chancellery democracy, where the President of the Republic has no effective means to counterbalance.[8]

The institutional building of the Hungarian constitutional order was completed between 1990-1997. The basic rules of parliamentary order were passed. Since 1994 the Parliament has had new rules of procedure. The legal and technical conditions of a permanently sitting Parliament were shaped. (The changes in the working order introduced in 1998, the three-weekly plenary sessions have been harshly criticized by the present opposition ever since.)

In 1990-91, the Parliament enacted the regulations on local self-governments. The rules concerning their organization, competence and property relations were provided for in separate acts. The transformation of the institutions of legal protection was also accomplished.

The institutions established during the transition period were supplemented with parliamentary commissioners for civil rights - a general ombudsman, his/her deputy, a commissioner for data protection and disclosure of data of public interest and a commissioner for the protection of minority rights.

The State Auditing Office and the Hungarian National Bank gained more independence from the government.

The elaboration of the general guarantees of judicial independence was a characteristic tendency since the beginning of the 1990s. In the region Hungary has provided the most effective guarantees in terms of the independence of courts. The amendment to the constitution in 1997 resulted in the establishment of the National Council of Justice, which – as the autonomous administrative organ of courts – took over the tasks from the executive in this respect.

We must underline the very special part the Constitutional Court played in the constitutional development. The Constitutional Court examined the connection between the rule of law and the legislation, elaborated the content of legal certainty, took a stand on the practice of the executive power in relation to the rule of law, made resolutions on the rule of law and separation of powers, which exerted decisive influence on the shaping of institutions and the practice of the rule of law. The Parliament having completed the institution building, new constitutional conventions, customs emerged and developed under the guidance of the Constitutional Court.

Since the promulgation of Act XXXI of 1989, that is during the history of the republican constitution, it has been amended 14 times. As a result, its regulatory subject matters have broadened. The constitution enumerates the subject matters of legislation in nearly 50 paragraphs, most of which are to be passed or amended by a two-thirds majority vote. Between 1990-1998 the Parliament ruled on a great majority of laws named in the constitution. With that the constitutional order has developed and to a large extent been completed in Hungary.

IV. The changes in the society and prospects for the development of the Constitution

The foundations of the Hungarian constitutional order had been laid down at an early stage of a large-scale transformation process in every sphere of society. This situation is clearly reflected in the Preamble of the Constitution of the Republic of Hungary, whereas the basic law fosters the peaceful political transition aiming at a multi-party system, parliamentary democracy and creating the rule of law based on a social market economy. It was especially stressed that a new constitution could be enacted only after the transition period was completed.[9] According to the intentions of the 1989-90 constitution-

[8] *see above pp 326-328*

[9] *The Constitution of the Republic of Hungary. Korona Kiadó Budapest p 11*

drafters, the "final" constitution could be elaborated only when some years had passed, after the social and economic relations had stabilized, and the institutions and practice of the rule of law had proved operational.

Unfortunately, the favorable political situation for making a new constitution has still not matured. We went closest to this goal between 1994-98, during the ruling of a socialist-liberal coalition. That government announced as a goal in its program to adopt a new constitution. That socialist-liberal government did possess the necessary two-thirds parliamentary majority. But the different political and philosophical views on the possible content of a new constitution hampered the completion of the process. The Ministry of Justice had drafted the regulatory concept of the new constitution already in spring 1995. This concept was highly spoken of by the domestic scientific circles and highly evaluated by the Venice Commission of the Council of Europe. An equally important partial success was that the Parliament accepted the concept on the new constitution and the normative text was also drafted. These documents may be a suitable basis for the continuation of the work in a more favorable political atmosphere in the future.[10]

The process of the drafting of the new constitution was characterized by disputes and dilemmas which are supposed to be affecting the constitutional development of the next decades as well. These days the connection between the constitution and the different aspects of social life are getting more and more direct. Besides being the basic law, the constitution has another vital function: it expresses and affects the scale of values of the society. In addition to regulating the structure and limits of the state organization, it declares the social functions of the state, defines the possibilities and merits of state interference in social fields. In this way it affects the enforcement of social peace and justice. With this the constitution appears to be given a new dimension. In addition to the traditional sphere of public law, it also gains significance in the realities of equality of opportunity, social security, solidarity and interest reconciliation. In the XXI century the constitution as a new social contract must arrange the relationship between the individuals, the society and the state.[11]

In the future the central problem of constitutionalisation processes will invariably remain the declaration of the social character of the rule of law, the acceptance of the basic law status of social rights and right to social security. Their qualifications as mere state objectives may lead to serious consequences:

- The governing majority may pursue a social policy not bound by the law.
- Moreover, the discretionary powers in the allocation of social allowances may open wide-ranging opportunities for subjectivism, consequently considerable groups may be left without any social assistance.[12]

Another very important group of factors affecting the constitutional development follows from the transformation of the political structure of the society. Parallelly with the institutionalization of the multi-party system, the civil society has become strongly organized. Besides the professional organizations, business federations, chambers and trade unions the structure of the emerging "public society" is more and more outlined; on behalf of the private sphere a greater demand is experienced in order to have an impact on the performance of public duties. These aspirations are mainly aimed at the legislation. The representatives of civil society (as called in modern terms NGOs) often criticize the established representative democracy, where the non-political organizations have a very limited opportunity of influencing and enforcing their interests. The operation of the directly democratic institutions has only a complementary character as a result of the complicated legal regulations, and it is very ponderous. The political, especially the parliamentary parties exert excessive influence on the social spheres where the presence and dominance of parties is not necessarily justified, they "grudge the very air" from the organizations of civil society.

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[10] *119/1996. (XII.21.) OGY.Hat. Törvények és rendeletek hivatalos gyűjteménye. 1996. Vol. 4 pp 5135-5146*

[11] *Herbert Schambeck: Az alkotmányos alapelvekről és megvalósításuk lehetőségeiről. Az alkotmányozás jogi kérdései. Budapest, July 6-7, 1995. ELTE Eötvös Kiadó Budapest 1995. pp 118-119*

[12] *Szigeti Péter: A szociális jogállam követelményeinek érvényesülése az alkotmányos berendezkedés ben. Budapest. Manuscript 2001. P 26*

In the next few years the internal and external ambitions and effects will again highlight the need for consensual democracy, the creation of the constitutional basis of interest reconciliation. There are several ways of establishing the constitutional basis and institutions of consensual democracy and interest reconciliation:

- The issue of a bicameral parliament was already raised at the beginning of the political transition (the present parliament is unicameral). Recently these aspirations have been renewed – probably as a criticism of the present situation – in order to complement the dominant political representation. However, in the European practice, bicameral parliaments are first of all the institutions of representing regional interests.
- In the constitution drafting process, the idea of establishing an Economic and Social Council, with competencies laid down in the constitution and working by the government or by the legislation, emerged in Hungary, too. Besides the classical French, Italian, Portuguese and Spanish constitutional practice, the constitution of the new democratic Slovenia introduced such an organization. In addition to making proposals and giving opinions, making original initiatives also falls within the competence of the council. This body ensures the participation of the different professional groups, employers, local self-governments in the formation of social policy.
- To go beyond the current situation, the reregulation of the legislative process may come up as a third solution. A democratic legislative procedure should be adopted where constitutional guarantees ensure multilateral participation, wide-ranging and true professional debates. (The provisions for professional or social debates were repealed from the Hungarian Act on Legislative Procedure in May 1990). However, this form might create only restricted opportunities for complementing or transforming the system of representation.

In one or another way, if next year a new left-wing Government came to power, there would be a political will to address this constitutional challenge. The parliamentary representation of national and ethnic minorities has not been solved for over a decade. The Hungarian Constitution grants wide rights to minorities, the conditions and guarantees of enforcement are regulated in a separate act. The system of ethnic self-governments is an important complement to local self-governments and it is possible to set up national self-governments as well. Since 1995 the parliamentary commissioner of minority rights has operated as a very effective institution of the protection of minority rights. Even in a European perspective, we can claim that in Hungary a wide-ranging system of institutions and guarantees has been established to enforce minority rights.

In 1993 and 1998 several proposals were submitted to amend the election laws in order to grant parliamentary representation to minorities. The amendments could have created specific - positively discriminating - rules for minority representation in the Parliament. Both amendments were voted down on both occasions. In the proposed solutions the majority of the political parties assume corporative elements which hurt the principle of political representation and make parliamentary relations unpredictable. That is why the two-thirds majority could not be achieved. Yet this problem will have to be solved in the near future as the European Commission has also criticized the situation in its recent Progress Report.[13]

At the same time, parliamentary representation is granted for ethnic Hungarians living in the neighboring countries. In several countries political organizations based on ethnic relations have the right to nominate candidates at the elections (Romania, Slovakia, Ukraine, Yugoslavia) or to grant representation in a specific way. Hungary will also cope with the problem either by changing the system of representation or by amending electoral rules.

Within the factors having an impact on the future constitutional process, we must give account of the changes in the territorial division of the state organization. In the Hungarian system of self-government built up at the beginning of the '90s, the roles of local governments were strengthened first of all. The now existing county self-governments neither by powers nor by tasks assigned to them are able to fulfill the future functions of regional governance. We will have to establish a new medium-level regional management with both administrative and self-governing character. To align with this objective, the

[13] *2001 Regular Report on Hungary's Progress toward Accession Sec. (2001) 1745. P 15*

powers of local, county, regional and central administrative and self-governing levels must be redistributed. This process not only will lead to legal-political restructuring, but will result in the implementation of the principle of subsidiarity. It will require the enforcement of a democratic organizing principle which limits the interference on behalf of superior state organs and delegates powers to the level closest to citizens. The requirements of both the European integration and internal modernization necessitate a comprehensive administrative and self-government reform, which should be based on constitutional footing.[14]

Finally, when looking at the requirements and tendencies of the future, we must pay attention to the establishment of the constitutional minimum of market economy as well. This means that the constitution must have a part which defines the fundamental constitutional principles of the operation of the economy, the recognition of the autonomy of entrepreneurs and in this context the limits of state intervention. The freedom of trade and industry, the protection of fair competition must be determined as constitutional fundamental rights. Constitutional regulations will at the same time create for the citizens the opportunity for applying for protection to the Constitutional Court.[15]

A separate chapter of the constitution will have to rule on public finances and – in relation to them – the constitutional foundations of taxation. These well-based claims had already been raised during the constitution-drafting process between 1994-96, and in the future these issues cannot be avoided being raised either.[16]

V. The impact of the EU integration process on the constitutional order

In the last decade the international impacts on and requirements for the institutions and constitutional structure of rule of law institutions have increased. Surveys conducted at the beginning of the 1990s proved that inside the EU the public policy systems, the ways of operation of big and smaller Member States had undergone significant transformations. In the Member States the notion of "national interest" is defined in itself but ipso facto in relation to the European Union, exactly in interaction with the EU. There are few "domestic" public policy processes which essentially should not be tightly EU related. Consequently, the sharp contrast between domestic and external processes in terms of politics and public policy system does not make sense any more. Experience has shown that every small country was forced to undergo a radical transformation process, that is their whole public policy system had to be reorganized from the central to each local government.[17]

The associated countries can not evade these impacts either. Moreover, their constitutional institutions will undergo significant changes. The depth and intensity of changes will be basically affected by the changes and development of the character of the Union. Namely, whether the supranational character or the intergovernmental cooperation will dominate?[18]

The EU integration process, the developments of the eastward enlargement show that the candidate countries will have to meet the requirements of a constantly evolving EU constitutional acquis. The Association Agreement concluded with Hungary in 1999 had not yet contained such formulas. But in

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14 *Szilágyi István: Európai Unió: Alkotmányos fejlődés és a regionalizmus. Valóság 1996. No.8 pp 46-47*

15 *Sárközy Tamás: Vállalkozási autonómia – feketegazdaság és a jog lehetőségei. Gazdaság és jogtudomány 1996. No. 7-8 p 25*

16 *A Magyar Köztársaság Alkotmányának szabályozási koncepciója. Budapest, Igazságügyi Minisztérium 1995. pp 64-67*

17 *Ágh Attila: Az EU közpolitikája és a magyar csatlakozás. Politikatudományi Szemle 1998. No 4 pp 100-103*

18 *Pokol Béla: Az uniós csatlakozás és a magyar parlamentarizmus. Politikatudományi Szemle 1998. No 1 p 90*

later association agreements concluded with other countries after 1994, the notion "Democracy Clause" can be found, which, among others calls for the respect of democratic principles and human rights.

In Copenhagen in June 1993, the Council of Europe laid down the membership criteria. The political criteria included some constitutional issues as well, like "...an applicant country shall assure ...stability of institutions guaranteeing democracy, rule of law, respect for human rights and protection of minority rights" etc.

In this field the Amsterdam Treaty in 1997 brought further specifications. The fundamental principles were formed into even more precise requirements, the rule of law was declared to be an accession criterion for associated countries, laid down in the Treaty on European Union.[19] The content of the third pillar of cooperation in the field of justice and home affairs was significantly reconsidered. Besides visa policy, immigration policy, refugee affairs, cooperation in the field of civil justice became ranked among community policies. Thus, from the point of view of national sovereignty more and more sensitive issues were raised in the community policies. The new requirements arising from the announcement of "the Area for Freedom, Security and Justice", the decisions of the Tampere Summit opened up new dimensions and set up new requirements for the candidate countries.

The adoption of the European Charter for Fundamental Rights in Nice in December 2000 clearly demonstrates the ambition of the EU to further develop the EU constitutional acquis.[20] It had already been expressed at the beginning of the negotiations with the Luxembourg group that the candidate countries will have to adopt and apply the whole acquis of the EU, moreover the constitutional acquis which will be in force in the EU at the time of the accession. Nevertheless, this task does not mean for the candidate countries that they ought to copy ready-made constitutional patterns in their own national systems. Flexible methods should be applied and forms suitable for national specialties should be found and adapted.[21]

Today we can regard Europe as a forming constitutional community, where the common historical, cultural and legal values manifest themselves. For this reason, the image of Europe cannot be merely reduced to a market economy determined by competition. When specifying the requirements to be met by the candidate countries, the EU must take into consideration these values, as well. These values must not dissolve in the enlargement process.[22]

This attitude is clearly reflected in the White Paper of the European Commission entitled "European Governance" published at the end of July 2001. In the course of the debate on the future of Europe effective forms of the modernization and democratization of European Government must be addressed upon. It is the Commission's intention to enforce the five fundamental principles of good governance: (openness, participation, accountability, effectiveness and coherence) not only in the systems of government at EU level, but at the national, regional and local (self-government) levels as well. The common principles will inevitably bring together the institutions and the practice in the Member States and in the associated countries.[23]

Hungary has begun to establish the constitutional preconditions for the accession and assess the prospective impacts. The most urgent task is to prepare the amendment of the Constitution. At present in Hungary there are no domestic constitutional obstacles to continuing and completing the negotiations. However, it is a solid expert opinion that accession to the EU requires the amendment of our effective constitution before the accession. Without this amendment the delegation of certain state powers deriving from our sovereignty or, in other words, the joint exercise of these powers with the organs of the

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[19] *Treaty on European Union Section 49*

[20] *Jenő Czuczai: Challenge Stemming from European Charter of Fundamental Rights for the Candidate Countries in Eastern and Central Europe. Európa 2002. vol. II. No. 3 pp 46-51*

[21] *Jenő Czuczai: The legal alignment process with the constantly evolving constitutional acquis of the EU in Central and Eastern Europe. Európa 2002. Vol. II. No. 1 p 311*

[22] *Peter Häberle: Európa mint formálódó alkotmányos közösség. Jogtudományi Szemle October 2001 pp 431-439*

[23] *European Governance. A White Paper Commission of the EC. Brussels 25.7.2001.Com. (2001) 428 final*

Communities would involve breach of the constitution. This conflict must be prevented by amending the constitution – hopefully not in the far future.

In the relationship between the Communities and the Member States it is irrelevant whether a constitution has provisions to allow the delegation of certain state powers to supranational organizations or not. The constitutional authorization is after all necessary so that the state will make way for the community law into the national legal system, thus, being enabled by the constitution, the community law can have supremacy over the domestic law.

The constitutional provisions of member states basically stipulate the definition of the content of the future amendment of the constitution. After comparing these provisions, we can draw the following conclusions:

In the Member States written constitutions rule on the limitation of sovereignty by an international treaty or for the benefit of an international organization, or else they rule on the delegation of constitutional state powers (except the United Kingdom, where in the absence of written constitution, the alignment was made in the European Communities Act of 1972.) The constitutions of several member states have addressed the European Union or the European Communities. They describe the peculiarities of community law compared to traditional international law and underline the outstanding significance of the European integration.[24]

The content of the amendment of the constitution must be defined by taking into account strict limitations and conditions, as they are important aspects of national sovereignty. The precise definition of the content is encumbered by the fact that in this respect the expression "moving target" used in connection with legal alignment is also relevant as community law is the case-law of the European Court of Justice. Furthermore, the relationship between national constitutions and national constitutional courts do not form a static system. Following the Treaty of Maastricht and the Treaty of Amsterdam, the tendency that besides establishing the transfer of powers, a wide-ranging system of conditions should be laid down as well is gaining ground. It refers to the notion that the delegation of constitutional powers

a) should be voluntary,
b) should be based on mutuality,
c) should be done for the benefit of an organization where the given state is a member.

On the other hand, on the occasion of the accession process no constitutional amendment is required to define the order of incorporating international treaties into the domestic legal order that is to convert the so called dualistic system into a monistic one, or to decide whether the implementation of the international treaty should be carried out in terms of a formal act, by promulgating it in a decree or by simply publishing it. From the point of view of the enforcement of community law in the national law, with regard to its direct effect, direct applicability, it is indifferent whether the dualistic or the monistic approach prevails in the national legal system.

When we wish to define the content of the so-called integration clause we must take into account that the preparatory work in Hungary is not unprecedented. At community level there are plenty of relevant reference documents. In this respect we must mention the resolution of the European Parliament in June 1995 on the relationship between the national laws, the community law and constitutional laws of the Member States.

Two decisions made by the Hungarian Constitutional Court have ruled on the precepts which can stipulate the approaching codification.

The amendment of the constitution cannot be narrowed down to the delegation of power issue, or declaration of their joint exercise. The constitutions of the Member States contain wider and richer subject matters on this issue. According to their subject matters they can be classified as follows:

a) delegation of certain state powers deriving from sovereignty, its principles and limits, declaration of constitutional reservations,

b) the revision of electoral rules, its application to the nationals of the EU in case of regional or local elections, the electoral rules to send members of the European Parliament,

c) the division of roles and responsibilities of the executive and the Parliament in integration affairs, the forms of cooperation,

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[24] *EU Enlargement. The Constitutional Impact at EU and National Level.*
Edited by: Alfred E. Kellermann, Jaap W. de Zwaan, Jenő Czuczai.
T.M.C. Asser Press The Hague 2001 601 final

d) preparation for and ways of nomination into the different organs of the EU e.g. the National Bank of Hungary into the European System of Central Banks.

From this we can draw the express conclusion that we must interpret the establishment of the constitutional preconditions in a very broad sense, by no means can it be narrowed down only to the establishment of the content and the enactment of the integration clause.

Prior to the accession, but as well as after it, the parliament is an important participant of the process. On 31 March 1994, by parliamentary authorization the Hungarian government submitted the application of the Republic of Hungary for the accession to the Council of the European Union. The government entered into the accession negotiations by parliamentary authorization. The result, the accession treaty will have to be ratified and promulgated by the parliament. These negotiations cannot be carried out without permanent parliamentary supervision. Over and above that this condition unambiguously follows from the legal situation, it is at the same time practical to respect and observe the role of the Parliament. On the one hand, it is easier and faster to have the accession treaty ratified by the parliament if the parliament has regular and substantial opportunity to oversee the preparation in process. On the other hand, the negotiating positions of the government can be stronger if sometimes the negotiators can refer to the position of the parliament, to the terms set by the parliament.

Another key issue is the role of the Parliament in influencing the positions to be represented by the Hungarian government in the decision-making processes of the community after the accession. Essentially, the success of the domestic democratic legitimization of the European integration turns on this very point. The Member States attach great importance to the role of national parliaments in the integration. This role has clearly and unequivocally regulated, the circle of legislative subject matters has been precisely defined. At present the roles and responsibilities of national parliaments in the process of integration are regulated in separate acts in ten Member States.

The preliminary reporting on community draft acts needs special forms of organizational and working order. (Under the Scrutiny System the British Parliament has to give an opinion of about 800 community documents, drafts.) After the accession the Hungarian Parliament will have to set up and operate a system that will be able to solve these tasks.

We cannot stress often enough: only a procedure granting the substantial participation of the Parliament can prevent the European integration process from losing its democratic legitimacy in Hungary, only such a procedure can prevent the principle of democracy based on public consent from getting injured and only the participation of the Parliament can prevent that community institutions lose contacts with the electorate of the Member States.

So far consensus has been reached in Hungary on the issue that the conclusion or ratification of the international treaty on Hungary's accession to the EU and the related amendment to the Constitution will have to be put to consultative referendum. I do believe that this referendum to be held will be confirmative for accession since public support is now at 62%.

In conclusion it is important to emphasize:

The Hungarian constitutional development has not yet been completed. The EU accession process has a significant impact on nearly every element of the constitutional order. Still, the demand for changes follows from our internal situation as well. Besides accepting the integration clause in a broad sense,

- we will have to grant parliamentary representation to national and ethnic minorities,
- create the constitutional basis for social dialogue,
- we will have to constitute the position of regions in terms of public law,
- we will have to guarantee the main elements of social security,
- we will have to lay down the basic economic rights,
- and last, but not least, we will have to amend the electoral rules.

As a member of the EU new tasks will be assigned to the judiciary, the public administration, local governments. The role of the Constitutional Court will change. Hungary will not be able to carry out all these tasks by simply amending the Constitution. I am convinced that we must return to the constitutionalisation process which stopped in 1997. This very complex task can only be fulfilled by making and enacting a new constitution.

Anna Huszty Salamon*

THE FORMS OF STRATEGIC THINKING IN THE EVOLUTIONARY AND REVOLUTIONARY PHASES OF DEVELOPMENT OF ENTERPRISES

Strategy appeared on the palette of management instruments of profit oriented organizations in market economies more than half a century ago, and is still there – except for one or two downturns. Moreover, in recent years, not-for-profit organizations have also tried to use this method of management. During that more than fifty years, the palette of strategic management instruments became continuously richer, today a voluminous literature is at the disposal of the entrepreneurs who consider it important to apply this method. It is not the same at all, however, that in the given phases of development of the enterprise which process and methods we choose to put into shape and support strategic thinking. According to the experience, the form relevant to the phase of growth can help, while an inadequate process applied can hamper the development of the enterprise.

In our study we show, with the use of theoretical and methodological material on the development of companies and by studying the life cycles of several of them, that in the framework of how many processes can a strategy come to existence. After that we examine that in the individual phases of growth, the adaptation of what kind of processes and methods can help the management succeed. First of all, let us look at what strategy really is as – like many other categories used in management science – this concept is interpreted in many ways.

1. VIEWS ON STRATEGY

Trying to show even the most important of the different approaches in detail would be hopeless and senseless. (A multitude of works are at disposal, among others by the foreign authors: Ansoff, Campbell, Drucker, Lorange, Mintzberg, Porter, and also by the Hungarian authors: Károly Barakonyi, Magdolna Csath, Tamás Mészaros, János Vecsenyi.) Instead of introducing the various approaches in detail, we rely on a general work and quote the book of Henry Mintzberg and his co-authors who collected the different approaches into schools (Mintzberg,1998).

To illustrate the different views on strategy, Mintzberg takes as example "The blind men and the elephant". If the blind men surround the elephant and we ask them to tell what the elephant is like, we will get the most different answers. The one who stands near its ear and feels it, will characterize the

* *(Ph.D.) Professor of Management, Head of Department, Budapest College of Management*

elephant as something soft. The one who feels its tusk will say quite a different thing. Again, we will hear something different from the one who touches the feet of the animal. Everyone is talking about the elephant, everyone is telling the truth but we can only figure out what elephant really is when we put together the different opinions. It is similar in the case of strategy. Theoretical and practicing professionals have tried to define it from different points of views. *Most of them attempted to interpret strategy on the basis of the possible methods of its formulation and formation. Again others have tried to give a definition on the basis of the content of strategy.*

Mintzberg collected the different approaches into ten schools. The propositions of three of them that belong to the so-called prescriptive group are founded on the premise that strategy can come to existence only as a result of intellectual activity (when we decide in advance in which ways we want to develop, what we want to focus on, and what we want to do in the future). The propositions of the next seven so-called descriptive schools are based on the fact that not every element of strategy can and needs to be defined in advance, as strategies rather form by themselves as a result of the interaction of different forces than are formulated. Before giving account of the features of the various schools, let us underline that according to Michael Porter, acknowledged as the "guru" of strategy formulation, strategy can come to existence only the former way, that is via the conscious formulation of notions.

HOW DO STRATEGIES COME TO LIFE?

1. The Design School

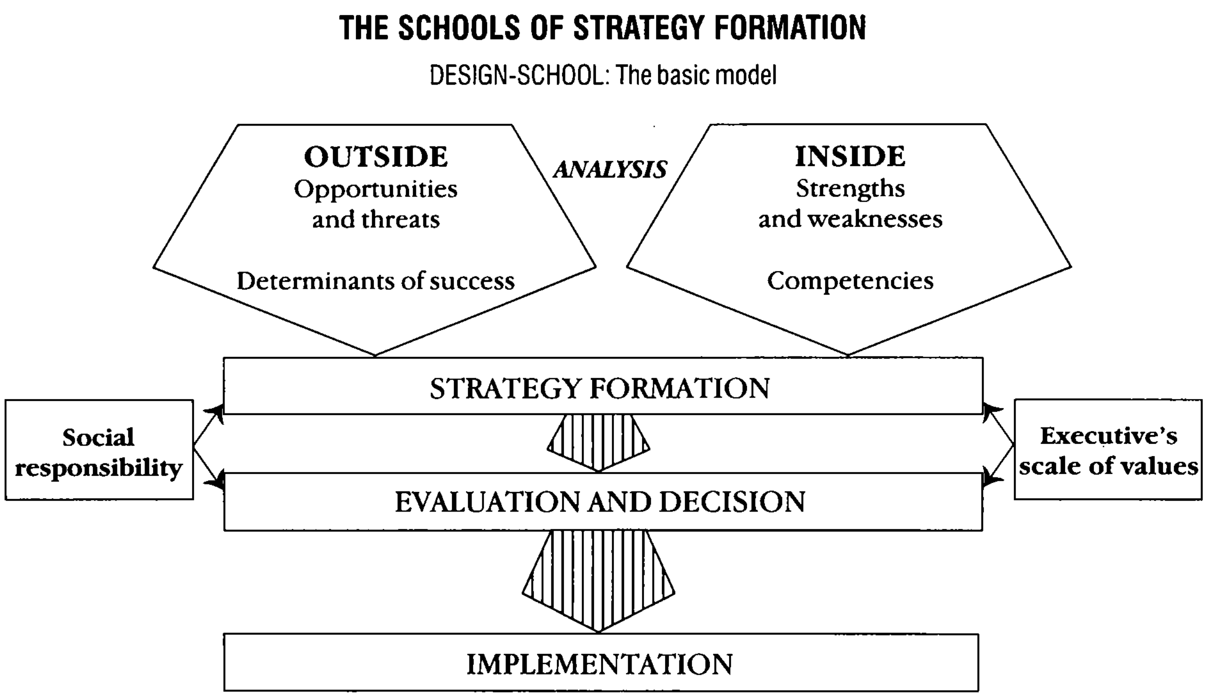
According to the advocates of design school, strategies are formed as a result of a conscious and controlled process:

Strategy formation = forming a concept.

They think that our notions about the future have to be formulated in the framework of a transparent, simple process (see Figure 1) under the control of the number one leader.

Figure 1

The basic model of design school



The basic principles of the school are:

- Strategy is individual, it has always to be tailored to the given situation, there are no standards and processes, the application of which is obligatory anytime and everywhere. It can be different across companies, even within a company, which task, to what extent is dealt with. (For example, what is given account of when the outside environment is analyzed.)
- At the end of a creative process, a whole, full-fledged strategy comes to existence, which means that strategy also extends to answering the questions *what* and *how*.
- Strategy has to be explicit, thus simple, clear-cut and easy to communicate.
- The formulation and execution of strategy are divided in time.

Thus according to the principles of the design school, strategy is hardly formal (only to a little extent formalized), it is formulated in the framework of a creative process, which is - as shown by its name – is an activity that requires creativity and imagination.

2. The planning school

Its followers also view only consciously formulated notions as strategy, but for this they think it necessary to apply a much more formal process (strategy is strictly formalized) than the advocates of the *design school*. In their view

strategy formation = a formal process.

It prescribes the application of different techniques in the individual steps of the process. We can thank to this school methods like SWOT and portfolio-matrix still applied today. The former is a method used to analyze strength, weaknesses, opportunities and threats, the name comes from the first letters capitalized; while the latter is a method that can be applied at the strategic evaluation of the field of activity or portfolio of companies. In principal the number one leader, while in practice the staff management/planning team assumes responsibility for the process. At the end of the process, a complete strategy is born, which has to be explicit to such an extent, that it can be broken down to targets, budgets and projects.

This is the most widespread method of strategy formation, and it has the longest past. Under the care of famous consultants, such companies pioneered its introduction as General Electric, Shell, and Xerox. Its main popularizer is the guru of strategy formation, the already mentioned Michael Porter, professor at Harvard.

One of the most popular models of the planning school was developed by Igor Ansoff still in the 60s in order to give such special methods of analysis that provide a general conceptional and methodological framework to solve the all the strategic problems of companies. The model recommended by him contains 57 elements. He prescribes in detail how to set targets. For example, there are nineteen steps in the hierarchy assigned to the long term ROE ratio alone. Another important phase is the valuation phase in connection with shaping the company's profile. Internal valuation deals with establishing whether the company can solve its problems without diversification, that is whether it can achieve its goals by utilizing on the opportunities given by its existing product-market strategy. If not, the external valuation follows. This means looking through the opportunities outside the existing product-market scale. In the end the total product-market strategy is born, also outlining its financial, management and budget consequences.

From the 70s, sharp criticism was addressed to the formulation of strategy in the framework of a formal process, as more and more "perfect", more and more detailed methods were born. A multitude of consultants worked on developing newer and newer techniques, we can say that nearly as many portfolio models as the number of consultants came to existence. The environment begun to change more rapidly, more and more people said that planning hurdle rather than helps strategic thinking. *It became a favorite saying in company circles that strategic plan is good for knowing what we departed from.*

The critiques of the school list the following arguments:

- The essence of strategic thinking is synthesis. It requires intuition and creativity. *The result of strategic thinking is an integrated company perspective not a picture about the direction to be followed composed with elaborate precision.*
- The use of rich methodology resulted in voluminous plans, experts peddled about with techniques instead of making strategy clear and communicating it. Form outweighed the essence.
- The true purpose of the advocates of strategic planning is to decrease the management's power over strategy formation. According to an expert, Peter Lorange: The executives should not interfere into the process to deeply in general. They should be its formulator in a general sense. How should we expect enthusiasm from executives for a process that forces them into such role? (Mintzberg, 1994)
- The process went to the hand of planners who produced newer and newer conceptions because of the environmental changes becoming more and more rapid. The detailed plans made them build a large amount of assumptions into the plans, which questioned in the eyes of the executives the seriousness of planning, they viewed the whole of it more and more as a needless ceremony.
- Executives were increasingly forced out of the planning work, they had neither time, nor energy for following the detailed steps, sometimes they were forced to play only the role of the approver. Strategic planning got far away from reality, it became the planners' own cause.
- Strategic planning was not able to treat the soft instruments of company management (values, culture). Among others, the book of Peters and Waterman, "In search of excellence" points to their importance.

We could quote the arguments against planning even longer, but this is not our purpose. With their introduction, we only wanted to draw attention to what kind of dangers can the application of detailed planning involve.

3. The Positioning School

The advocates of this school also stand up for the conscious way of strategy formulation but approach strategy rather from the point of view of its content and are not interested in the method of its formulation (how formalized this process is). According to their view:

strategy formation = an analytical process

that is aimed to determine the market position of the company on the basis of detailed analyses. Their starting point is that the economy is a competitive market, the structure of the market is to be analyzed during strategy formation with well-established methods. To do this they also suggest – like the believers in the planning school – several techniques. (For example, the portfolio model, Porter's model with five elements suitable for discovering the industry's competitive forces.)

Thus analysts are important actors of the process, the managers decide on the strategy, that is on the market position to be achieved based on the result of their work. According to the followers of the school, *in a strategy, first of all we have to define what we want to achieve, and have to pay less attention on the conceptualization of the methods of achievement.*

4. The Entrepreneurial School

This school represents a compromise between those who think strategy can only be formed as a result of a conscious process (see the schools mentioned so far) and those who think it rather evolves in a 'spontaneous' way. According to the followers of the entrepreneurial school, certain elements of the strategy have to be determined and thought over in advance, at the same time, other parts have to be left to evolve. The *key factor* of the formulation and realization of strategy *is the personality of the number one executive,* he is the pivot of strategy. The followers of this school believe in the following principles:

- Strategy is the vision of the *leader* (executive):

strategy formation = a visionary process.

- The organization adapts to the vision, to the *leader*.
- The process is built on three elements: consciousness, experience and intuition.
- The strategy (vision) is similar to positioning
- It is inevitable that the leader be committed to the vision and be able to articulate the vision clearly both inside and outside. This strategy can work only if the leader is a person with charisma who is able to "visualize and depict the desirable future" and has such a charisma that he is able to mobilize his co-workers for the visualized future.

According to several professionals, in the organization of the future, leader-type executives will be needed. A lively description of the differences between the leader and the manager is presented by B. Nanus:

- The leader is the master of connections
- The manager administers, the leader innovates
- The manager focuses on systems and structure, the leader focuses on people
- The manager relies on control, while the leader relies on trust.
- The manager has a short-range view, the leader has a long-range perspective.
- The manager asks how and when, the leader asks what and why.
- The manager accepts the status quo, the leader challenges it.
- The manager does things right, the leader does the right thing.
- He defines the role of the leader as follows:
- Direction setter: he selects and articulates the target;
- Change Agent: he catalyzes changes in the internal environment of the organization;
- Spokesperson: He represents and sells the vision to the stakeholders from the external environment;
- Coach: he builds team, lives the vision and acts as a mentor.
  (B. Nanus 1992.)

5. The Cognitive School

The followers of this school state that

strategy formation = a cognitive process,

namely that kind of cognitive process that takes place in the head of the strategist. Strategy is aimed at taking a survey of the effects (inputs) coming from the environment and managing them, the method for this, however, depends basically on the personality of the cognizant, the strategist (who is in most cases the chief executive of the company). The advocates of the school point out a very interesting aspect: the cognizant unavoidably *decodes* information coming from the environment. This does not mean a conscious distortion of the incoming signals but it means that the strategists' past, their memory (what they remember) their personality, the schemes and biases residing in their minds also have an effect on what they notice from the environment, how they judge it. (Different personalities interpret the same event quite differently. The story of two salesmen trying to sell shoes in the desert is considered a stale joke in marketing fields: one of them reports to the boss that sale is impossible, for no one wears shoes, while the other announces with wild enthusiasm that there are incredible opportunities as no one wears shoes yet.)

We can see the realization of the above principles in the practice of Nokia. Few people know that when Jorma Ollila took over the company in 1992, it had a $ 213 million loss. It had a wide range of operations, manufactured everything from power generation equipment through tyres and computers to television sets. It also manufactured mobile phones, this branch was started in 1979, but its size was insignificant, the number of staff working there did not reach 100, and its operating profit was negative. (Ollilla had been CFO of Nokia, he was appointed head of the branch because of its financial difficulties. He was promoted from here to head of the company.

Today, Nokia is world leader of the wireless telecommunications market. How did this huge transformation happen? According to the literature, Nokia took notice of the fact that while the market for computers and electronic devices had come to saturation, that of wireless telecommunications had started to grow at an incredible pace. The Fortune Magazine wrote about this after an interview with Jorma Ollila: "In August, 1992 he came out of a brainstorming session and quickly scribbled on a piece of paper: 'telecommunications oriented, global, focus and value added'". Not exactly a piece of art, but from then on, this vision is the driving force for the company. (Lovio, R.-Pulkkinen, M.-Vaananen (1997)). Thus the first vision for the company was born: the "grocery" called Nokia had to be transformed into a telecommunications oriented company. "We made important decisions partly on the basis of intuition, partly on the basis of careful considerations" says Ollila about this change in another interview. (Lovio, R.- Pulkkinen, M.-Vaananen.1997)Thus both the elements of conscious design (entrepreneurial school) and intuition appeared in the strategy of the company. What were these intuitions based on? Probably the fact that Ollila had been working in the field of telecommunications and knew this profession the best played a role in this. From the signals coming from the outside environment, he unavoidably paid attention most delicately to the ones concerning the telecommunications market, that is he filtered outside signals through his own set of information that is (also) the reason why he decided that the company should focus on the telecommunications market in the future. Thus Nokia's strategy was formed partly through a vision formation process, partly through a cognitive process. The vision was changed in the meantime. The new vision of Nokia sounds, "We put the Internet in every pocket. Everything grows together – mobile and the Internet, and Nokia grows together with them."

6. The learning school

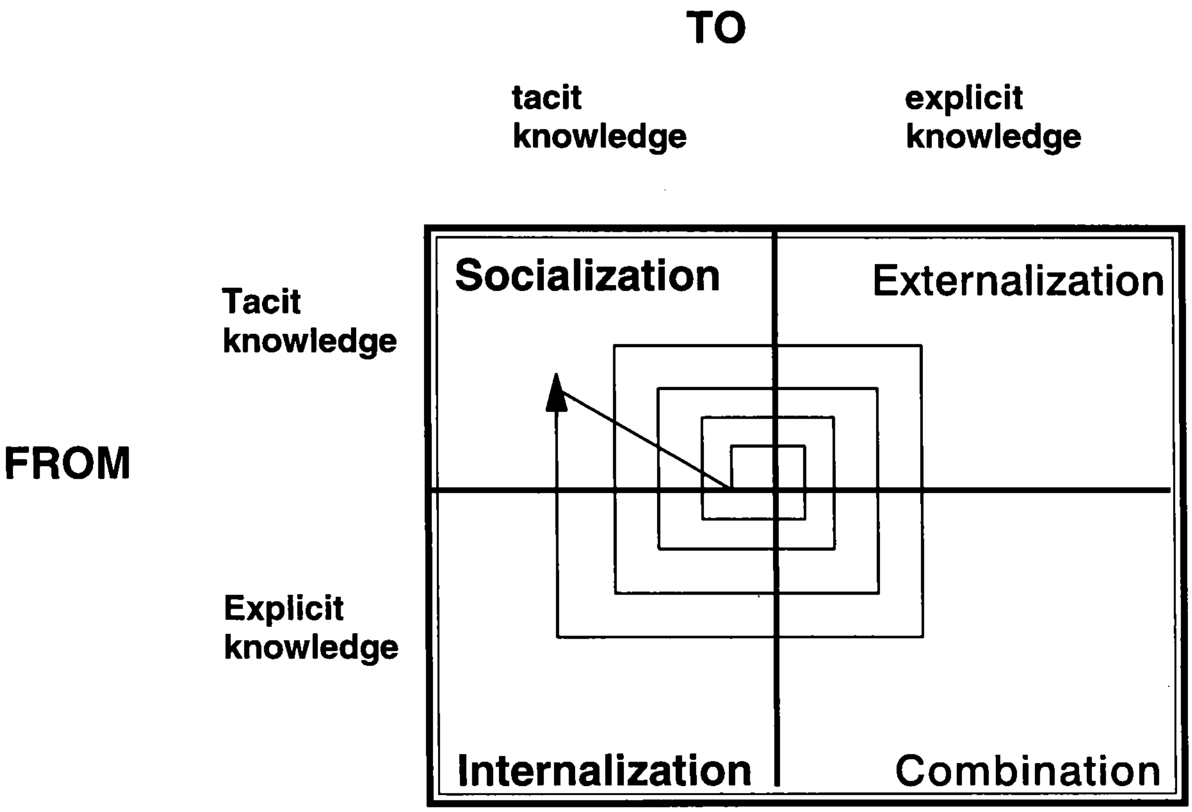
It is built on the assumption that the environment is complex and unpredictable, the information on it is scattered about within the organization, thus strategy cannot be formed in advance, it is formed as a result of a collective and continuous learning process.

Strategy formation = a learning process.

Both the leader and the organization learn, the management's task is to assist and manage learning. According to the knowledge born as the result of learning, we distinguish different phases of the process, see the following figure:

Figure 2

The learning process and levels of knowledge



The subordinate and the manager both learn through cooperation (socialization) but this knowledge is tacit in the beginning. When it reaches a given level, it can be articulated and expressed (externalization) then becomes a matter of discussion (combination). During discussion the executive's and the organization's knowledge is enriched with different opinions then knowledge deepens (internalized) then the process goes on and on.

Mintzberg draws comparison to a craftsman. The shaping of a jug can happen in many ways. If an engineer is given the job, he probably makes a plan of the jug in advance. He draws it in details, precisely calculates the sizes, determines the amount of material needed, etc. when the plan is complete, he begins fashioning the jug. (Turning it into the language of strategy formation, the jug is made as a result of a planning process.)

If a craftsman is given the job, he takes a lump of clay, puts it on the jigger and starts fashioning it. If he doesn't like it, he alters it a bit. He learns making jug continuously. The final shape of the jug is formed in his hands. This is the learning school. If the process takes place in a larger manufactory, many people are shaping jugs, then it is the executive's task to determine, which jug he finds good and who he stops working. He can choose the really well made ones, these can become patterns and now he can intently require everyone to make these kinds of jugs.

Thus the advocates of this school do not totally deny the raison d'être of strategy formation. They admit that after a kind of learning phase it can be time to *form* a strategy. The notions are presented in such a concept, vision or plan, in which they build the so far tacit knowledge, experience and behavioral patterns of the management and subordinates.

7. The Power School

According to the teachings of the school, strategy formation is cardinally dependent on power and policy, strategy is formed as a result of fighting forces of power:

strategy formation = a process of negotiation.

Here the stakeholder groups of the company represent the power forces. (We are talking about those persons and organizations who are in some way interested in the profitability of the company's activity, it brings them profit or loss.)

The stakeholder groups of the organization can be inside or outside of it.

Outside stakeholders:
- owners
- customers
- suppliers
- industrial associations
- local/general government
- creditors
- the population
- the ones that live in its geographical environment
- the press (representing publicity), etc.

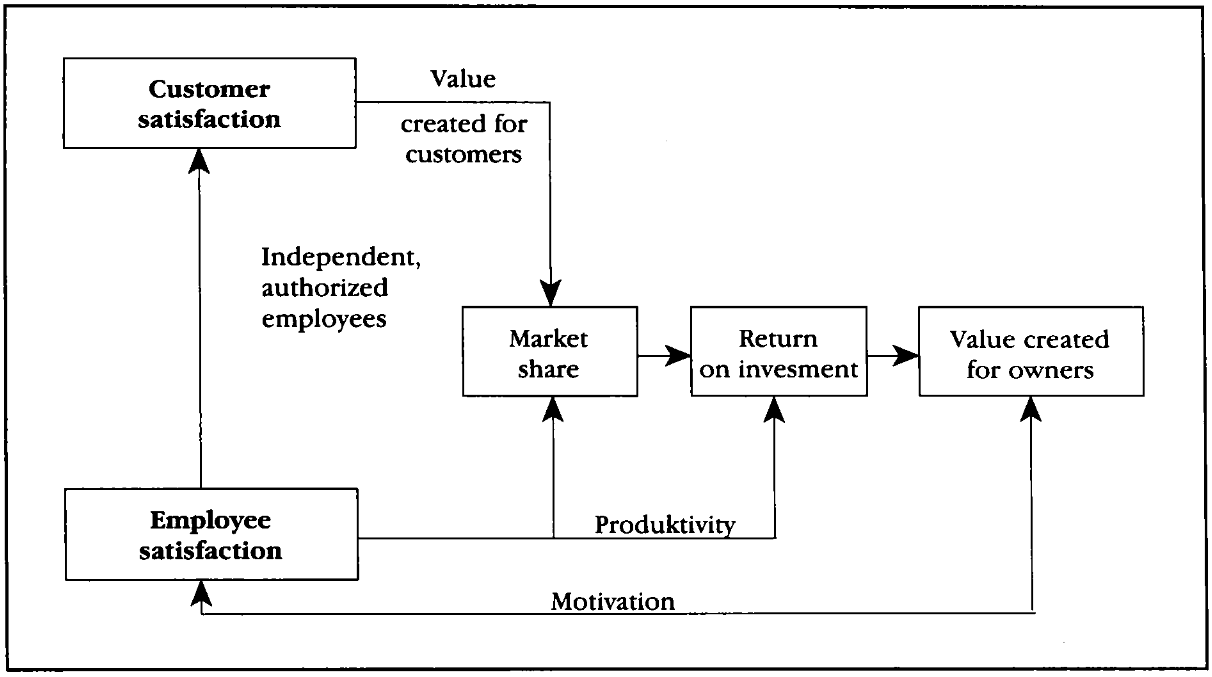
Inside stakeholders:
- top management
- staff management
- middle management
- employees
- workers
- experts, etc.

Those vote for the raison d'être of this strategy formation process, who think:
an organization can be subject to its stakeholders, that is rather to one or two more powerful stakeholder group to such a great extent – with some exaggeration it is their galley-slave – that it cannot do anything but forms strategy through different games with them, by persuasion, bargaining, blackmailing, alliance, confrontation, etc.

There are companies that consider the compliance with the requirements of the shareholders of prior importance, but there are those who also find it necessary to meet the requirements of other stakeholder groups as well (the ones following the stakeholder model). According to the latter group, the company can operate successfully in the long run only if it equally serves the interests of its most important stakeholder groups (owners, customers, employees.) This (relationship) is shown by the following figure on Xerox.

Figure 3

The magic circle of Rank Xerox



8. Cultural School

The views of its advocates are in many ways similar to those of the cognitive and learning schools, but they are more interested in the collective and cooperative processes of strategy formation.

According to their view:

strategy formation = a collective cognitive and learning process.

According to the principles of this school, during strategy formation, not only one person's (the executive's, the strategist's) personality filters the signals coming from the outside environment, but the whole community decodes them. They do not even take notice of some signals, they magnify some of them, they transmit some information, do not transmit others, etc. Besides their personality, such factors influence their behavior as the culture of the organization: the dominant views and beliefs in the organization (for example, which behavior will be valued by the boss: if one is quiet about bad news coming from the market or not.

According to a renowned culture expert this catch is experienced by many American executives who happen to live abroad. The executive, arriving from the pragmatic American culture assumes and is sure that the solutions to the problems are always given priority. When they meet an employee grown up in another culture, things can easily happen according to the following scenario: the executive suggests some kind of solution to a problem. The subordinate knows it won't work but his subconscious assumptions suggest him keep quiet because contradicting the boss would bring discredit on the executive's authority and the judgment of the way chosen by him. The action is carried out, the result is negative. The executive becomes surprised and perplexed. He asks the subordinate what he should have done. The subordinate is baffled by the executive's behavior because he didn't try to defend his authority. For the executive, the subordinate's behavior is equally incomprehensible. He does not find a reason for his behavior except for that he is not concerned about efficient operation at all and it would be better to get rid of him. It does not even occur to him that there is another assumption – never offend the boss – works in the background and this has a stronger value for the employee than the command "do your job well." (Schein et al.)

Strategy according to this view as well is difficult to change because culture back up existing strategy, less the change.

9. The environmental school

The advocates of this school adopt the theories of Darwin to business life. They proceed from the assumption that organizations form ecological systems, individual companies are totally subject to the rules of their environment. (According to some observations, laws can be found in the macroeconomy just as in the biological nature. Several researchers try to model these patterns.) The organization cannot do otherwise than trying to adapt to the rules of its surrounding environment but it has to be prepared to being selected at any time.

strategy formation = a selective (reactive) process

The most important principles of the school are as follows:

- the environment seen as the set of powers is in the center of strategy formation;
- the task of the executive is to help in the accommodation;
- the positions remain until funds are sufficient, the climate is not too unfriendly.

This school denies the most markedly that it is possible to prepare consciously for environmental changes. The widespread saying about forming strategies is well suited to it: *Strategy is nothing but success explained afterwards. (Edward de Bono).*

10. The configuration school

Its advocates approach strategy from organizational development. According to their views organizations take the form that is suitable for the given situation, from which ways of behavior and strategies come out:

strategy formation = a process of transformation.

Through the course of their life cycles, organizations go through characteristic life cycles and different form of organization belong to each life cycle. They have a simple organization or do not have a formal one at all at their foundation and their early years. They take a more complicated form (e.g. divisional or matrix) in the growth period and it again changes in the saturation phase. The different forms, however generate different strategies. The task of the management is to support either the stability or the change of the organization.

Let us summarize the conclusion of what has been written. Returning to the elephant-metaphor: every school – approaching from its own system of notions – gives important knowledge and useful departure points for the interpretation of strategy. It also warns us that strategy formation is a very colorful process so it can be planning, conception forming, positioning and learning at the same time. As a consequence, the content of the strategy to be born can be different. It makes the case more complex that at the same time more methods of strategy formation can exist. (see Nokia)

The principles of the last school draw our attention to the fact that in the life of an organization, from time to time, the application of different processes can answer the purpose. Accepting this, in what follows we will try to give a detailed analysis of the phases of development of organizations and their characteristics. Within this we concentrate on the ways in which strategies form by themselves or are formulated.

2. PHASES OF DEVELOPMENT OF ORGANIZATIONS AND THEIR SPECIFIC FEATURES

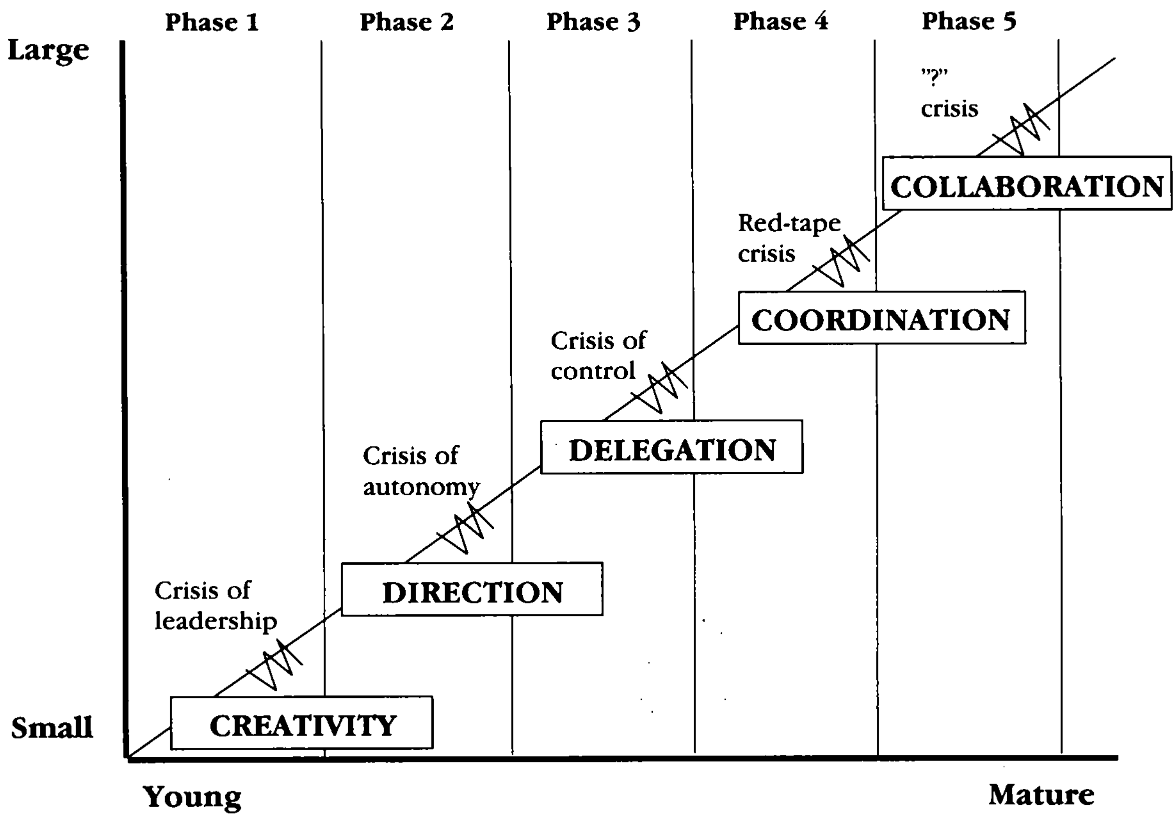
One of the best known life cycle model of enterprises was worked out by Greiner who distinguishes the following phases of development:

1. creativity
2. direction
3. delegation
4. coordination
5. collaboration

In Greiner's view a relatively smooth evolutionary process takes place for the first time in every phase but as a consequence of development problems appear that cannot be remedied in the usual way. Radically new solutions will be needed that basically affect the company's operation. Evolution is thus followed by a revolutionary phase, the company enters a new phase of development and again the evolutionary steps can follow. The process is demonstrated by the following figure:

Figure 4

The five phases of organizational growth



In practice most companies go through all the five phases. Depending on industry some of them move faster some of them slower, but there are organizations that skip some phases. Now let us look at the characteristics of the individual phases in more detail.

2.1. Growth with creativity

When enterprises are founded, detailed plans and calculations are almost never made. The starting phase is characterized rather by experimenting, trying out several ideas. Successful entrepreneurs pay big attention to the environment already at the beginning they try to gather ideas from it for the start. At the same time, there are those that proceed from their existing capabilities they try to seek market for that product or service that they are (able to produce) expert at. (This way started for example Graphisoft in Hungary. According to the head of the company the enterprise was founded on architectural software because that was they wee experts at.) One cannot experiment with many things even in the starting phase, they have to decide what kind of product, service or satisfaction of which market need the enterprise is to be based on, the founder or founders of the company have to set the focal points. Thus strategy forms at the early stage of the company's life cycle in the framework of partly a recognition process (watching signals from the environment and filtering them) partly an entrepreneurial process (setting the focal points). We have to mention that there also exist such entrepreneurs who even find setting the focal points of no interest trusting that they manage to adapt to the environment in such a way that it will not select them. (They follow the environmental school according to Mintzberg). The successful "founding fathers" are usually charismatic personalities they are characterized by creativity, special "aura" with which they can carry the others with them. Their management style is characterized by keeping personal contact, trying to form a friendly, shirt-sleeve atmosphere. The organization is simple and organic. There are no rules, preset scope of activities responsibilities, there is no formal control and motivation system.

If the attempts are met with success and the enterprise starts growing, the growth pains will inevitably come about. The star-dust of everyone does everything but is good at nothing leads sooner or later to expedience/flurry, expedience leads to mistakes, mistakes lead to loss of revenue. The first conflicts arise, the employees start complaining of being overstressed and underpaid. They demand "order", better flow of information, coordination of jobs and attractive, clearly set motivation system. This phenomenon is called crisis of leadership. Revolutional changes are needed for the survival of the organization, different focal points, management style and organization.

2.2. Growth with direction

In this stage it becomes clear for the executive that it is no longer possible to manage the enterprise intuitively, by impulses as the problems that need to be solved need expertise, professional managers. The firm is already invented, the basic question is now how it can be efficiently managed and stabilized. The organization of the company becomes the case at issue the first rules are written down. The company is transformed, usually into a linear-functional organization in which the dependence relations are unambiguous, , the organization chart is tree-type. In a larger firm, special expertise is needed to perform the individual tasks thus the job descriptions are determined according to functions. In the management style the form of direction dominates, the managers continuously and closely control the subordinates' work. When time passes (with the passing of time) the organization's operation becomes increasingly formalized and mechanical. The number of rules increases the managerial and administrative duties start to be clearly circumscribed, the distance between managers and subordinates increases. There are strictly prescribed communication channels, everything has to be laid down in writing.

The number of conscious elements in the formation of the company strategy increases in this phase. Especially the incursion of the analysis work can be noticed as the executives of the firm become aware of the fact that the setting the direction of development they need much more information on the environment and their company than they have. The use of strategic diagnostic method starts. Westel 900, for example, used the SWOT method for its strategy formation. There are those who having detailed analyses try to position the company, they may work out a draft or detailed strategy. The former apply the positioning, the latter the conception forming or planning process. (The already mentioned Graphisoft positioned itself the following way: They want to sell first of all three dimensional planning program to architects on the foreign markets. Bill Gates, CEO of Microsoft also drew up a clear position not long after the foundation of the company: one PC on every desk in every home.) Besides consciously formed visions, other processes also play a role in strategy formation both the managers and the subordinates learn from the accumulated experience (learning process), often bargaining with the inside and outside stakeholders also affect the strategy followed (bargaining process). As the result of changes, the organization grows further it goes into new lines of business and establishes favorable positions in newer and newer markets with newer and newer customers. Sooner or later it has to face the fact that strict regulation the official channels to be observed make decision making slower. The operative issues are often solved on the highest level, such staff management units come to existence that deal solely with regulation and their observation. It happen sometimes that strategic planning also becomes a management instrument that hinders development. The detailed action steps worked out for long term and sticking to them in them in a rapidly changing environment hampers fast adaptation. As a result of all these the operation of the organization becomes rigid, inflexible it cannot serve the differentiated and rapidly changing needs of customers. Again a shock, loss of revenue, decreased income can follow. Change is thus unavoidable.

2.3. Growth with delegation

At the companies with increasingly diversified activities operating in an increasing number of markets, the formerly centralized operation is replaced by decentralized decision making in order to maintain flexibility, arguing that decisions have to be made where the greatest amount of information and expertise in the given field is at disposal. To put this into practice, the divisional organizational form is the most suitable. The divisional system makes the management of large companies easier, the strategies and operative levels can be separated. The headquarters deal with answering the issues concerning the whole company. The operative decisions are delegated to the divisions that know the market well and can serve quickly and flexibly the needs of the customers. In most cases the division covers some product-market combination it has its own product, market, revenues, costs and income that can be shown separated from the other divisions. The divisions operate like individual enterprises within the company. The head and staff of the division are responsible for its profit.

Strategy formation is characterized by consciousness at most organizations. Strategies are worked out at both the company and division level, both levels have their own specific task: the company level and functional strategies (if the functional departments belong to the headquarters) are formulated in the headquarters. The target portfolio of the company is often determined in the company strategy, that is they decide in which lines of business the company wants to operate and in which it does not. An important field of the central strategy is the determination of long term goals concerning the individual divisions. (For example which they support and how, whether they expect them to cooperate or to compete.) Functional strategies contain the objectives relating to marketing, innovation and human resources. In the framework of divisional strategies among others market position, competitive strategy, distribution strategy are determined. (The topics of functional and divisional strategies depend on where the company delegated the given activity in its organizational structure.) In this phase the whole methodology of strategic planning and analysis can be applied, especially the use of portfolio techniques is advantageous. The consulting firms developed the various portfolio matrixes for large companies in the delegation phase. (Like the well-known four-cell matrix by Boston Consulting Group, the nine-cell matrix by Mc Kinsey at the order of General Electric.)

Naturally, the strategic planning or conception forming process is not applied at every company in this phase either, there are those that even in the delegation phase stick to the positioning school that is they deal only with setting the positions. And there are others that do not set long term targets consciously at all but rely solely on the processes that support strategy formation. (Learning, cultural, bargaining processes.) These processes can also be found at the organizations that consciously formulate strategy. At every organization, the learning process plays role: both the executive and the organization learn, in the different areas (divisions and headquarters) knowledge with various content is accumulated, which is expressed and discussed. In the meantime both the organization's and the individual's knowledge becomes richer. The notions formed as the result of debates can be built into the consciously formulated strategy, then follows the elaboration again and the process goes on. The cultural process also appears, for in this phase there are already formed behavioral patterns and customs that also form the strategy. It can often happen that power games make the most powerful effect on the strategy, that is it is formed as a result of the bargaining process between the divisions and the headquarters.

In the delegation phase, the situation of crisis forms as a result of the tension between the headquarters and the divisions: it is more and more difficult to hold together the increasingly independent profit centers that dispose of their own earnings and make them cooperate. The headquarters loose their grasp, the divisions step on an independent path of development, the advantages following from corporate existence disappear. The change becomes necessary.

2.4. Growth with coordination

To get through the crisis, the executives of the firm centralize again but to a much lesser extent than in the phase of direction. They strive that the company operate like an integrate organization while at the same time they try to maintain great independence of the divisions.

There are cases when they change organizational form, they shift to matrix organization. In this organizational form division of labor according to both functions and products are applied. First of all, the dynamic matrix, the so-called project organization provides greater independence: the employees of the company are divided by professions but for the individual tasks from experienced professionals/ experts projects are created. Projects are directed by appointed managers they operate until the task is solved.

The executives of the firm (work, put in)apply company level communication instruments make operations more organized. (For example, introducing integrated management information systems, SAP, controlling). As far as the strategy formulation of the headquarters is concerned, the emphasis is placed on the integration of the activity of the separate units and the utilization of the synergy effects. They work out actions to enhance the headquarters' ability to create value. (They strive that the headquarters not play a role to destroy but create value.) For this, they mainly apply conception formation process. They introduce new techniques to link strategy and short term plans (e.g. Balanced Scorecard) that support the directing and controlling activity of the headquarters. The effect of learning, cultural and power processes can also be noticed.

As a result of centralization, more and more conflicts break out between the headquarters and the divisions that is more and more conflicts blaze forth within the matrix organization. (Very few organizations can solve the problem of reporting to two superiors.) because of the regulations, the employees feel they have less and less chance for independence they begin to complain of their job being mechanical, their creativity decreases, thus the innovative ability of the organization also deteriorates. The red-tape crisis emerges. The situation is ripe for change.

2.5. Growth with coordination

In this phase of life the most important task is to increase the organization's ability to reform itself for which intellectual property is needed first of all. The carriers of intellectual property are those employees who – with their expertise, knowledge, readiness for cooperation and their network of connections – are able and ready to support the growth of the organization with newer and newer solutions and ideas. To develop creativity smoother, more humane coordination and controlling instruments are needed than plans and regulations. The management of the company therefore tries to keep the employees together with vision, mission and values and achieve that they become committed to the organization. All this means that strategic thinking appears in the framework of entrepreneurial process in which only vision, mission and guiding principles are articulated; working out "how" is not dealt with. Thus in this phase, strategy partly forms by itself, and is partly formulated. The management of the company pay much attention to shaping company culture.(It is difficult to change culture and it requires a long time thus it can be a process hindering renewal, change of strategy.) The leaders try to accomplish that sooner or later the values they find important appear in the company culture. The learning process also plays a dominant role.

In the fifth stage of life cycle, the mechanical organizational forms start to disappear the (less regular) organization becomes more organic, the appearance of more elastic, network-like forms can be expected.

In the end, we give a summary of the most important features of the individual phases.

	PHASE 1	PHASE 2	PHASE 3	PHASE 4	PHASE 5
PROCESS OF STRATEGY FORMATION	Entrepreneurial Cognitive process	Positioning Conception forming Design Learning Bargaining process	Design Conception forming Positioning Learning Cultural Bargaining process	Conception forming Learning Cultural Bargaining process	Entrepreneurial Cultural Learning
MANAGEMENT STYLE	Individualistic and entrepreneurial	Directive	Delegative	Watchdog	Participative
OGANIZATIONAL STRUCTURE	Informal	Centralized and functional	Decentralized	Line staff and product groups	Matrix, team
FOCUS	Innovate, make, and sell	Efficiency	Expansion Diversification	Consolidation of organization	Renewal of organization

Summary

The study examines the possible ways of the formation or formulation of strategy, which is one of the most important instruments of company management. Based on the book of Henry Mintzberg, who is considered the guru of management science, it draws attention to the fact that strategy can form in a multitude of ways. Some experts, for example, question the wide spread view that strategy can only be a consciously formulated conception. They think it can form spontaneously, for example through bargaining or learning process. The study deals with the possible processes of strategy formation in detail, then going through the characteristic phases of company development, it gives an answer to the question which processes should be applied in the individual stages. Besides the possible forms of strategic thinking, we can also learn from the study the typical problems appearing through the course of the growth of companies and the set of instruments for their successful solution.

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Gábor Vértes*

INTERNATIONAL AND HUNGARIAN TENDENCIES IN RETAIL BANKING

The study shows the main international tendencies in retail banking today. Together with the analysis of technological development and modern distribution channels, it deals with two new features: the role of small investors in the money market and the results achieved in west European bank quality management.

After reviewing the state and perspectives of Hungarian retail banking, it finds the opportunities for the industry's further development positive. There is still a lot to be done, especially considering the need to catch up with the European Union: in order to meet the requirements of the personal customers at a high level, the new technological methods and modern banking techniques have to be adapted to Hungarian circumstances.

Though retail banking came to the foreground of the Hungarian banking sector several years ago, only in the latest period has it become clear that it needs to be developed more vigorously than has been up to now. For Hungarian banks, the issue is that they have to invest heavily in this area for market and profitability reasons but this investment breaks even rather slowly. The development of retail banking is motivated by not only the demand and the opportunity for long term profit making but also by the limit set by shrinking corporate margins. This also directs banks towards retail banking.

In the first part we give a description of the most recent international tendencies. Among others, we deal with the role of technology, competition, new non-bank players in retail markets, the transformation of the structure of distribution channels, as well as with the theory and practice of Western European bank quality insurance – in the light of accession to the EU.

After that, considering the above, we attempt to review the situation of Hungarian retail banking, what kind of developments can be expected in the near future and what is to be done in order to improve the level of bank products and services.

I. FEATURES OF THE ADVANCED RETAIL BANKING MARKETS, THE LATEST TRENDS

1. New market players

Most Western analysts agree that in the decade just started the market for bank services will change to an unbelievable extent. An important feature of this change is that the number of players competing for market dominance will decline. The new non-bank players enhance competition and further strengthen bank management's policy of reducing costs and increasing efficiency. The increased importance of e-commerce transforms a considerable part of this branch of business into e-business.

* *Hon. Professor of Finance, Head of Department, Budapest College of Management*

It is to be noted that in an era of increasing competition, tendency for cost reduction and considerable technical transformation, the developed countries continue to be overbanked, although to different extents, and the number of branches is also too high. The dynamic banks try to win new, desirably profitable, markets. Today most commercial banks have retail branches or a subsidiary having such a profile, they especially deal with the management of long term personal investment products.

Let us pick some characteristic examples from the new market players. AT&T, the US telecoms giant, is the largest issuer of credit cards in the world today. General Electric went from being a manufacturer of appliances to a global financial power. Virgin, the record company became a provider of pension and investment products. Carrefour, the French retailer – as well as its rivals (Safeway, Tesco, Marks&Spencer) – broke into the market of banking. Direct Line, the first company offering mass-market sales of insurance products via the telephone, became one of the leading providers of property and motor insurance within five years.

Naturally, financial institutions have also tried to keep up with these processes and made attempts to anticipate the novel developments: one insurance company, for example, founded an Internet-based banking unit.

It has also been proved that the new market players are able to "migrate" their brand names to the market of financial services.

An expert named Virgin as the service provider most beneficial for customers. The company had learned to sell airplane tickets, apparel and beverages long before where the emphasis is on the customer and brand name. With the financial products becoming mass products, Virgin has been able to capitalize upon its advantages.

The fundamental change of consumption customs has also added to the above processes. A western family with average income keeps in touch with a number of banks today as opposed to one, maximum three financial service providers some years ago. The purchase of securities has come to the foreground, today securities and stocks are available even for small investors.

2. The technology factor – Internet-based services

Internet as an instrument has quickly become a considerable player in the market for financial services. This, at the same time, requires heavy investment and some kind of transformation of financial processes.

According to the analysis of Forrester Research, 10 % of American households keep connection with their banks via computers, and this number is expected to grow to 18 % in 2002. The first figure is 9 %in Western Europe today and is forecast to become 16 % by 2003. In the US, the use of the Internet is increasingly becoming an offensive strategy under the pressure of necessity, while Western European banks mostly employ it as a defensive strategy.

Another survey that examined 836 websites of retail banks in Europe and 1676 of them in the US gave the following results. As opposed to the former statement, most European websites were medium level or more advanced electronic banks, while only 15 % of the banks surveyed reached this level in the US, thus according to the survey, Europe proved to be more advanced.

It is difficult to compare the differences in Europe as in some countries regional financial institutions play the leading role, however they rarely play role in other countries. The largest number of web applications are unquestionably in Germany; and France and Spain have six times as many advanced e-banks as the UK.

Even in e-banking, the WAP system is a completely novel feature. It makes it possible to view text websites on the mobile phone, thus connection is established between the Internet and the mobile phone directly, without the use of computers.

Now it is hard to predict what effect the Internet will have on the profitability of banks. The general opinion is that Internet reduces costs of operation, thus makes banks more profitable. However, evidence so far is in contradiction with this notion. After setting up the business, there are losses at first. Though transaction costs are really low, introducing the product and the brand name to the market goes together with considerable marketing expenditures. Costs of funds can at the same time be higher than at traditional banks as part of the customers can be lured with deposits paying higher interest.

3. New system of distribution channels

New distrubution channels offered by technology do no longer come up for banks as making a decision on whether they use them at all or not but as a decision on that at which pace the introduction of the new channels should take place. Customers are increasingly sensitive to modern delivery methods. Financial institutions have up to now been not much concerned about the profitability of delivery channels but today this also has come into the focus of their attention.

One of the leading organizations of retail bankers, EFMA, together with Gemini Consulting prepared in the recent past a study involving 118 European banks and insurance companies on the development of multiple channel delivery systems and their application by financial institutions introduce and apply them.

Still today, branches can be considered as the leading channel (92 % of banks apply them) but other channels are also coming to the foreground. The figure for the application of telephone is 48 %, that for the Internet is 25% and the bank points, agents and brokers in malls are becoming more and more general. According to half of those questioned, electronic delivery channels will account for more than 50% of total sales.

It is interesting that the use of telephone is less intensive in Italy, France and Central-Western Europe compared with Spain and the UK. In Italy, only 3 out of 10 banks operate telephone systems, while in Spain this ratio is 7 out of 10. In France and Italy the percentage of banks using the Internet was only 10 and 20 % respectively. In Germany and the Scandinavian countries, this ratio is 50%.

According to the survey, foreign banks, retail networks, and service companies together will achieve 10-20% share in the market of financial services in this decade and they will vigorously use non traditional channels.

Financial institutions have completed their traditional channels with new ones to increase their capacity concerning the operations that were traditionally done in the branches. Such mechanic completion of traditional channels, however, has not proved to be sufficient.

Today novel solutions are sought in connection with delivery channels. One general principle is to deal with delivery channels in an integrated way, that is we are talking about an integrated delivery system. One form of this is the so-called **simple integrated distribution system**. In this, one channel is the main one, for example the branch, and further functions are oriented between the other channels according to cost/value ratios. For example, non-profitable customers will be asked to do all of their transactions via call center or they will have to pay for certain services at the branch. All of the profitable customers' connections with the bank will be via the Internet because the customer likes this instrument.

The second form, the **integrated portfolio of distribution channels** consists of the portfolio of such channel-specific solutions that satisfy the differentiated demands of customers. For example, offer for young families, virtual banking in special branches for new generations or advisory "boutique" for wealthy customers. Usually, in this pattern every offer is transmitted through a different brand name, that is they are tied to a given channel or to more channels at the same time.

90% of banks are expected to have integrated systems by 2005, and 60% of them are likely to introduce a simple integrated delivery system.

A number of changes have to be carried out in the traditional branch network in order to utilize on the advantages of the new channels. The branches have to be specialized, their expertise base has to be renewed, the administrative tasks have to be removed from them, and certain, from the point of view of customer relationship management, mixed back offices have to be established, and the branches have to be reorganized. It should be noted that costs generally rise in spite of the introduction of new channels. The main reason for this is that the above changes, which were planned long ago have not been carried out, and especially the organization of branches varies from country to country. (Figure 1)

Figure 1

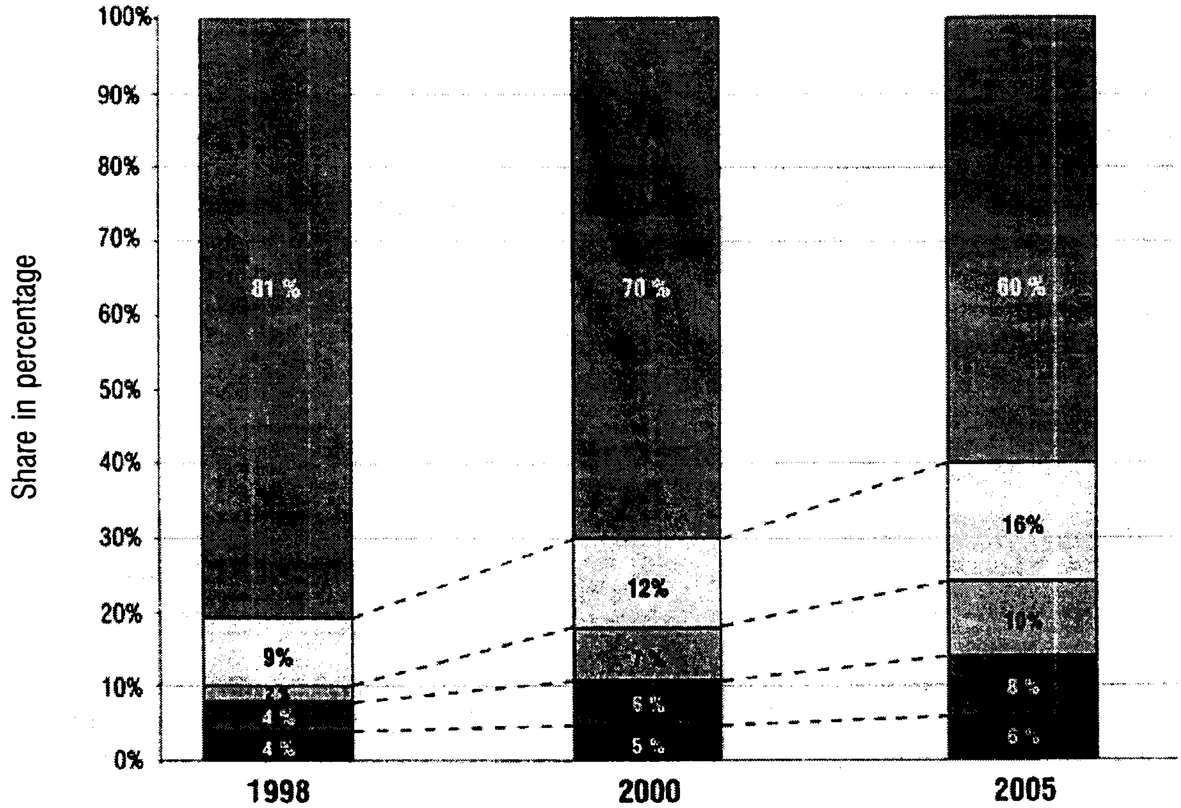
Transformation of branch network

The ratio of universal branches that was 81 % a couple of years ago is expected to decrease to 60 % by 2005 as the number of limited service branches, the ones operating in shopping centers, and the ones dealing with corporate customers and doing private banking will increase (Figure 2).

The ratio of professional bankers in the staff can increase from 42% to 67%, while the number of tellers and other administrative staff is rapidly shrinking. 18% of the administrative staff is expected to be redirected to special units (service centers, mixed backoffices and especially administrative centers). The majority of banks asked during the survey mixed backoffice units will be in direct connection with the customer concerning processing and after sale activity.

Figure 2

Changes in the proportions of the various types of branches



Types of branches (from top to bottom in the column diagram)

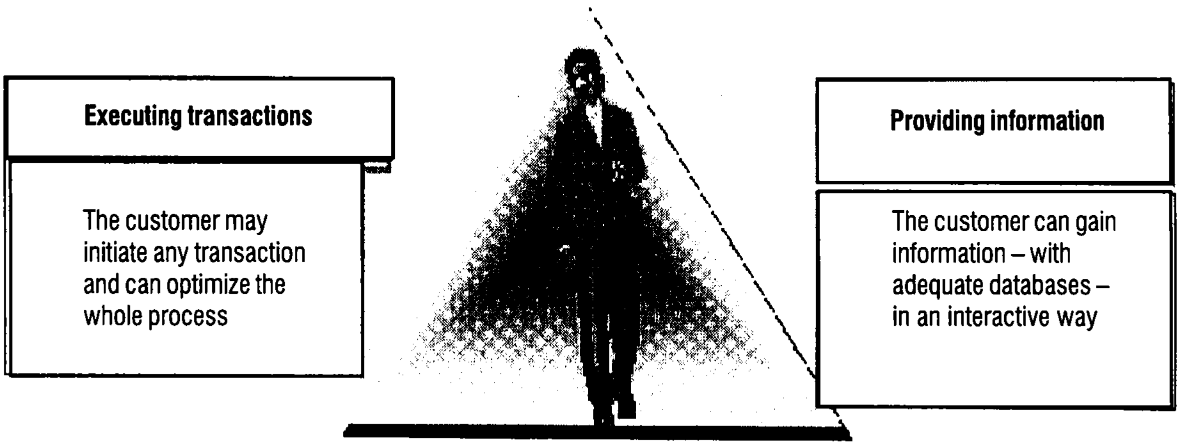
- Universal branch
- Branch providing limited services
- Branch operating in shopping centers
- Branch providing corporate banking sevices
- Branch providing private banking services

The greatest problem is that the progress of the main driving force of cost reduction, branch-reorganization is very slow. France and Italy are especially conservative in this respect. In these countries, only 6% and 3% of branches respectively were projected to be shut down by 2000, after 2000 a further, 15% and 16% of branches will be shut respectively.

This means that a number of Western European countries, that is banks, are facing the painful process of an impending drastic reduction of the number of branches.

The delivery channels are used to increase the satisfaction of customers they try to put the principle "anywhere and anytime" into practice. The profitable customers for the bank have to see the advantages of the multiple channel system, i.e. that with the help of several instruments they can reach the products, the consulting and the information at any time. This means that the financial institutions have to transform their "reactive", passive distribution systems into interactive ones. The interactive system puts totally the customer in focus, where, with the help of several channels, they can find offers, choose the most convenient channel for their shopping, can initiate any transaction, and acts interactively via the appropriate database. (Figure 3) For this, every point has to identify the customer the same way and the place of the customer has to be clear in the customer relationship. This is, however, not the typical case realized, firstly because of system integration problems.

Figure 3
The interactive distribution system



DISTRIBUTION

The customer

- goes through the rich choice of offers
- chooses the channel that best suits the given transaction
- discusses a personally tailored service with the provider

The service provider

- develops customer relations via individual offers

The financial institutions often view electronic channels as cost reducing strategy and not as the instrument of a strategy to increase customer value. According to banks, electronic channels have made more profit for the suppliers (for example higher profitability of products, more efficient marketing, etc.) than for the customers.

Delivery channels have to be used efficiently to put main customer relationship strategies into effect: acquisition of customers, retaining customers, cross selling, increasing market share, cost reduction.

Acquisition of customers

Electronic channels play an important role in the acquisition of new customers. At the same time, many view these instruments as techniques to inform customers or to conclude banking transactions. Except for Scandinavia and the United Kingdom, only 35 % of banks view the Internet as a delivery channel.

An outstanding positive example in this topic is that in Germany a special electronic bank was established to acquire customers and this brought in 25 thousand customers in 9 months.

Retaining customers

The strategy to retain customers is equivalent to the already mentioned "anywhere, anytime" principle. This requires the adequate handling of individual customer profitability, channel preferences and requirements.

Cross selling/increasing market share

Critical element of cross selling is knowing the customer's "profit making" potential. The importance of customer information is underlined by most banks, they find collecting data for marketing and risk management inevitable. It deserves attention that banks on average spend 49 % of their IT budget on the creation of database.

Cost reduction

The basic goal of financial institutions is to transfer non-profitable customers to electronic channels that bear lower transaction costs. (The literature has several data series of the average transaction cost of the individual distribution channels. Let us see one – to my view reliable – data series here on average costs, in USD: branch cash-desk 1.07, postal services 0.73, check 0.68, active telephone 0.35, ATM 0.27, pre-authorized transfer 0.14.)

American banks use a multitude of ways of this transfer. As an instrument of cost policy, for example, they charge a fee for branch operations and provide free checking account if customers use ATM or the telephone. One bank drastically reduced the number of checking accounts, and at the same time introduced a new product to the customers with an appropriate pricing and service. The fees of non-profitable customers using branches are increased.

In view of the above, 82 % of the banks asked are planning the total restructuring of their price policy, and 87 % of them are trying to introduce equivalent products depending on the distribution channels.

The banks do not unambiguously support electronic channels. They do not believe in them unconditionally because they undermine the requirement of secrecy, make personally tailored services and optimal consulting more difficult.

It is a generally accepted view in Europe that **the three determinants of success in selling financial services are making the right strategic decisions, the further education of employees so that they suit the new requirements and projecting the behaviour of customers. The basic precondition of the latter is the collection of data on the customers and putting them to efficient use.**

If the bank was able to determine which customers do not visit the branches, who of them make electronic transactions and who of them have adequate technical background, it could determine the realistic amount for an Internet/PC-based service. If the bank knew the profitability and price sensitivity of these customers, it could calculate the revenue of such kind of investment.

As far as retaining customers is concerned, the financial institution has to know that from the point of view of profitability, which customer it wants to retain and it has to adjust its actions to this decision (for example the use of loyalty programs). To increase market share, the bank has to know to what extent their customers are interested in the various products and which features of products and services can entice them away from their rivals.

4. Small investors in retail financial markets

In the past years, securities trading has become characteristic of the retail market, especially in the US. A notable share of middle class buy stocks and shares in investment funds. More than half of households have investments worth more than USD 5,000.

One of the main driving forces of small investors is saving for their retirement. The ratio of active earners to pensioners (also called dependency ratio) shows a decreasing tendency in the US, which puts enough pressure on the state managed pension systems that they contribute to the easing of such way increasing tension. The mentioned need also finds its way in Europe and increases securities trading.

Personal investment is no longer the privilege of the rich but it can rather claim itself a growing clientele who view these investment products as common commodities. What has been said here also points to the fact that the individual areas of retail banking are not hermetically closed from each other but are in continuous motion and transformation.

Not so long ago, securities trading started to break into the area of private banking from the stock exchange and corporate sphere, later formed an important part of it, and today it has become an everyday part of mass retail banking.

Experts also see great opportunities in the European security market. According to the well known Merrill Lynch brokerage firm as much as 3.5 million people have savings for investment purposes worth at least USD 100,000, and this demographic group grows by 6 % each year. These financial institutions naturally do their best to take this favorable opportunity to increase their profits.

As it can be expected that in view of the above retail banks will receive increasingly less deposits, they have to start to introduce a wide scale of savings and deposit products. The mergers and strategic alliances with brokerages make it possible for the banks to learn the required knowledge.

From the point of view of securities trading, the opportunities of personal investors are very favorable. At the same time, they have to be aware of the challenges facing them and work out a strategy that makes them possible to fully utilize on the coming opportunities.

5. Quality management in retail banking

Quality management is not only a trendy topic but, through the control of quality, is an anchor of development and can be an important instrument of market consumer control. Even before the accession in the EU, Hungary has to learn the European methods concerning quality management and have to pay more attention to their introduction.

Prod by general development and union requirements, quality management issues gain more and more attention. In connection with it, an indicator called European Consumer Satisfaction Index (ECSI) was introduced in the European Community. The use of this indicator is in introductory phase yet, it is now being tested in a wide range.

It is to be noted, however, that quality management measures concerning European banks are restricted to a relatively small area. The next phase will include all quality management issues.

The aim of the index mentioned above is to measure consumer satisfaction that strengthens the fidelity to the institution rendering service to them. It was initiated by the European Community as an integral part of its quality management policy with the final purpose to support the growth of productivity and economic development. This index is the compound of the similar individual national indexes. The calculation of the European national indexes is based on the methods applied in the cases of the indicators for the similar purpose in the US, some Asian and other American countries. This methodological harmonization makes comparison across companies, sectors and countries possible. The organizations responsible for the calculation of the indexes ensure the best quality, integrity and independence, and provide keys as well as that make the general acceptance of this index by the European organizations and companies possible.

The index gives opportunity to the customers (and indirectly to the alliances that represent them) to form opinions on the products and services in the market. It provides a *benchmarking* system to the companies that makes it possible for them to compare their internal measures with the levels attained by their competitors. This also means a reference concerning their own quality measures. On industry level, this ensures the measurability of competitiveness. On national and European level, the index is an important macroeconomic indicator that can be compared with data on productivity or can serve as the basis for quality adjusted prices to improve data on inflation.

Banks provide an especially good opportunity for the interpretation and comparison of the quality of services as seen by their customers in the individual European countries. The satisfaction index (CSI) applied by banks is the weighted average of figures concerning the general judgement, the valuation compared with their acceptance and a valuation compared with an ideal case. Weighting is done with a method that optimizes the effect on the fidelity to the bank, thus an index that serves the purpose is calculated.

Experience concerning the similar Swedish and US indexes applied from 1989 and 1994 respectively support **a positive correlation between the satisfaction index and profitability, as well as between the index and stock prices**. Thus those Swedish companies whose satisfaction index has grown the most considerably (10% of them) have achieved three times higher growth rate as compared to the average (according to the data of the Stockholm Stock Exchange). There is also a strong correlation between the movement of the American satisfaction index and that of the Dow Jones in half a year.

II. THE CURRENT STATE OF THE HUNGARIAN RETAIL BANKING SECTOR AND ITS PERSPECTIVES

After looking at the newest international features of retail banking, we examine where the Hungarian banking sector stands in the light of the above, which are the main strategic directions of banks, what steps they have necessarily to take in the near future in this area.

The basic issue is the new situation arising from the quantum leap of technology, especially the rapidly spreading use of the Internet in retail banking It is inevitable that the Hungarian banks should also follow the leading international methods but they have to apply these methods by all means taking into consideration the Hungarian situation.

The leading Hungarian banks possess today telephone- and some kind of Internet-based services. The area of I-based services, that are now on different levels, increases all the time.

1. The main features of the current situation

In contrast to the western situation outlined above, **in Hungary the delivery channels do not operate as a system but virtually independently from each other**. Banks rarely analyze what kind of transactions, how frequently have been concluded by their clients and whether an instrument can be replaced by another (yet the banks are satisfied with watching quantitative data and those on earnings). It would be important to find out who is the customer with the opportunity for more profit. In spite of the factors hindering the development of a service culture, it is an important question, which banks try to please their customers, and which of them pay attention only to collecting fees and increasing profit.

In the international overview of delivery channels we have dealt with the price and other shifting methods with which western banks try to direct customers to the appropriate delivery channels. This is not the main issue yet in Hungary, on the other hand, even if we take into account the relative underdevelopment, we can assert that this process has hardly started. This leads us to the **problem of customer segmentation**.

That definite views have not been formed concerning the issue of customer segmentation shows strongly how inchoate Hungarian retail banking strategies are. One bank thinks that a large part of the population with low income does not promise any profit for a long time, thus it rather strives to win the affluent layers of society. From this follows that the bank aims at the sale of only a few mass products and services in large quantities and it does not develop a wider palette of products.

Another financial institution in Hungary is aimed at the middle class, now beginning to take shape, especially at the self-employed. The competitive situation, however, is judged by the same bank as it does not make it necessary today to lure customers from other banks for the customers of banks do not move easily anyway. According to its view – as several million people in Hungary do not have a bank account and buy bank products yet – retail banking has to lure them first of all.

A third bank also aims rather at a segment than the whole of the retail market. It leans from active earners on those that have at least high school education and preferably above average revenue.

A circumstance making the development of retail banking more difficult is that banks are still surrounded by a kind of mystery, their activities are not adequately known. The lack of trust also adds to this, which trust, to put it mildly, is not at all strengthened by the series of bank scandals, the several instances of abuse. A large number of personal investors use the interest rate level as the basis of their decisions when choosing a bank although they should also take into account its general situation and results.

Through the course of their activity, banks should strengthen trust concerning its potential customers too, and this can be achieved by carrying out transactions that are advantageous also from the customers' point of view.

The generally low level of incomes is a barrier to business concerning especially active transactions (consumer loans, home financing). For this reason, a considerable part of potential customers does not have the preconditions for creditworthiness and means a high risk even in the case of getting the loan.

The new type of consumer financing is characterized by the closer connection of market players to retailers.

Nowadays both consumer behavior and the view on taking out loans are changing in a positive way. Today it is judged less negatively if someone runs debt, people are less averse to loans than earlier.

An important development of the recent past in the area of home financing is that on May 23, 2000 the government made a decision on the extension of the eligibility for preferential home financing. As of July 1, 2000, every married couple or single parent – as opposed to the previous age limit of 35 years – can take out a loan of HUF 10 million, instead of the former HUF 8 million, at an 8 % interest rate. The eligibility for this preference covers not only the case of the first common home, but also the purchase of every new one. The purchase of new homes is even free of stamp duty (up to now the stamp duty was 2 % up to HUF 4 million and 6 % above that amount). Conditions of home financing have considerably improved recently.

Hopefully, the new measures change the banks' general attitude concerning this area too, their thinking in terms of short run and not considering the building of long term relations with their customers and the acquisition of new ones.

2. Expected directions of the Hungarian retail banking market

Several leading consultants have dealt with the issues concerning the future of the European market of banking, outlining the likely reactions of banks to the challenges. The studies draw interesting conclusions from the European and Central and Eastern European perspectives.

According to the experts, **in the banking markets of the region's countries, parallel with the survival of some smaller institutions specialized at some specific services, the weight of large banks will increase, and further mergers and acquisitions are expected.** In connection with customer relations and the acquisition of customers, the establishment of long term relations and the development of electronic channels will be given priority. In the future the customer will be in the center instead of the products, not only as borrower or depositor but also as an all-round investor.

In this region, still universal branches play the leading role, among the new technological facilities, the Internet is yet of minor importance, which can change revolutionary in the future. It is considered an interesting feature in Hungary, that individual banks invest heavily in the development of both the branch network and the electronic services.

The fact that virtually the whole of the Hungarian banking system is privately owned will make its integration easier. Naturally, the freedom of markets and the gradual introduction of the common currency will cause some temporary problems. In the retail business, the accession is not expected to bring about fundamental changes in Hungary, since the market is already overbanked, although further competition can modify the current picture to a great extent.

According to the analysis of Nomura, **the importance of branch network can decrease even in the middle run**. The capacity of collecting deposits is increasingly insufficient for the maintenance of branches, thus only banks having a choice of up-to-date (corporate and retail) products will be able to finance a large network.

Another consultant expects the most dynamic growth in wealth management and investment in Hungary. It also assumes that financial institutions will specialize in individual segments to greater extent, only a few of them can keep the role of a universal player.

It can be expected both in the region and in Hungary that the cooperation between banks and insurance companies will become closer. Insurance companies will increasingly involve the branches of banks in the distribution of their products. According to a Hungarian expert, among the three players of the financial market, insurance companies are now more developed than banks but they are also in a better position than brokerages.

Several banks can already show some results in the introduction of investment products for small investors. Investment in securities is expected to take the "shot in the locker" role of foreign currency savings in Hungary, too, which means purchasing shares of investment funds, life insurance and stocks.

Let us have an overview of the **latest developments in banking technique**. I-banking was first started in Hungary by Inter-Európa Bank in 1997. It was followed only in July 1999 by OTP (National Savings and Commercial Bank), then in October of the same year by Raiffeisen Bank. A basic issue connected to the Internet is the protection of secrecy, in which banks also try to apply up-to-date solutions. The number of services also increases and in some cases, the services already extend to more difficult transactions as well.

As of May 2000, the customers of Inter-Europa Bank and Raiffeisen Bank can also initiate active stock exchange transactions on the Internet.

I-banking is also hurdled by the delay in accepting a law that would make it official and would accept electronic signature as attestative also before a court. An otherwise comfortable transaction is hindered by the fact that even entering into an agreement containing the general terms is made difficult by the above mentioned signature problem. Naturally, the issue of accession to the EU also arises here, it has to be harmonized with community norms as well.

The foreging ahead of the Internet is helped by the government's decision in the recent past to support the purchase of computers in accordance with its IT program. The preferential or free use of the internet would also show in the same direction. In the international overview the WAP system – the connection between mobile phones and the Internet – was also mentioned. Here it should be also taken into account, whether it is worth for banks to develop a WAP system. With a great number of customers – and adequate capital – this can be profitable but in the near future, smaller banks can render this service to their customers rather through a service provider specializing in WAP.

It is memorable, that in banking transactions the so called check era was replaced by the credit card era. This made it possible that in certain countries and regimes, where the use of checks had not become widespread, to conclude the transfer of funds mostly by credit cards, practically skipping the use of checks. The case is a bit similar concerning WAP. There are views that some people will shift to the WAP system not from the use of the Internet through PC's, but they skip this phase.

According to our judgement, the use of the individual systems, the individual "eras" will not be clearly separated from each other. As in Hungary even Internet connection is still in its infancy, it cannot be expected that it will be totally outplaced by the WAP system in a short time, rather, they will coexist for a relatively long time.

As far as the homepages of banks are concerned, the services offered earlier on only a few websites have spread. More homepages of banks contain search function.

Multilingual homepage is also very frequent. It is an interesting feature that more banks advertise jobs on the web. At the same time, an increasing number of financial institutions give information on their operational profits and show related press releases.

On the whole, it can be asserted that there are few opportunities for the interactive actions of customers yet.

A characteristic piece of news of the recent past is that two years after its start, foreign capital also appeared in the company (NET Média Ltd.) hosting Portfolio, an on-line economic newspaper. The German net.IPO AG gained a 35 % share in it by raising its capital. Net.IPO AG is the first and also biggest I-investment bank to be quoted on stock exchange. It has offices in Frankfurt, Paris, Milan and Rome. It has investments worth DEM 30 million in shares of Internet-based companies and on-line companies rendering financial services.

CONCLUSIONS

As far as retail banking is concerned, the saying that the business is facing revolutionary changes sounds well. However, this statement is certainly true in Hungary.

The existing and potential customers of banks get to know the international level of financial services from the foreign banks settled here and through personal experience travelling in the more and more open world. Demands are also induced by technology, in the technology of banking, the introduction of new instruments and methods is especially fast.

On the other hand, foreign banks operating in Hungary – a dominant part of the Hungarian banking sector – have, relying on their parents, adequate funding to carry out investments necessary for the development of retail banking operations. They will naturally always consider whether these investments will realistically break even or bring profits. This in turn depends on the political climate, on the development of the Hungarian economy, on the measures of economic policy, and last but not least on the global and structural development of personal incomes and savings.

The expected accession to the EU already has its direct and indirect effects on the Hungarian banking sector involving retail banking. This effect is basically positive, as it gradually but necessarily establishes real competitive conditions and requirements also in this sector in Hungary.

Political and macroeconomic prospects are favorable and they provide a good basis for the further development of the retail banking sector. Hungarian banks have also had some achievements in this area, at the same time, they have a number of important tasks to complete. A marked retail banking strategy has not been formed yet, as well as its realization applied to the special Hungarian conditions.

In comparison with corporate financing, Hungarian banks do not have such retail banking expertise and experience that would guarantee the effective completion of a business policy developed according to the above. The foreign bankers working here - while they represent western level – have less knowledge of the local conditions.

These are naturally maximalist requirements that cannot be met overnight. At the same time, the privatization and results of the banking system, the Hungarian bankers' high level of expertise, technological development that is strong here too, and the improvement of banking culture already manifesting itself can further a development, after which Hungarian retail banking sector can go ahead with joining the same sector in the EU.

All that is not an end in itself: the aim of the process that does not end with the accession has to be that – besides making a fair profit – meeting the growing demand of the Hungarian private customers (including also foreigners living here and the visitors) on a high level.

Peter Geisler* – Zoltán Szegedi**

EU-PARTNER HUNGARY A SHORT TRANSPORTATION – LOGISTICS OUTLOOK

Introduction

The Budapest College of Management (Általános Vállalkozási Főiskola) has recently signed a cooperation agreement with SIEMENS-DEMATIC AG (Produktions- und Logistiksysteme, München) to provide business educational services and applied business research. This agreement will include a survey on how far Hungary, as a prospective member of the European Union and a cooperating trading partner, must differentiate itself from other emerging economies moving towards the EU. The authors' goal is to involve both students and faculty of the College in this project. The purpose of this paper (the first in a series) is to analyze the prerequisites of commodity flows; i.e. transport by rail and road. This paper will also consider the possibility of switching the transport of some commodities from road to rail. As a practical example we areusing the Munich–Vienna–Budapest route. The reason for the proposed switch is, among other things, the negative environmental impact of the growing number of trucks on Europe's highway system.

The growing amount of goods transported by road carrier and the decreasing use of rail in the transportation market is a long-term trend. Increasing pollution caused by an ever-growing number of trucks has made international transportation organizations (UIC, IRU) consider developing more railroad infrastructure, as well as find ways to develop some type of cooperation between the rail and trucking sectors. In our project we summarize statistical information from different sources, analyze current trends and outline approaches for tackling particular problems. However, most sources contained little helpful information on these issues. Another difficulty encountered concerned transportation companys' reluctance to disclose information on their clients and goods transported. We contacted several transportation organizations in order to derive information[1] from "primary sources" such as MÁV, MKFE, Hungarocamion, and ÖBB. In organizations such as these, tracking the amount (quantity in tons) of the goods transported makes more economic sense than any classification of commodities. Because of this, it was quite difficult to obtain information from managers regarding the differentiation of goods their companies transported.

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* *Dr.-Ing., Vice President, Siemens AG Production and Logistics Systems, Elektronics Assembly Systems, München. Member of The Advisory Board of Budapest College of Management*

** *(Ph.D.) Professor of Management, Head of Department, Budapest College of Management*

[1] *Information was collected by Á. Door, M. Neskoromniuk, J. Várga and A. Zlatin, MBA students of IMC Graduate School of Business*

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In this paper we will first outline recent changes in the export-import pattern in Hungary (and Central and East Europe), then we will analyze a sample international route between Hungary and Germany. After that we will analyze selected statistical data which we consider to be relevant to our topic. A separate chapter will describe the ROLA system – the transportation of trucks on railway platforms. This method so far represents the most obvious example of cooperation between rail and road carriers. We will finish with an outline of some dilemmas faced and directions for future research.

1. Changes in International Trade Patterns

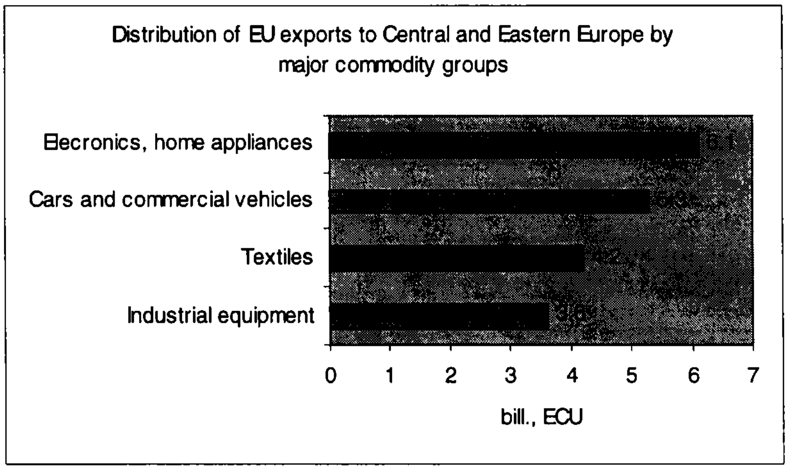
At the end of the eighties, with the transformation of Central and Eastern Europe's (CEE) political and economic systems, major changes in export-import flows occurred. The biggest change was the switch of foreign trade patterns and commodity flows from the East to the West. This period was characterized by the dramatic reduction of imports of CIS-origin ready-made goods, the decrease of exports of Hungarian ready-made goods to the CIS countries, and the increase in the export and import of ready-made goods to and from Western European countries[2]. From 1991 to 1995, the average annual growth rate of EU exports into the region reached 25%.[3] In 1995, the share of CEE exports to the EU reached 8.4% compared with 4.2% in 1991. CEE imports from the EU exceeded 7%, with an average annual growth rate of 20.8%. EU trade into Eastern Europe continues to grow significantly faster than that of other regions, the biggest flow coming from Germany and Italy. These countries are the two biggest EU exporters/importers to/from the region with a share of 70% of the overall export-import volume. Among the countries of Eastern Europe, the most active exporters to the EU are Poland, Hungary, and the Czech Republic (with about 61% of total regional export into the EU). Germany absorbs about 54% of the total regional exports and provides over 50% of total imports.

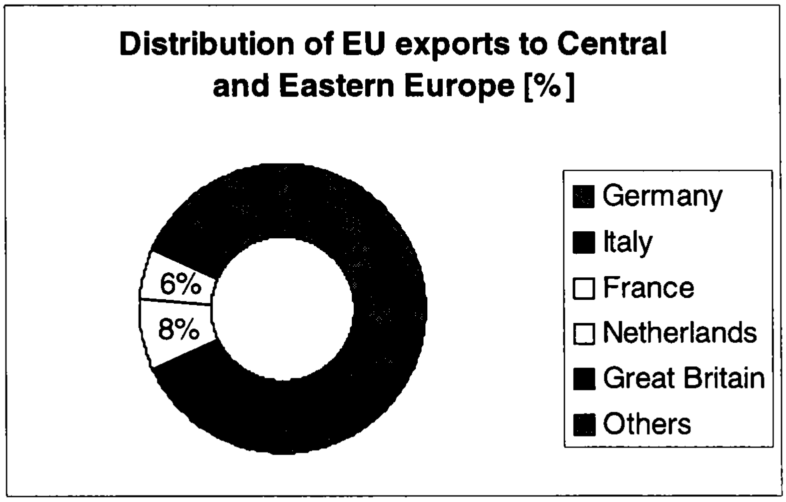
Export-import relations between CEE and the EU are characterized by the growing liberalization of trade rules and elimination of trade barriers. Relationships in the transportation sector are still based mainly on bilateral agreements and existing multilateral UN Conventions related to transportation. For road hauliers, the institution of "permissions" is still in place. Development in the transportation sector is primarily aimed at improving combined transportation and financing development of regional infrastructure. Hungary, the Czech Republic and Poland (as the most advanced regional players) are expressing deep interest in the further spread of the Trans-European high-speed railroad, the implementation of PACT (Pilot Actions for Combined Transport), and the development of their own highway networks.

[2] *For the sake of simplicity we will refer to these countries as the European Union (EU).*

[3] *Data is taken from the research made by ASMAP – Association of International Road Carriers, Russia in 1999*

The graphs below outline some of the statistical data discussed above:





2. The route Munich – Vienna – Budapest

First we will provide a general description then describe some features of the transportation corridor in each country. The total length of the route is 695 kilometers, relatively long by European standards; 130 km in German territory, 370 km in Austria, and 195 km in Hungary. All three cities are connected by highways in full length of the route; M1 in Hungary to the Austrian border (Hegyeshalom / Nickelsdorf), A1 in Austria to the German border and A8 on German territory. The transit through Austria creates problems for road hauliers due to strict environmental regulations. Trucks must be put on railway platforms in order to cross certain Austrian regions and can only be unloaded from platforms at certain points (i.e. Wels or Graz). All three cities are also connected by rail. In Germany and Austria railway tracks have been fully upgraded. However, the Hungarian section is deficient. On the Budapest –Hegyeshalom track, the maximum speed is limited to only 120 km/h. Only one segment – 80 km long – can bear train speeds of 160 km/h. The average road transport rate between Budapest and Munich is about 1,400 – 1,500 USD; the tariff for transporting a 25 t load by rail is about 1,720 USD. However, calculation of rail tariffs are much more complicated than that of road tariffs, so this should be considered an approximation.

We consider our findings about general processes currently taking place in the transportation of goods by road and rail to be valid in relation to this particular route. Below are some comparisons regarding the transportation of goods by road and rail in these three countries:

2.1. Transportation of goods by road

Regulations concerning international transportation are unified in Europe, and encompass a large number of documents; conventions on road signs, technical conditions of trucks, international transportation according to the TIR procedure, etc. As a result, the following general rules are applicable in Germany, Austria and Hungary:

- Speed limit for trucks on highways – 80 km/h.
- Width – 2.55 meters (for refrigerated trucks – 2.60).
- Height – 4.0m.
- Length – 18.75m for a truck with a standard semi-trailer
- Maximum weight for a truck with a semi-trailer (2 + 3 or 3 + 3 axles) – 40 t
- Fuel can only be taken in the quantity of 200 liters.

Truck transport with an overall weight exceeding 7.5 t are subject to certain limitations on weekends and public holidays. However, empty trucks going from border crossing points, transports of fresh dairy products, fresh meats and breads, trucks participating in combined transportation (distances not exceeding 70 km) or technical assistance vehicles are subject to exemption.

The overall length of highways[4] in Hungary is about 500 km, whereas the length required by the "Helsinki Passage" is 1230 kilometers in order to correspond to the requirements of passing Trans-European corridors.

Germany and Austria possess a much more developed road (and rail) system than Hungary. However, regulations regarding weekend traffic are different. For example, Austria prohibits the movement of trucks with a total weight exceeding 3.5 tons (compared to 7.5 t in Hungary or Germany) during weekends. Moreover, there are additional limitations in various regions of Austria, such as the prohibition on movement at night, compulsory transit on ROLA trains across certain territories, and a complicated system of entering the so-called "green areas" (such as the Salzburg region).

2.2 Transportation of goods by rail

In all three countries, international railroad transportation has been regulated by a document called the "Agreement of International Railroad Freight Transportation" in effect since 1951 (with changes).

Since 1989 MÁV has gradually reduced its fleet of rolling stock, as a lot of manufacturing plants which used to generate heavy traffic have been closed. To offset this, MÁV is promoting container and piggyback transport. The railway-owned international container company Intercontainer-Interfrigo (ICF) was established in 1992. An Intercontainer service "Adria Express" runs daily between Budapest and Trieste, transiting Slovenia. Other similar services operate from Sopron to Hamburg (the "Hansa Hungaria"), to Rotterdam (the "Hungaria Express"), and to the Balkans.

In conjunction with MÁV, Hungarocombi – the Hungarian member of UIRR (the International Piggyback Organization) – operates ROLA ("Rollende Landstrasse") services for trucks accompanied by their drivers. ROLA services were first introduced on a twice-daily basis between Wels (Austria) and Budapest in 1992. Since August 1993, service has operated three times daily between Wels and Kiskundorozsma, on the south-eastern border of Hungary. A daily service runs between Sopron and Wels, and in 1995 between Budapest and Ljubljana, Slovenia, followed by a second service into Slovenia.

Hungary has a total of 7,606 km of rail track. The cross-border railway between Győr, Sopron, Ebenfurt - GySEV – is about 101 km in Hungary and 65 km in Austria. Germany contains 312,771 km of rail track, and Austria contains 5,336 km of it. Since 1993, the freight business of ÖBB (Österreichische Bundesbahn) has traded as Rail Cargo Austria in three divisions; Complete-Cargo (wagonload traffic), Combi-Cargo (inter-modal traffic), and Express-Cargo (less-than-wagon load business). With growing transit flows between the East and the West coming through Austria, ÖBB is investing heavily in the development of new routes and logistics centers. In 1999, ÖBB carried 74.3 million tons or 14,791 million ton-kilometers.

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[4] *This word refers to "Autobahn" and "motorway"*

3. Development Trends

Developments of the last decade demonstrate a shift towards road transport. The following table (*Table* 1) demonstrates the large gap between the amount of goods transported by road hauliers versus rail.

Table 1

Goods' transport performance of the transport sector [t][5]

Year, quarter		Total	Of which			
			Rail	Road	Waterway	Pipeline
		Mass of goods transported, 1000 tons				
1999.	I.	40,067	9,742	22,953	449	6,920
	II.	51,332	12,171	34,376	514	4,168
	III.	63,505	12,479	46,031	551	4,440
	IV.	60,619	15,349	37,955	584	6,725
Total:		**215,424**	**49,741**	**141,316**	**2,098**	**22,253**
2000	I.	40,997	10,005	23,932	444	6,611
	II.	54,189	12,555	36,808	635	4,186
	III.	62,602	12,845	43,300	708	5,741
	IV.	58,411	13,589	38,350	646	5,813
Total:		**216,199**	**48,994**	**142,390**	**2,433**	**22,351**

As we see from the table, road carriers transport almost three times the volume of goods as rail. Note that in Austria, where transit rail traffic is very intensive, the difference is smaller.

[5] *Központi Statisztikai Hivatal – Szállítási Teljesítmények, 2000. I-IV. negyedév*

Table 2 shows the same pattern expressed in freight ton-kilometers:

Table 2

Goods' transport performance in the transport sector [t/km][6]

Year, quarter		Total	Of which Rail	Road	Waterway	Pipeline
		Freight ton-kilometers, millions				
1999.	I.	5,758	1,392	2,645	267	1,443
	II.	6,121	1,993	3,087	192	835
	III.	7,059	2,052	3,899	248	845
	IV.	7,402	2,296	3,504	251	1,334
Total:		**26,340**	**7,734**	**13,135**	**958**	**4,457**
2000.	I.	5,975	1,596	2,870	178	1,318
	II.	6,243	2,058	3,135	241	793
	III.	7,054	2,121	3,876	257	784
	IV.	6,876	2,066	3,448	219	1,119
Total:		**26,149**	**7,842**	**13,329**	**896**	**4,014**

Table 3 illustrates the significant increase in the number of trucks crossing the Hungarian borders:

Table 3

Development of Border Crossings on Road

Border crossing point	Number of trucks (thousands trucks) 1997	1998	1999	Goods transported (thousands tons) 1997	1998	1999
Hegyeshalom	78	133	151	911.1	1,108	1,178
Total*:	**289**	**433**	**473**	**2,887**	**2,771**	**2,911**

**includes all six crossing points on the Hungarian-Austrian border*

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[5] *Központi Statisztikai Hivatal – Szállítási Teljesítmények, 2000. I-IV. negyedév*

At all international border-crossing points into Hungary, steady growth occurred in the number of trucks during this same period. The sole exception is the Ukrainian border. This can be attributed to the consequences of the Russian financial crisis, which also negatively effected Ukraine, causing significant reductions in border traffic.

By summarizing data from all border-crossing points between 1997 and 1999, the number of trucks entering Hungary almost doubled from 642,000 to 1,058,000.

Tables 4 and 5 summarize the distribution of different types of goods between different transport modes:

Table 4

Transported goods by category (Int'l traffic, Hungary, 1999)

Based on tons (percentage)

	Rail	Road	Water	Air	Pipe	Total
Agricult. products, live animals	13.3	14.7	16.8	0	-	13.6
Food	3.3	14.2	0.6	0	-	11.8
Solid mineral combustible	16.6	1.6	1.6	-	-	3.5
Mineral oil, Oil	8.6	2.9	5.0	-	100	10.2
Ore	10.8	1.1	18.3	-	-	2.4
Iron, steel	6.9	1.9	15.5	-	-	2.5
Building materials, stone	9.4	31.8	38.4	-	-	26.7
Manure	1.5	2.2	3.8	-	-	2.0
Chemicals	6.7	1.7	-	7.1	-	2.2
Vehicles, machines and others	22.9	27.9	0	92.9	-	25.1
Total	**100.0**	**100.0**	100.0	100.0	100.0	100.0

Source: Statistical Yearbook of Hungary (1999).

Table 5

Transported goods by category (Int'l traffic, Hungary, 1999)

Based on ton/km (percentage)

	Rail	Road	Water	Air	Pipe	Total
Agricult. products, live animals	11.6	14.0	38.1	1.4	-	12.0
Food	3.4	23.4	1.0	1.8	-	14.8
Solid mineral combustible	8.7	0.3	2.3	-	-	2.3
Mineral oil, Oil	8.7	2.6	3.1	-	100	17.9
Ore	15.7	0.9	22.0	-	-	4.8
Iron, steel	8.9	3.7	28.5	-	-	5.0
Building materials, stone	7.2	14.28	1.7	-	-	10.2
Manure	1.1	1.8	3.3	-	-	1.4
Chemicals	7.9	6.9	-	2.7	-	6.0
Vehicles, machines and others	26.8	32.2	0	94.1	-	25.6
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Statistical Yearbook of Hungary (1999).

The modal split shows that some types of international goods are almost exclusively transported by rail (i.e. solid mineral combustible, ore, chemicals), while others use road transport. More research is needed to measure whether it is really possible to switch a portion of certain goods from road to rail. Current trends seem to show the reverse. This may be due to several reasons:

First, there is a tendency towards decreasing the size of shipments.[7] In Europe, many goods are delivered in a less-than-full-truck-load basis (standard truck load = 20t). According to statistics, trucks transport only half of their volume in shipments in load capacities exceeding 10 tons.[8] The decreased shipment size means that trucks must be transported together with the goods by rail. Thus, for example, a Swiss-registered company FRI-Trade GmbH – an average-sized cotton trader with the sales of 45,000 tons annually - currently uses trucks to deliver cotton to different destinations throughout Europe. Of course, rail is used for transportation of cotton from Uzbekistan and other places where they may buy it. Cotton is then unloaded at a warehouse located in Záhony after which it is delivered to clients via truck or in another way.

This example illustrates the main advantage of rail – it is much cheaper for long-distance transportation. At the same time, railway deficiencies, such as the lower speed/safety of cargo, make shippers of items such as expensive electronic goods transport their cargo by road carrier for both long and short distances. Notwithstanding, in Europe, because of high fuel prices, rail can be cost-effective, even on distances of 200 – 300 kilometers. Since road hauliers are subject to different expenses in addition to fuel (i.e. "Euro vignette", or the fee for obtaining permission) the lower price of rail could become a very important factor for shippers selecting between various modes of transportation.

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[7] *This was confirmed by a survey conducted by AMEROPA Consulting, February 2001*

[8] *Központi Statisztikai Hivatal – Legfrissebb adatok – Szállitási Teljesitmények, 2000, page 19.*

In the following section we will describe ROLA – so far one of the most efficient working examples of cooperation between road and rail.

4. Combined Transport – a Solution for the Future

According to quite a few experts, the solution for the future is combined transportation. The basic feature of combined transportation is that loading units – meaning interchangeable bodies, semi-trailers and complete trucks – arrive at their final destination via at least two different modes of transportation (i.e. road and rail). Combined transportation can pool the advantages of both modes of transport, such as the great efficiency of rail transport for volume shipments – ideal for long distances – with the undisputed advantage of road haulage in the collection and distribution of goods within a short to medium range. Combined transportation is also more environmentally friendly than road haulage alone.

Freight forwarders and hauliers are the main contractors for delivery for such a system. They invest in interchangeable bodies for flat wagons and switchable semi-trailer units. They represent themselves at UIRR (Union Internationale des sociétes de transport combine Rail-Route) organizations, and are therefore active participants in the development of combined transportation. Thus, cooperation between road and rail transport companies can provide the basis for the possible success of combined transportation. The infrastructure for the operation is provided by the railways, as the operators would be purchasing engine capacity from the railway companies. Rolling stock necessary for combined transport is provided partly by the railways, partly by the combined transport companies. Terminals are operated by the railways or the operators, often together within a private enterprise. It is on this basis that operators define their range of services, offering clients a complete supply chain, and offering freight forwarders and hauliers a viable inter-terminal service.

The most common form of combined transportation in Europe is carried out using containers; interchangeable bodies and semi-trailers. This is known as unaccompanied transportation. This form of transportation – where only the transportation storage containers are loaded on the train – accounts for around 80 % of the entire combined transportation market. Although this ratio differs slightly from country to country, the reverse is true in Hungary, where for the time being the market is defined by (ROLA) traffic. Unaccompanied transportation requires significant technical, organizational and infrastructural preparation. Transportation and freight forwarding companies need to use containers that can be crane lifted, loaded by mobile equipment, or a static crane (vertical loading). Vehicles with interchangeable bodies or loadable semi-trailers cost more than standard lorries. In addition, the freight forwarder has to ensure that the container is properly transferred at the terminal and forwarded to its final destination.

In contrast, accompanied (or ROLA) transportation means that the truck is driven up a ramp onto a specially built railway wagon (horizontal loading). During the journey, the truck driver stays on the train, accompanying the vehicle in the comfort of a wagon lit. At the off-loading point, the driver returns to his vehicle and continues his journey to his final destination. As the driver can relax during the journey, time spent in this way counts as rest time in many countries, meaning the driver can comply with laws regarding driving hours and rest stops. In addition, working conditions are improved as there is less need, for example, for night driving, which is forbidden in some regions such as parts of Austria. Trains of the Rolling Road (Rollende-Landstrasse – ROLA – or Rolling Highway) can be loaded and unloaded in a relatively short time. ROLA has seen great success in transportation through the Alps, and in places where combined transportation needs to be executed quickly. This form of transportation is also ideal for those transport companies who are just entering the field of combined transportation. This is because there is no need to purchase a new fleet or even update the existing one in order to take part in ROLA transportation. In addition, ROLA does not require costly investments in infrastructure, such as the building of terminals. Therefore, this method is practical for short and medium range journeys and where speed is required. The most obvious disadvantage is the significant amount of dead weight transported, as not only the goods, but the entire truck is loaded onto the train.

In the past, road transportation won a great share of the market from railways, as it was more client-friendly and flexible in the area of pricing. In contrast to the railways – which are tied to their tracks – road hauliers deliver door to door, and their representatives – the truck drivers – inspire trust in clients. That being said, railways can be more economical over long distances, reliable for clients, and more environmentally friendly. With ROLA it is possible to eliminate the respective disadvantages of both forms of transportation; space required for tracks, danger from accidents and environmental pollution.

In most countries, however, the greatest cost savings can be made by reductions in vehicle tax. The principle behind the alteration of relevant tax laws would be that the user of combined transportation would be assisting in the reduction of the road infrastructure burden. An enterprise might be "licensed" to claim a tax refund arising from non-usage of the road network. Some firms provide information on the Internet regarding amounts of available space on trains, which means clients can respond immediately to any excess capacity. The significance of the space reservation service is that wagon usage can be evened out, clients can plan deliveries more easily and there is no need for unnecessary delays at terminals.

It is difficult to persuade traditional road transport customers to switch to combined transportation, since the multiple-loading processes and the possible extra costs may frighten them off. Clients preferring multiple-loading transportation are usually those that tradie in non-perishable goods which can be transported easily in container units, or those companies that can manage longer transportation times. Unaccompanied combined transportation is the major mode of freight-forwarding abroad, and practically all transportation overseas is carried out using this method. The majority of freight is sent to European ports such as Hamburg or Rotterdam with scheduled deliveries. One of the most important freight-forwarders delivering to these destinations is Hansa Hungaria Container Express (HHCE) operating along the Budapest-Hamburg route. In 1992 a ROLA link was established between Budapest and Wels, Austria. Five pairs of trains run daily on the Sopron - Wels line, in which trucks can travel straight to Austria without special clearance. The daily 3-4 pairs of trains on the Szeged-Wels link (mentioned earlier) will carry 20 trucks each. This might be the solution for the Budapest-Vienna-Munich route as well.

Combined transportation can be directed anywhere within Europe, but carriage is rather varied. These charges are set by participating railway companies and combined transportation companies each year following price negotiations. If, during the year, the need for a new route emerges an additional license must be obtained.

5. Road or Rail? A Dilemma for the Future

In order to remain competitive, the railway company's priority should be the development of international railway transportation links, information systems for clients, upgrading the aging fleet of locomotives and carriages, combined transportation, standardization of shipments, high-speed transportation, JIT trains, and quality service for small-size shipments. In order to achieve these, railway companies should go through the privatization / reorganization and/or BPR processes.

Another important perspective for the railroad is international networking. A good example of this development is the TERFF system – Trans-European Fast Freightreeways – a network of special railroad lines able to transport goods at much higher speeds than common railways. According to the plan, one of these lines should follow the Munich – Vienna – Budapest route, connecting these cities with the ports of Hamburg and Rotterdam. So far, Budapest and Warsaw are the end points of the proposed lines in CEE, so that transportation further East and South would possibly be made using multi-modal transport. Because of this development, Hungary should consider developing terminal networks to provide fast handling of goods arriving on these high-speed trains (such as efficient loading, unloading, re-packaging, etc.).

It is clear that switching the transportation of goods from road to rail will not be an easy task. To become more competitive, railroads should be more responsive to customer needs (by providing door-to-door transportation, JIT, etc.). To compete on price is not enough anymore. To build new terminals, to turn existing ones into transportation hubs, and to provide warehousing and distribution services could help the railroad remain competitive. These tasks, however, require substantial investment. In addition, railroads face a lack of unified rules across Europe. Since the majority of countries still have rail monopolies, they are usually less open and responsive than road carriers. Standardization of technical requirements, locomotive and carriage fleets, and the penetration of foreign railroad carriers into home markets is needed for more efficient international railway transportation in Europe. At the same time, railroads should form a more positive public image emphasizing its environmental benefits. This could give an incentive to regulating authorities to limit truck traffic on certain routes and implement ROLA transit-type systems, as has been done in Austria.

However, the continuing development of regional multi-modal hubs – which combine the complex reality and economy of railway and road transportation, warehousing and distribution – provide the best way forward to profitable, reliable and environmentally sustainable transportation in Europe.

Antal Tóth*

CONFLICTS OF SOCIALIST VALUES AND ECONOMIC FACTORS IN THE COMMUNIST SYSTEM

Ideological-structural priorities of the "socialist values"

It was always the so-called "socialist values" that determined the official political "goal systems" of the communist social transformation that was carried out in Hungary and the other countries of the region. These values constituted the basis of the ideological structures of the production and distribution model. The most important characteristic of these structures was that they were in contradiction with those scarce economic factors that ultimately determined the model's social-political breathing space, and the realization of its values. The fundamental conflict of the system was always that, as a consequence of the shortage of economic resources, it was incapable of satisfying those political-ideological ambitions and social expectations which these values suggested. As it is commonly acknowledged, the essence of the conflict was that the systems under examination should have financed both material conditions and forms of social provision for every member of the society at one and the same time, using state means. The problem was that this would have far exceeded the financial means and stamina of any nation, today, even of those with the most developed market economies.

At the same time, the communist regimes made the promise to all strata and groups of society that these legally canonized and politically declared pledges, based on values enshrined in the communist constitutions, should be extended as basic rights to everyone. A unique paradox concerning these constitutional allowances was that the group of basic rights declared in the basic law did not decrease as the economic model became ever less tenable. Actually, it rather increased, (to conform with its fundamental mission as expressed in its ideological tenet system attempted to "build" into its system, recodified internationally accepted basic rights (1)). Consequently, the communist states, headed by the so-called reformist countries, ratified virtually all the international human rights and social-legal basic treaties of the 70s and 80s. By doing so, they 'proved' their regime's humane character and social orientation (2). At the same time, these regimes naturally regarded as one of their most important ideological goals, that these "allowances", and constitutional basic rights declared in high level legislature, be organically built into the political values of society, and be an organic part of the communist regimes' basis of legitimization. By doing so, it was argued, this would reduce the intensity of the analyzed conflict, and the social range of influence (3). The social-economic conflict discussed here determined all three prototypes of the communist system as outlined by János Kornai (4). As such, it equally determined the ideological, the social-psychological and the redistributional character of the revolutionary transition, the classical and the reform system, as well as that of the post-socialist system.

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* *The late Antal Tóth (Ph.D.), former Professor of Political Science, former Head of Department, Budapest College of Management.*

Its effects can be demonstrated to this day. All this became especially unambiguous during the time of the change of regime, when (with regard to the collapse of ideological taboos formerly regarded as everlasting) the titular conflicts intensified to a never before witnessed degree. From this, we can now posit as a working hypothesis, that the populations of the Central-Eastern European region experienced the political contradictions under analysis, conforming to their economic-cultural development, with relatively differing social-psychological character. This exerted an influence that shaped the formation of their "market economy knowledge" in all that was to follow (5).

This working hypothesis can be summarized, according to the following points of examination.

Main Characteristics and Models of the East European "Market Economy Knowledge"

In those countries (for example, Hungary and Poland) where – using Elemér Hankiss' well known terminology – there was a gradually developing "second society" appearing in increasingly distinct subcultural institutions, it adopted a form for itself for the "second economy", the "second public", the "second culture", the "second social conscience" and also for the social-political interactions of the "second sphere" (6). It brought about what was always a unique and pluralistic social system of values. In the countries analyzed, as a result of the unique central European "semi-bourgeoisification" processes, analyzed by Iván Szelényi and others (7), the social system of values that evolved was such that by the beginning and the middle of the seventies, it had fashioned a social-psychological climate (which was much more open than that of other countries in the region), which made it possible for certain strata of the population to accept these "economically conformist", less voluntary values. We believe that one reason for the formation of the higher adaptive abilities of the populations of the relatively more developed countries, and their only moderate susceptibility in connection with orthodox ideological values, was that the transmission of "western style" economic microstructures, as well as the exploitation of developmental opportunities contained within them, was, in this subregion, much more powerfully effective than in, for example, Romania or the republics of the former Soviet Union (8). The clear explanation for this is that in thelatter countries, the state appropriation of private property and the state directed "ideological brainwashing" was far more drastically successful than in the former ones. Besides this, for example, even by the nineteen fifties, the running of the Hungarian agricultural co-operatives, their property character, and their inner structure departed significantly from the Soviet-type collective farms that initially served as a model. And as time passed, these differences only grew further (9).

All this, viewed from a different angle, means that from the beginning, in the "developed" Central-Eastern European nations, transmitted "foreign" values from the past were in contradiction with the values required for building a socialist egalitarianism, which this policy was never capable of entirely refashioning. This brought the consequence that the Hungarian and Polish stimulus threshold with regard to voluntary values, in all periods of the party state system, was always higher than that belonging to the populations of most other countries in the region, since a significant proportion of the former had never reached the point of the esoteric communist values (10). Naturally, certain social strata of the communist regimes experienced the social-psychological effects of the examined conflict in relatively differing fashions. One of the most vivid formulas was certainly the development of Hungarian society through the sixties, seventies and then eighties. Its most predominant feature was the formation of "the two societies" (11).

In this unique dual social structure, there existed over the course of nearly thirty years, two adjacent societies – an "official" and a "non-official" one. It was possible for an individual to enter, from the latter, the "official" political and economic elite, through position achieved via membership in the party, and through working their way into the "legal" political and economic hierarchy, and by so doing, accept the canonized relationship between "official" values and economic factors.

At the same time, it was also possible to become a member of the "well off." So if an entrepreneur wanting to assert his economic interests (in practice discarding the "official" interest explanations and interest interpretations, and with them, making a "tacit" compromise) he was able to select the route to a "semi bourgeois" existence, by being a small entrepreneur or through a family business. In this last case, the always mildly "schizophrenic" Kádár regime made no demands for a factual ideological espousal of values or political activity, from a "semi bourgeois" individual in the event of their resigning from active participation in the political sphere (12).

All of this was modified during the period of total collapse of the regime, in that the total and "explosion-like" loss of values affected the "official" political economic elite as well, and the conflict under examination can be said to have solved itself. As for the transformation of the system and for the majority of the "winners" emerging from the post-communist period, all this emerges as a purely "official" interpretation. The conflict itself was never experienced amid such drama, and finally, it vanished from the agenda (13).

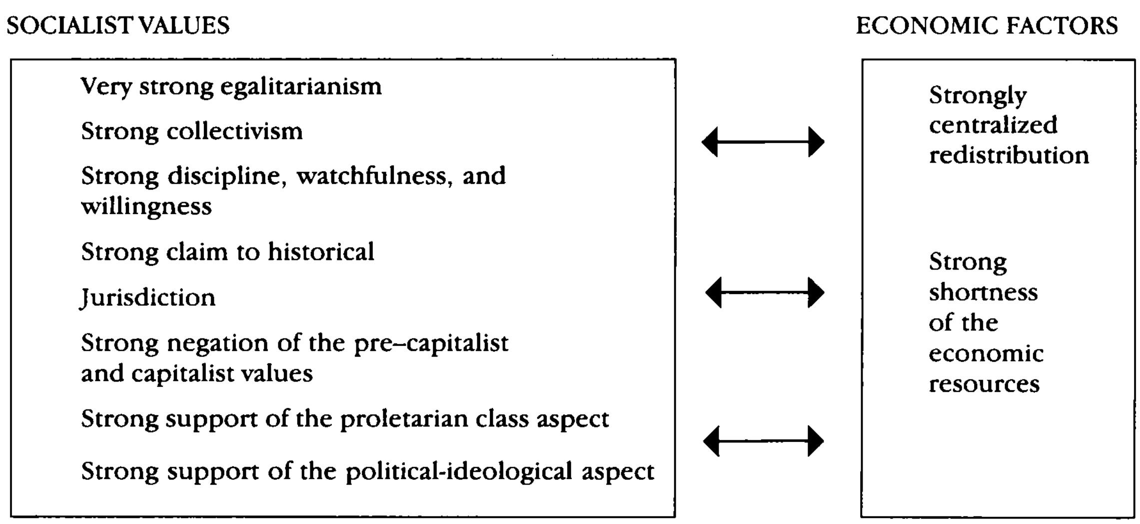
At the same time, a significant segment of the population of the communist countries, even in the more "developed" subregion, was not bereft of egalitarian values, at the center of which, stood post-Stalinist state paternalism, centrally planned schemes of distribution, and furthermore, restrictions (described as voluntary) on democratic state political institutions. As a consequence, the large portion of "losers" only managed to digest successfully the actual political-economic effects of the changes and their determining factors, many years after they happened. Consequently, in connection with the social transforation processes of economic factors their relations have been, in more than one respects, contradictory. For these strata (and this particularly applies to those areas such as employment, health and welfare provisions, social help and old age pensions) it was not easy to perceive that the "rule of economic factors", looking at a virtually irrevocable but for them, relatively long historical period, once and for all queried the validity of egalitarian values canonized in the party state period. This remained true even in the more developed countries of the region, where the state had long ago abnegated the "social contract" signed during the period of "classical" socialism (14).

Naturally in their case, the social integration of the values of market economy, and their consistent espousal and experience are, for the time being, nothing other than a highly desired political fiction that is relatively difficult to realize, despite the fact that they originally expected something quite different from the change of regime (15). Therefore the increasing political and economic untenability of the Central-Eastern European communist social experiment, viewed from a different kind of perspective, can be expressed as a slow, irresistible erosion of "classical" ideological values, and also, as a more vivid social recognition that economic factors compel the socialistic redistribution mechanism built by the political decision makers, to strict rationalization (16). In consequence, in a unique paradox, the individual communist societies at the time the regimes collapsed, had most of all come to the realization what deep historical truth content there was in the basic construction dialectic as sounded to such a degree in classical Marxist economics (17).

Naturally, with regard to the chronological appearance of the discussed process and its social-economic depth, there were, are and will be highly important differences between the post-communist countries of the region. In spite of this, we regard it important to show a model of the conflicts of social values and economic factors that pervaded the socialist system:

Figure 1

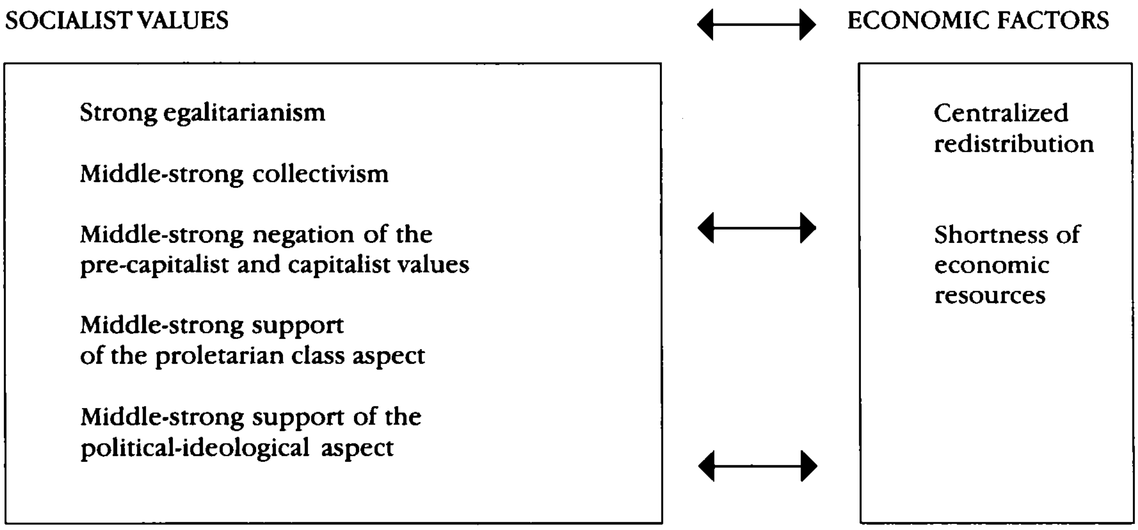
Conflicts of socialist values and economic factors in the period of revolutionary – transitional system



Source: author.

Figure 2

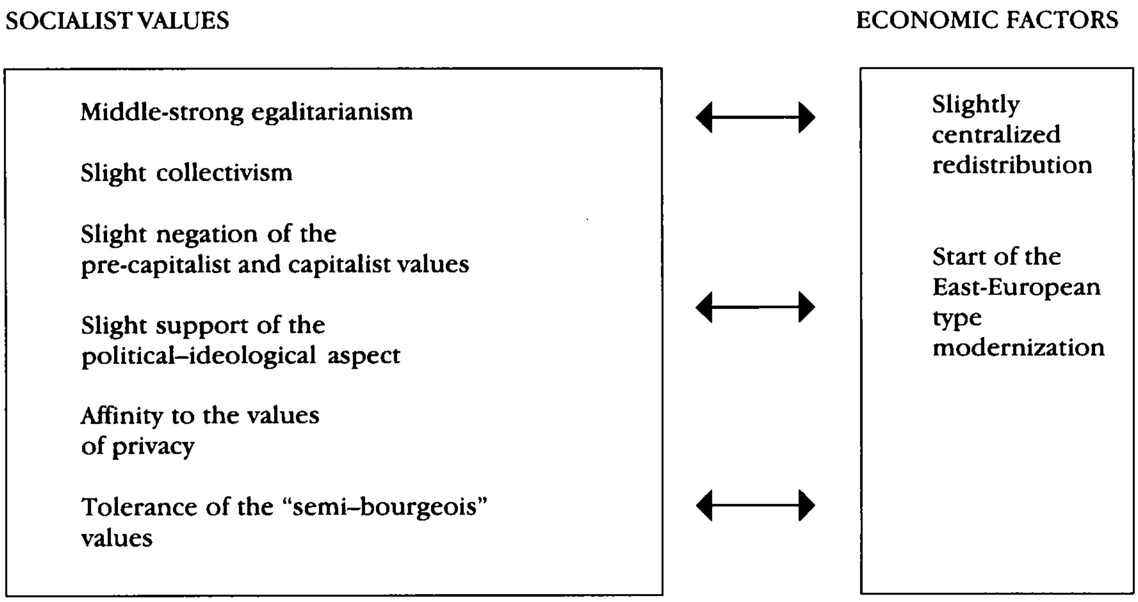
Conflicts of socialist values and economic factors in the period of classical socialism



Source: author.

Figure 3

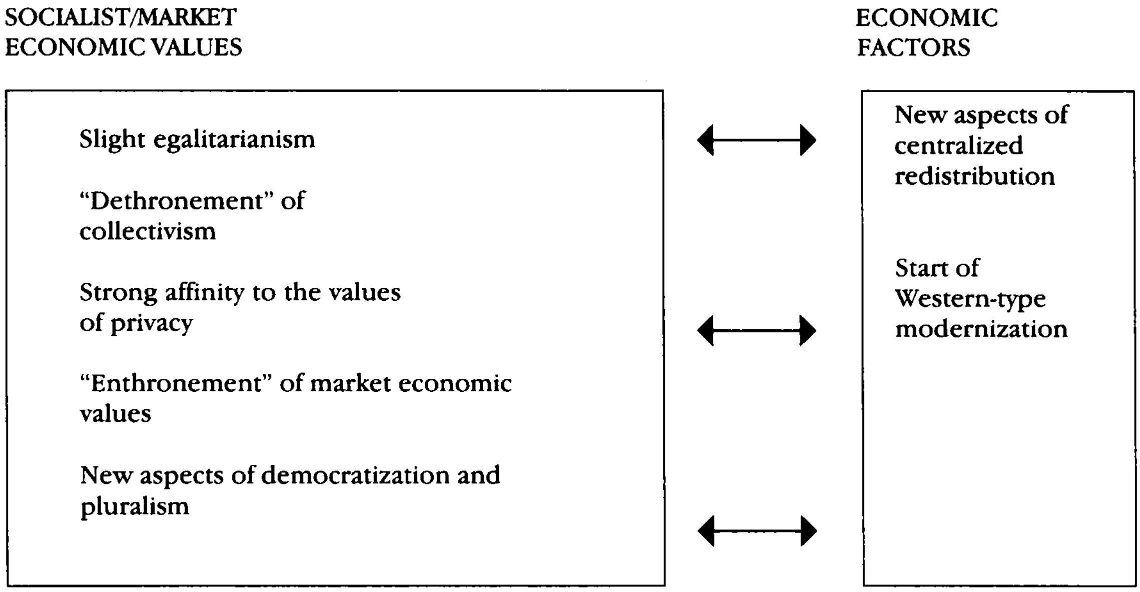
Conflicts of socialist values and economic factors in the period of reform socialism



Source: author.

Figure 4

Conflicts of socialist values and economic factors
in the period of post-socialist system



Source: author.

Remarks on the Permanent Legitimization and Value Crisis

This shows that the communist regimes of the Central-Eastern European region, in all the phases of their existence – with the possible exception of the Tito and the best 15 – 20 years of 'golden' period of the Hungarian Kádár regimes – suffered from a long term crisis of values, spreading to a significant section of society, clearly linked to the model's crisis of legitimization which can be said to have been permanent and relatively deep. Without getting into the complications of a deeper analysis of this circle of problems, it is still necessary to stress that see a close connection between the two processes. By comparison, Ágnes Heller is correct. Besides these identical situations, Heller sees fundamental differences between the legitimization types employed by the Soviet and the Central European communist regimes (18). Miklós Szabó, Mária Márkus and Thomas Rigby also identify with a similar point of view. These authors approach this circle of questions from a rationality-supposition angle that is itself a fundamental departure (19). Taking into account their approach, it is worth directing our attention to the following consideration in connection with our topic.

The mass base of legitimization in the "developed" countries of the region was never as wide as in the Soviet Union, where until Stalin's death, party membership meant in practice the acceptance of the entire regime, and identification with its goals. At the same time, the political leaderships in Hungary, Poland and later in Czechoslovakia were always aware that the private convictions of party members did not much differ from that of those who had not joined it. Accordingly, in these countries there was no kind of "organizational cover" for identity with the "official" system of values (discounting a few "hard" years of personality cult) which kept the political leadership in permanent uncertainty.

Following the Second World War, almost all the East European countries endeavored to build states supported by pluralistic, European democratic value systems. These were all destroyed after a few years of the Stalinist terror though. The sharp discrepancies that emerged from the very beginning put in doubt the basis of legitimization for the local "little Stalins" and the consolidation of the imported values that they represented. Particularly in Hungary, Stalin's death terminated, in a relatively short period of time, the terroristic, totalitarian political system of values resting on a very narrow social basis, and in their place came a much more elastic, less voluntaristpraxis of legitimization. As a result (with the exception of the Soviet Union) all the East European countries had to make a break with the "traditional" political system of values and its basis of legitimization. As has already been seen, the answer of the "developed" countries of the region was the construction and political practice of pragmatism, that was a kind of substantialism, which rejected the previously voluntary values.

The political decision makers of the latter countries, in the absence of the appropriate social basis, were not able to use the "catch up tactic" of the Hruschov leadership, which strived to gain military and technical superiority over America, nor were they able to flirt with the rehabilitation (on even a partial level) of terrorist methods, the Stalinist leadership style and ideological value systems. Because of this, they had to simultaneously accept and proclaim the "eading role" of the Soviet party and the "international road of socialism", even though this strategic approach did not seem overly original. Additionally it was also overly built on the existence of the Soviet protective umbrella expected to last for possibly centuries. This legitimization crisis was slow but could be followed well in the political attitudes expressed in public opinion. There was also the "generic process of loss of values". Both were present in the consciousness of the region's societies long before the "great explosion" and this accelerated in the middle to late eighties.

One of the great historical merits of the social science forums developed in Eastern Europe in this period, was that they endeavored to analyze with empirical methods, the political behavior and orientation of these countries' populations, and the relations leading to the changes. The value and legitimization researchers of this period (20) concentrated essentially on the following themes:

- the loss of confidence and values related to the regime's political institutions;
- the transformation of the basic categories of political legitimization;
- the social politics of developed market economy systems;
- perspectives of democratic institutions and the development of civil society movements;
- the expected political consequences of a possible construction of a multi-party system.

The results of these empirical researches proved that the majority of countries in Eastern Europe - and particularly Hungary, Poland and Czechoslovakia - were prepared to accept the changes, and ready to confront a radical change of regime from a political and social perspective as well. By comparison, on the basis of the research conducted then a speeding up of the following tendencies could be predicted in Hungary between 1985 and 1989:

- in the center of the one party system, the MSZMP (Hungarian Socialist Worker's Party) was expected to lose serious political space, but the legitimization crisis would gradually reach all the basic power institutions of the regime (parliament, trade unions, local committees);
- ever fewer people would believe in the leadership's working methods of government, in its style. The population would not believe in the country's current economic policy;
- by contrast, confidence in the church, civil organizations, independent experts and the press would increase;
- an ever growing segment of the population would desire a multi-party system, as a consequence of which they would only regard those parties and MPs as legitimate who were freely elected;
- the population would increasingly willingly accept transformation to market economy, however the countries that would exert the greatest attraction were those (Austria, Sweden, FDR, Holland, Finland, etc.) which contained socialist and social democratic welfare institutions;
- the Hungarian population would not particularly favor political demonstrations and strikes, and in particular, they would not sympathize with their violent manifestation (seizing factories, rebellions, arson, etc.). By contrast, they would believe in negotiated solutions.

As is apparent from the opinions of the population in the era preceding the change of regime, the Hungarian population was ready in 1989 to accept the fact of system change in accordance with political and social traditions. At the same time they wanted to avoid the violent toppling and its handing over of power where possible, as well as the putsch like removal of the old order or their physical liquidation. Besides all this, legitimization factors had slowly but surely become threadbare by this period.

These factors made it possible to make long-term compromises with the old system in its final throes. Neither in this period did there exist an economically established compromise scenario, with the help of which the power center, based on the "tried and tested" Kádárist traditions, would have had a realistic chance of avoiding "the big bang." Noting that in practice, the regime had used up all its ideological and economic reserves, it could only hope for an "organized retreat" in the case of a fortunate outcome of the "negotiated revolution".

All this brought with it the very necessary political consequence, what could not be seen for a long time, that a significant segment of the population had to bid farewell to the gentle security of paternalistic state care, and gradually befriend a diametrically opposed, stone-hard economic rationale based on a different logic of redistribution. This had to be done in a social-psychological environment that was filled with anxiety but was essentially hopeful, which unchangingly believed in the assertion of some kind of "balancing justice", and in the development of a new system of social values, which in the not so distant future, was capable of regulating the crude economic factors.

NOTES

1. See Földesi, Tamás. *Emberi jogok* (Human Rights). Budapest, Kossuth Könyvkiadó, pp, 89-115.

2. See Szabó, Imre. 1987. *Ember és Jog* (Homo and Law). Budapest, Akadémiai Kiadó, pp, 148-56.

3. *Ibid,* pp, 129-38.

4. See Kornai, János. 1992. *The Socialist System: The Political Economy of Communism.* Princeton, Princeton. University Press, pp. 19-21.

5. In my opinion the main question of this aspect is the quite different "modernizational attitude" of these nations. See Kulcsár, Kálmán. 1989. *A modernizáció és a jog* (The modernization and the Law). Budapest, Közgazdasági és Jogi Könyvkiadó, pp, 89-95.

6. See Hankiss, Elemér. 1990. *East European Alternatives.* Oxford, Clarendon Press, pp, 110-31.

7. See Szelényi, Iván. 1992. *Harmadik út? Polgárosodás a vidéki Magyarországon* (That is the Third Way? Achievement of Middle-class Status in the Rural Hungary). Budapest, Akadémiai Kiadó, pp, 72-82. and pp, 148-228.

8. *Ibid,* pp, 42-43.

9. See Tóth, Antal. 1998. *Érdekviszonyok a magyar társadalomban a rendszerváltás után* (Interest Relations in Hungarian Society following the Change of System). Budapest, Napvilág Kiadó, pp, 17-27.

10. See especially Berend, Iván T. 1997. *A történelem – ahogyan megéltem* (History – asI had been through it). Budapest, Kulturtrade., Michnik, Adam. 1996. *Gondban a bohóc. Esszék és tanulmányok* (The Worried Clown: Essays and Studies). Bratislava, Kalligram., and Ash, Timothy Garton. 1990. *The Magic Lantern: The Revolution of '89 Witnessed in Warsaw, Budapest, Berlin, and Prague.* New York, Random House.

11. See especially Héthy Lajos, and Csaba Makó. 1972. *Munkásmagatartások és társadalmi-szervezet* (Workers' behavoir and social organization). Budapest, Akadémiai Kiadó., Kolosi, Tamás 1987. *Tagolt Társadalom* (Stratufied Society). Budapest. Gondolat., Konrád, György and Iván Szelényi. 1992. *The Intellectuals on the Road to Class Power.* New York, Harcourt Brace Jovanovich.

12. See Lengyel, László. 1989. *Végkifejlet* (Endgame). Budapest, Közgazdasági és Jogi Kiadó pp, 185-240.

13. See Thoma, László. 1995. *Alternatívák nélküli társadalom* (Society without Alternatives). Budapest, Gondolat Kiadó, pp, 80-122.

14. See Ferge Zsuzsa. 1996. "A rendszerváltás nyertesei és győztesei (The Winners and Losers of the Change of System)." In Rudolf Andorka, Tamás Kolosi, and György Vukovich., eds., *Társadalmi Riport, 1996* (Social Report, 1996). Budapest, TÁRKI, pp, 414-43.

15. *Ibid.*

16. See Ferge, Zsuzsa. 1998. "Szociálpolitika, 1988-1997 (Social Policy, 1988-1997)." In Sándor Kurtán, Péter Sándor, and László Vass., eds., *Magyarország Évtizedkönyve: a rendszerváltás, 1988-1998* (Political Decennial Yearbook of Hungary: the Change of System, 1988-1998). Budapest, Demokratikus Kutatások Központja Alapítvány, pp, 554-70.

17. This is a reference to the relevance of our "economic factors".

18. See Fehér, Ferenc, Ágnes Heller, and György Márkus. 1992. *Diktatúra a szükségletek felett* (Dictatorship over Needs). Budapest, Cserépfalvi Kiadó, pp, 205-230.

19. See especially Szabó, Miklós. 1989. "A legitimáció történelmi alakváltozásai (The historical methamorphosis of legitimacy)." In Miklós Szabó., ed., *Politikai kultúra Magyarországon, 1896-1986* (Political Culture in Hungary, 1896-1986). Budapest, Medvetánc-Atlantisz, pp, 575-306., and Márkus, Mária. 1982. "Overt and covert modes legitimacy in East European Societies." In Rigby, Thomas Henry and Ferenc Fehér., eds., *Political Legitimation in Communist States.* New York, St. Martin's Press, pp, 82-93.

20. See Simon, János, and László Bruszt. 1991. "The Development of Party Preferences is Hungary." In György Szoboszlai., ed., *Demokratikus átmenetek* (Democratic Transitions).Budapest, Magyar Politikatudományi Társaság., pp, 166-89., and Bruszt, László, and János Simon. 1992. "The Great Transformation in Hungary and Eastern Europe. Theoretical Approches and Public Opinion about Capitalism and Democracy." In György Szoboszlai., ed., *Flying Blind: Emerging Democracies in East-Central Europe.* Budapest. Hungarian Political Science Association, pp, 177-204.

ABSTRACTS OF STUDENTS' PAPERS PRESENTED IN STUDENTS' RESEARCH FORA

Anna Gellért – Barbara Vágó*

IT WILL NEVER BE ENOUGH – INFLOW OF FOREIGN WORKING CAPITAL TO HUNGARY

The flow of foreign working capital plays an especially important role in international economy as there are countries that suffer from capital insufficiency an there are others where excess supply of capital accumulates.

The interest of the owners of capital is to invest their funds as fruitfully as possible – whether at home or in other countries.

Central and Eastern Europe was put on the map of international flow of working capital in the 90s after the change of regime.

How can we benefit from foreign working capital? The answer is simple: if we want a market economy, we have to integrate into the world economy.

Developed technology together with modern organization methods:

- help eliminate technological lags,
- improve the ability of the national economy to generate earnings,
- support the international flow of know-how, marketing, management, commercial and monetary processes,
- assist in the acquisition of currency,
- broaden and modernize foreign trade structure,
- support the increase of the volume and economy of export.

We can talk about a success story in the case of Hungary. We can do so in terms of quantity because among the countries of the region, Hungary received the greatest foreign working capital inflow; in terms of quality because in an unbelievably short time the technological equipment of the country was modernized, corporate management methods rapidly developed, and the point of view of marketing generally determined company decisions.

At first, capital came to acquire new markets, to which contributed other factors as well – for example, cheap labor, advantageous geographical situation, adequate legal background and now the companies already settled here are the most alluring factor, they attract newer investments.

Most capital investors make investments year after year; many times doubling the capital already invested. Which is normal, as capital or investor is lured by above average profit and a short payback period.

Here, however, a problem arises:

- if profit is taken abroad from companies with foreign interest, this hits the balance of payments hard,
- if profit making companies with foreign interest leave their profit within the territory of the country and reinvest it, their ownership share will increase and this changes the ownership structure of the Hungarian economy.

The domestic companies cannot keep pace with the foreign ones therefore an increased support for the use of domestic savings for investment purposes is inevitable.

The modernization of the economic environment is undoubtedly an uneasy task, but we have to admit that domestic enterprises will have a chance to catch up only after a longer time.

The manufacture of transport equipment is expected to attract the most amount of capital in the future; investments will also increase in the manufacture and assembling of electronic components, as well as in the manufacture of plastic products; concerning investment in real estate, the construction of offices will probably decline but the number of newly built warehouses, distribution centers and logistic bases will increase.

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* *Tutor: Anna Székács M.Sc. Associate Professor of Finance, Péter Csillik, Assistant Professor of Finance*

As far as commerce is concerned, the construction of shopping centers, malls and discount stores continues to be very dynamic.

We do not have to like foreign working capital, we just have to take advantage of it; at least, it is advisable to do so.

Anna Gellért – Barbara Vágó*

BEWITCHED CASTLES OR THE PLAZA-MALLS

The structure of trade in Hungary has undergone great changes. The liberalization of the economy and trade has been accompanied by the appearance of large-scale foreign investment. Investors naturally thought they would be able to invest in Hungary with small risk. Foreign (Israeli, French, American and Austrian) investors brought, together with their capital, western distribution patterns to our country. Such a new pattern is the mall.

Malls can be divided into three groups according to their placing:

- local,
- district,
- regional.

These malls, which bring in new spirit, have wide-ranging effects: on trade, society, the environment, transportation, tourism, and catering – both in a positive and a negative way.

From these effects, different conflicts necessarily arise. Conflicts may be between the small shopkeepers and the malls but competition also goes on between large malls.

Marketing-communication plays a great role in the life of the malls, for their greatest role is satisfying the customers' needs (comfort, safety...).

The keystones of the effective operation of malls are the following:

- the appropriate design of the interior and exterior of the building,
- the organization and management of successful campaigns,
- the founding of intensive marketing work.

We live in the decade of illusion, the old saying: "Cogito ergo sum" (I think therefore I am.) has changed by now to: "Sentio ergo sum" (I feel therefore I am).

According to Sándor Demján (also called Mr. Mall) malls or rather megacenters - where with one parking everything can be found at one place from shopping to doctor, from theater to travel bureau - do have a future. Naturally, these centers do not belong to the city center but to the outskirts. Thus city centers remain the place for traditional retailers. At the same time, more and more cultural functions will be focused in the shopping centers of the future, thus the same quality of services can be received "uptown" as "downtown".

At the same time, we could ask the question "is the market already saturated, aren't there too many malls?"

According to Mr. Demján, the market of malls is not saturated even in Budapest. Of course, there have been, there are, and there will be malls that go bust. People divert from the malls with not so satisfactory services to the ones that provide better services, and this rearrangement naturally effects market competition all the time, too.

The "mall fever" started with Budagyöngye in 1994, then Duna Plaza and Pólus Center came in 1996, Europark and Csepel Plaza were established in 1997 Rózsakert, Új Udvar, Mammut, Lurdy-ház, and

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* *Tutor: Ferenc Papp, Associate Professor of Management*

Orczy Plaza in 1998. These were followed by Westend City Center in 1999, which is the biggest mall even now; Campona was built at the same time. The last ones were Rózsadomb Center and Eurocenter. But not only the capital was covered with malls, but provincial towns and cities as well: Szeged, Pécs, Békéscsaba, Kecskemét, Miskolc, Székesfehérvár, Debrecen, Győr, Sopron, Veszprém, Nyíregyháza.

We agree with the opinion that the efficiency of malls can be increased by hardly anything other than either the development of their entertainment sections or further expansion: Mammut 2 was opened on September 28, 2001, and now the building of Duna Pláza 2, Europark 2, and Pólus Center 2 can be expected.

Keeping abreast with the development of modern technology (Internet) and operating also as virtual marketplaces can also bring boom for the malls.

We should not forget either that Hungary is still cheap for foreigners, that is foreign investors will still come here to build plazas.

A Hungarian customer spends $ 110 per one square meter in a week – the European average is $ 90, while the American one is $ 37. At the same time, barely 10% of those who turn into the malls actually buy something, which is a quarter of the similar ratio in the West. Which brings us to the conclusion that only a relatively weak layer of Hungarian society can afford shopping in malls. The question is how many more malls this layer can and is willing to keep.

In our opinion, the dynamism of this layer's growth is lagging behind the expectations of foreign investors, that is there is no need for the building of new malls but the existing ones could and are advised to be developed and enlarged.

Edina Kozsdi*

THE ACTIVITY OF BUSINESS ANGELS AND THEIR ROLE IN FINANCING ENTERPRISES

The strengthening of our economy is in the interest of all of us; at the same time, it is the responsibility of many of us. The healthy development of our national economy and the continuous improvement of its earnings generation and maintenance abilities are based first of all on the strengthening of enterprises. In order to support the development of these enterprises, the instruments have to be sought that help well performing enterprises start to strengthen and grow, as well as increase their potential for technological development.

The distinguishing feature of technology-based enterprises is that they need real venture financing in the pre-company, starting and early stages of development. The amount of capital needed by them may be relatively small, whereas the expected term of investment may be quite long. This role has to be played by "traditional" venture financing but lately – mainly in the United Kingdom – the venture capital industry has been characterized by some reluctance to invest in technology based firms in their early stage of development.

In the framework of my study, I would like to set light to an area of financing enterprises that generates a large portion of economic growth in developed countries but is a hidden source in Hungary as yet. These are the so-called *business angels* with enterprise development and finance activity.

The Bank of England drew attention to how important role business angels can play: they fill a need for supporting the development of small enterprises with a great growth potential and providing capital for them, especially for those that rely on the new results of innovation, the invention and utilization of developed technologies.

It is well known, too, that in the mightiest economy of the world, the US, the investments of business angels comprise the greatest source of external funding for promising small technological enterprises.

I would like to introduce these special market players' activity not very common in Hungary that exploit investment opportunities promising great profits and help Hungarian SMEs contributing to the increase of their profit producing ability.

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* *Tutor: Anna Székács, M.Sc. Associate Professor of Finance*

Benedek Sándor*

HISTORIC MEASURES IN HUNGARIAN MONETARY POLICY

Act LX of 1991 on the National Bank of Hungary:
Section 1.
The National Bank of Hungary (hereinafter referred to as the 'NBH') is the bank of issue of the Republic of Hungary, the central bank of the national economy.
Section 3.
The chief objective of the NBH shall be to protect the internal and external purchasing power of the national currency.

After the first decade following the change of regime in Hungary, the economic situation has been so stable that this stability made it first possible then necessary to rethink monetary policy. The monetary instruments that had been applied successfully for ten years were no longer able to fulfil their role. Crawling peg, the exchange rate policy and an anti-cyclical economic policy had created new opportunities and new conditions.

Hungary is in the first line in the negotiations on the accession to the European Union. The accession disputes naturally contain elements concerning the National Bank of Hungary as well – first of all regarding the independence of the central bank and its goals. From this point of view, the measures of the past half-year considered of historic importance were nothing else than the adaptation to the changes in the circumstances.

My study written in the framework of the Scientific Students' Association tries to analyze in which form this adaptation took pace during the work of the new leadership of the bank, what effect they have on the further development of the Hungarian economy. I investigate whether the National Bank of Hungary weighed up the situation correctly, whether it made the right decision at the right time. I analyze the anticipations of the national bank in both theoretical and practical approach.

In my work I first show the operation of the National Bank of Hungary, its basic goals, and talk about the rules in effect until the above-mentioned time. When analyzing a time period during which important events and changes took place, I cannot omit to mention the provisions of earlier laws and monetary targets.

I will mention the amendments to the laws concerning the national bank and the new act on the national bank. We will get to know structural and operational elements, and also touch upon the expectations of the EU concerning status of the national Bank. I will go into deeply what is behind the currency liberalization called historic, the new exchange rate and inflation targeting systems. I will look ahead concerning the new policy of the national bank; the inflationary expectations of analyzers will be also touched upon. I will examine the trend of expectations based on the surveys of economic dailies. I will analyze the future of the forint in the shadow of the ceasing of the crawling peg and the introduction of the Euro.

I prepared and finalized my study following the dramatic events of September 11: the reaction of the Hungarian economy to the global recession can be a proof of the new monetary regime. In my analysis, special attention is paid to the widening of the Hungarian currency's intervention band, the inflation targeting system, currency liberalization and the effect these make on inflation. My observations thus also my work covers the period between the widening of the intervention band of the forint and the publication of data on inflation September 11, 2001.

In my study the measures of the central bank are criticized or disapproved depending on whether the inflation target is met.

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* *Tutor: Anna Székács, M.Sc. Associate Professor of Finance*

András Drexler – Miklós Fiáth*

THE HISTORY OF LINE 4 OF THE BUDAPEST UNDERGROUND SYSTEM

We wrote our study on the history of Line 4 of the Budapest underground system (metro) – we could say on its history up to now because it will hopefully have a continuation.

Our work can be characterized as descriptive and factual, that is our aim was to contain only objective statements in it. We feel that everybody is affected by the possible construction of the new metro line, thus everyone has a view on it. We will list arguments for and against it, and propose a more cost-effective solution.

When last year we began dealing with the topic and collecting material, our plan was to make a report whose content would prove, without biasedly opposing the topic or standing up for it, how great the demand in Budapest for the construction of a new metro line is. To prove this statement, looking beyond the circumstances in Budapest, we included in our study a more or less detailed introduction of the underground systems of great cities abroad, which points out how underdeveloped our capital is from this point of view.

We give further account of the planned stations, then show some interesting findings of opinion polls, which serves the goal to point out how much the citizens of Budapest are concerned with this topic. The polls break down people's opinion on the metro according to their party preferences, and we will also show the results of polls on the effects of a possible referendum. Further, although not going into details, we built in some polls on the opinions on public transportation.

It is regrettable that the political fight of the government against the opposition and the capital in the background became inherent in the history of Line 4, which is the reason why it is unavoidable to give an insight into the political background of the planned metro summarizing the most important stages.

There was not a really serious bibliography at our disposal. We tried to balance this with spending plenty of time browsing the Internet, trying to put together the pieces of information from the press releases into a homogeneous material.

All in all, the construction of a new metro line would be crucial for Budapest. Although the constructions use up enormous amount of funds, great sacrifices and patience are needed, it would be worth investing in the metro both in the short and the long run.

The arguments can be divided into economic and environmental points of view. From an economic point of view, many foreign examples show that with the construction of a new metro line, the accessibility and the infrastructure accelerates, and this can lure investors and induce the starting of new businesses as well.

Another point of consideration is environmental protection: the clearing of roads, the decrease of car traffic and several similar factors that reduce above-ground traffic and make life easier.

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* *Tutor: Péter Benkő, Professor of History*

Annamária Drótos*

THE SPECIAL FEATURES OF HUMAN RESOURCE MANAGEMENT OF SMALL AND MEDIUM SIZED ENTERPRISES

My choice of theme was largely influanced by the topicality of the question: in Hungary the micro and small sized enterprises are in majority, thus many peaople are affected. (In the book of Kornélné Apatini entitled Banking Business 2000 – Financing SMEs[1] it is written that "according to the definition adopted by the EU, around 99% of the companies operating in Hungary belong to the size category of SME ...".)

In my study, I first introduce two small companies (City Squash and Fitness Club Ltd., and Bosch Fortuna Ltd.) in general, then analyze the human resource management of the two of them than make a comparison between them. In the following chapter I analyze the survey of satisfaction applied among the employees and management at small enterprises. In the end I use my experience and the results of the analyses to summarize the characteristics of their human resource.

The basis of comparison – besides that the sizes of the above entities are the same – is that both operate in catering, what is more, both for approximately 10 years. The past ten years have been rather eventful in the Hungarian economy. The companies that stayed alive – especially those of this size –, provide a strong basis for analysis.

The research methods applied were: own research (own sample collection), interview and the analysis of obtained information. As a result of my research it turned out that the incidental problems are closely tied to the manager's personality. If the managers admit this (with some self-understanding and self-criticism) and regulate the HR area more, they can solve the problems, and can make the, management of these issues more effective, with which they make their work easier.

All in all, it became unambiguous that small enterprises operate in an environment (both from an inside and an outside point of view) that in itself impels executives to use a similar style of leadership. As managers have a good grasp of the whole working process, it is also barely formalized, written regulation is scarce but the management's discretionary measures are frequent. There are close ties between the managers and the subordinates, strict control is characteristic, and decisions are always made by the managers. These are the general characteristics of the management of every small enterprise. Besides these similarities there are differences, however concerning the attention paid to the subordinates.

In the case of SMEs, human resource management depends entirely on the managers, who generally do not pay enough attention to this, although at both organizations, the retention of employees means a great problem. The analysis of the surveys reflect too that much could be done to increase the satisfaction of employees at both companies with introducing an incentive system, more satisfactory flow of information, increasing the quality of feedback.

Unfortunately in Hungary today and especially at small sized enterprises, the strategic importance of the human resource is not yet recognized. The employees are the most valuable assets of an enterprise, no physical asset can replace the work and performance of committed and satisfied employees thus every enterprise should strive to achieve it.

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* *Tutor: Éva Karcsics, Assistant Professor of Behaviour Sciences*

[1] *p 13, paragraph 1. (KJK, 1999.)*

Szilvia Békési*

ARMY OF THE SMALL AGAINST THE POWERFUL BIG: A LOOK-ROUND ON THE HUNGARIAN AUDIT MARKET

Auditing is such a notion that is inevitably connected to the operation of business enterprises in today's economic life. It is a service in itself that has to be sold like anything else in today's buyers markets.

Public opinion relies on the reports of accounting professionals therefore they are one of the cornerstones of financial markets. This is the reason why it is necessary for auditors to have sound knowledge and be able to think creatively. They also have to represent competently the interests of their profession and their clients and strengthen the trust put in them by their partners.

Army of the small against the powerful big – characterizes the Hungarian auditing business, where there is a persistent competition: the five big international auditors, the so-called "Big Five" are present, together with 25-30 medium-sized and 300 small auditors. In this market annual revenues can be anywhere between HUF several million to HUF 500 million. The study deals with the special features and expected tendencies of the Hungarian auditing sector, among the players of which about 1300 companies earn together only one fifth, in contrast, 30 companies generate four fifths of its total revenue. Are they really each other's competitors? Who is the competitor of whom?

In some people's opinion, the market opportunities of the medium-sized auditing companies are not really endangered by the big five, as many of them work with similar international methods, the characteristics of their customer relations many times differ from each other, as the medium sized ones offer much more personalized services to their customers. According to another opinion, however, it can also be felt in the domestic market that the "Big Five" group bring their limit down to an increasingly smaller company size when hunting for customers: a number of examples confirm that they seem to have an increased interest in the market for the second-line companies.

I chose a reputed auditing company, Consultatio Ltd. operating for more than 10 years as the subject of my study. This company stands at the ninth place in the auditing market based on total revenue.

Economic enterprises receive their auditor's report at the end of the reporting period, a part of which is the audit opinion. This is perhaps the most important part of the auditor's report, for if their bookkeeping is not correct or it does not reflect reality, they do not receive an audit opinion saying their financial reports show a true and fair view, which can have disadvantageous consequences on the future of the company. (To give a foretaste, the ratio of approving opinions extends 90% and only 1% of them are disapproving ones.) Companies struggle for this opinion, auditors come into conflict or are forced to compromise with their customers because of it many times. This is the reason why I would like to pick just this area from the many fields of analysis of auditing and take on showing it though the practice of Consultatio Ltd.

I do not let any cat out of my bag if I tell in advance that among the three companies studied, one will get an approval, the second one a limited approval, while the third one a disapproving opinion at the end of my "audit", and I will analyze the stages of the way leading to success or failure.

The overview would not be concise if I did not give an insight into real market circumstances as well, thus individual research, a survey in which I asked the executives of the individual auditing companies on their experience on the audit opinion also forms a part of my study. The answers show a mixed picture but they do not at all show unexpected results.

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* *Tutor: Elvira Böcskei M.Sc. Assistant Professor of Accounting*

Judit Rácskay*

NATIONAL COMPETITIVENESS AND THE NEW ECONOMY: THE US ECONOMY IN THE 1990S

Competitiveness is quite simple to define at microeconomic level. That company is more competitive which is more profitable in the longer term, that is being profitable, it grows faster. There are many possible interpretations what this means at the level of a national economy. In the beginning, competitiveness was in a large part identified with the amount to which a country is able to increase its share in international trade to the detriment of other countries. It was not too important what kind of relationship this had with the domestic economy. It is especially to differentiate between competitiveness at the micro- and macroeconomic levels when economic policy, the point of view of the determination of the scope of its actions comes to the foreground.

Even well known economists are divided on competitiveness at the level of national economy. According to some of them a country's competitiveness has to be continuously followed up, and economic policy has to be formed in a way that the country's position concerning international competitiveness can be maintained or improved. The majority of American economists belong to this camp: Lester Thurow, Robert Reich, Jeffrey Garten, Clyde Prestowitz, Ira Magaziner and Laura D'Andrea Tyson. Three of them were members of the economic team supporting President Clinton; others occupied leading positions at key economic organizations. In contrast to them, Paul Krugman not only questions the importance of competitiveness but also denies that it can be interpreted at a national level. In his opinion, competitiveness has become a fad in economic circles, which fad can – beyond generating inappropriate expectations – pose a threat to the formation of economic policy in the US.

Indeed, if we think it over, always interesting reports and studies have been born as a result of comparing two or more countries. Publications on competitiveness spread as bestsellers not only among economists but many businessmen read them, too. At the same time, using competitiveness as an explanation for the American economy's situation is a comfortable solution for the administration: according to Thurrow's team, the fallback of the rate of growth, the stagnation of wage levels, and the decrease of employment in the production sectors can all be explained with the decrease of the country's competitiveness. Thus the connections in the world market have to be immediately revised; there is no need to deeply analyze the national economy.

While there were ongoing debates on international competitiveness, the US underwent an extremely long growth cycle. The features of growth between 1991-2000: the length of the business cycle, the invalidity of the Phillips curve, the dynamism of the growth of production, and the increase of stock market values all questioned not only traditional business cycle theory but the applicability of centuries old macroeconomic principles and placed new problems into the center of attention. Economists have formed several theories on the "new economy" that came into existence in this period but all of them agree on the fact that the US economy was altered by globalization and information technology. With these theories coming into the foreground, the debate on competitiveness was put into the shade without conclusion.

Did the 1990s really bring about a special situation in the US economy? Can the notion of international competitiveness interpreted? If yes, can it give an explanation to the change in the position of the US? Can we talk about the birth of a New Economy where new rules prevail? Or was it just an unexceptional growth, and the old theories will be able to work in the future?

My study is looking for answers to these questions. In the first part, I am dealing with the issue of competitiveness touching upon both Thurow's and Krugman's theories, while in the second part I present the 1991-2000 business cycle – the New Economy – and the theories on it.

* *Tutor: György Csáki, (Ph.D.), Professor of International Relations*

Zsuzsanna Uszta*

THE CONDITIONS FOR VENTURE CAPITAL TO BECOME WORKING CAPITAL ON THE BASIS OF THE FINNISH EXPERIENCE

The unemployment of the economic potential of small and medium sized companies due to inadequate financing is a much-discussed subject in Hungary nowadays. I would like to sketch a possible solution for this topical problem from the point of view of **venture financing**, the relatively new form of financing having no traditions. In contrary to its name, however, this financing method does not take unreasonable risk either, it is ready to invest capital only when appropriate economic circumstances are available, through which – as we will see – it can contribute to the development of the whole national economy.

I would like to show the how the when and the wherefore of the establishment of these economic circumstances based on the Finnish experience and examples. I chose this country because on my internship there I discovered many similarities between the current Hungarian and the earlier Finnish (end of the 80s) situation. Maybe some elements that have stood the test of time there can be adopted into the Hungarian practice as well.

The development of small and medium sized economies is essential for the Hungarian economy too. It is a problem, however that a great part of them does not have access to external financing necessary for their start, operation and development or can obtain it with conditions very hard to meet for them. A starter up needs funds not debts; it has to apply its liquidity to internal use not to meeting the capital and interest repayment obligations of loans.

The technology intensive companies are in especially difficult situation as the success of their future product bears above average risk and uncertainty that is they can count on external funding even less.

Venture capital can be an answer to the above problems, which takes part in financing the company not the traditional way of extending credit – in return for interest ant capital repayment – but in return for investing in the company it acquires an ownership share in it and its return is realized through the profitable sale of its share.

Thus in the study it is shown through Finland's example what kind of tested opportunities present themselves for our country to establish favorable conditions for the operation of a venture capital industry. It could be interesting to see the development of the industry in Finland after all; we have to start from scratch too. We have the advantage, however, that not everything has to be invented by us, it is enough if we apply the tested methods. Naturally, we have to adopt everything to our special conditions.

In the beginning of the study, I come to the conclusion that in the early stage of development of the industry the presence of government is apparently inevitable.

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* *Tutor: Anna Székács, M.Sc. Associate Professor of Finance*