THE POLITICAL ECONOMY OF TRANSFORMATION IN HUNGARY

A Dissertation Presented

by

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DEDICATION

In loving memory of my father,

Imre Ferenc Dancs

1938-1998.

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ABSTRACT

THE POLITICAL ECONOMY OF TRANSFORMATION IN HUNGARY

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Across Eastern Europe sweeping changes happened in the 1990s. Although the field of economics became preoccupied with the region during the decade, mainstream analyses were confined to prescribing policies rather than understanding change with their historical and institutional context. This dissertation examines transition processes with a historical perspective using the French Regulation School as a theoretical framework. The conclusion reached through the research is that a neoliberal-integrationist strategy of accumulation was adopted in the 1990s, and although growth has at least been temporarily restored in Hungary, the country remains on the periphery of the global capitalist system.

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CHAPTER I

INTRODUCTION

A. Introduction

In 1944, Karl Polanyi (1944) argued that the self-regulating market of which Adam Smith (1776) wrote so fondly carried the seeds of its own destruction. Although firmly established or evolving in many places in the nineteenth century, the self-regulating market was but a blip in human history and had the capacity to destroy the society in which it existed. Hence, Polanyi claimed, it brought about its own destruction by society acting in self-preservation and bringing about means of social protection.

For Polanyi, the end of the nineteenth and beginning of the twentieth centuries gives evidence to his thesis that social protection would always necessarily be introduced with markets and thus the self-regulating market could not exist and was only a utopian vision. The postwar period seems to provide further proof of the rejection of laissez-faire capitalism. Keynesian economics took over intellectual thought and the idea of managed capitalism became the new orthodoxy.

The 1980s and 1990s, though, brought about a renewed interest in the self-regulating market utopia of Adam Smith. Continued economic stagnation and growing public debts within Western countries stimulated a search for new answers. Those who also put forth passionate defenses of "free markets" blamed Keynesianism and state-managed capitalism for the economic crisis of the 1970s. Keynesianism was replaced by neoliberalism as a new orthodoxy. According to the new orthodoxy, laissez-faire capitalism was superior to state-managed capitalism because an interventionist state interferes with the workings of markets causing inefficiencies and even stagnation. Since the state is an inefficient co-ordinator of economic activity and the market is superior, all economic activity should be left to the private sector and the state should be rolled back; the invisible hand must prevail.

Meanwhile, economic and political changes during the second half of the 1980s in the former Soviet Union and Central and Eastern Europe appeared to not only support the view that capitalism had triumphed and Fukuyama's (1992) "end of history" had approached, but for neoliberals, these changes also reinforced the position that the state is to blame for economic inefficiency and waste. These countries around 1990 began moving towards capitalism as an economic system, and many Western economists were more than willing to provide advice. Recommendations for "transition" policies reflected the laissez-faire/free market ideology of many Western economists. Even though the greatest time of prosperity and development in Western countries was brought about during post-war state-managed capitalism, and many lesser developed countries had suffered catastrophes due to the International Monetary Fund

(IMF) and World Bank sponsored austerity programs informed by neoliberalism, it was the laissez-faire vision which was pushed upon state socialist countries.

Academic and institutional advisors argued that with certain policy prescriptions, capitalism could be introduced in a few easy steps. Debate about the policies and their effects was scarce. The debate that did exist was confined to the speed at which policies should be introduced. The "gradualists" argued that reforms should be introduced gradually and the "shock therapists" argued that reforms should be implemented at once.

This dissertation tries to avoid outright policy prescriptions. In other words, it is not the intention of this work to discuss what should and should not be done. Instead, it examines the transformation process in an attempt to explain what is happening in the hope that it will give better insight into economic development. Hungary is the focus of this analysis. Clearly, Hungary is different than the other Central and Eastern European countries given its history of reforms, what Brezhnev labeled "goulash communism". However, it is still my hope that understanding transformation in Hungary can give some insights into transformation in other former state socialist countries. Even though the intention is to avoid prescription, analysis may provide some insight for those interested in developing and mobilizing support for an alternative development trajectory to that of laissez-faire capitalism.

I take the terms "transition" and "transformation" with respect to Central and Eastern Europe to mean a set of processes breaking down state socialism and forming the conditions for capitalist accumulation.

Capitalism is a system where there is private ownership of the means of production. Capitalists, the owners of the means of production, hire wage-laborers produce goods and services for exchange with the aim of making a profit. Capitalists decide what to produce and how it is produced. Buying and selling takes place on markets, and therefore capitalist economies are often referred to as "market economies". The main features of the system are the drive for profits, the existence of at least two classes, the capitalist class and the wage-labor class, and that markets are the primary allocation mechanism. Both historically and spatially, capitalist economies may differ substantially from one another due to institutional structures especially the role of the state.

State socialism on the other hand, has either no private ownership of the means of production or it is extremely limited. Instead, the means of production are almost entirely state property and the state co-ordinates many or most of the decisions regarding output and prices. Production is for use and not for exchange as free markets do not exist or are limited to the shadow economy. Competition between enterprises is not a central feature and is also limited.

State socialism, like capitalism, has an accumulation drive and is growth oriented. The accumulation drive, unlike the profit-drive of capitalism, is based on political factors. As state socialism is supported by a one-party political system and exists within a global capitalist economy, high economic growth is needed to reproduce the system. This is necessary in order to prove that state socialism, as a mode of production and as a political system, is intrinsically better than capitalism with bourgeois democracy. If living standards rise quickly, and eventually achieve higher levels than that of the advanced Western capitalist countries, and downturns in the economy are diminished, avoiding unemployment and general economic insecurity, state socialism would guarantee people a better life materially. State socialism would minimize the insecurities and crises in capitalism and would also eliminate poverty and great disparities in income and wealth, and would provide opportunities and access to education and culture. Hence, the politicized accumulation drive is caused by competition between political-economic systems. If state socialism "won", more of the world's people would presumably want to live under it.

This dissertation uses the term "state socialism" to describe the system that existed in post-WWII Hungary until the late 1980s, and rejects the labels "communism", "centrally planned economy", and "command economy". Although the former Soviet Union and the countries of Central and Eastern Europe are often referred to as "communist" in common parlance, state officials in those countries did not refer to their systems as "communist", instead they used the term "socialist". To describe Hungary as having been "centrally planned" is overly simplistic; the term attributes too much importance to only one of the tools used to direct economic activity.[1] "Command economy" should be rejected on similar grounds - the term over-simplifies the social-political-economic system; instead it sounds as if a computer operates everything. The term "state" in front of "socialism" highlights the concentration of economic and political power in central state organs, which would not necessarily be the case in other potential variations in socialism. Like capitalism, though, state socialism historically and spatially has taken on different forms, for example, Hungarian state socialism was significantly different than that of Yugoslavia which in turn differed from the state socialism of Czechoslovakia.

Aside from the source of the accumulation drive and the absence of free markets, state socialism also differs markedly from capitalism in that there is no private ownership of the means of production and therefore no capitalist class.

But the term capitalist class may have different meanings to different authors because of their desire to elucidate key relationships. A traditional Marxist definition refers to the minority of the population that owns and controls the means of production. Modifications on the definition of the capitalist class take into account a particular country's relationship with the world economy. World systems theorists such as Wallerstein (1979) divide the world capitalist economy into three segments: the core which is the advanced capitalist countries who import many of their raw materials but have a high degree of

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[1] And as Kaminski claims, centrally planned society is normatively loaded and implies absolute, effective central controls (Kaminski 1991, p. 3).

manufacturing and services; the periphery that relies mainly on exporting raw materials; and the semi-periphery which is somewhere between the core and periphery and thus has some level of manufacturing. In recognizing the relationship between core and periphery, world-systems theorists refer to the "comprador" bourgeoisie in peripheral countries which aligns its interests with those of multinational capital, and, is "inefficacious, stunted...incapable of identifying its interest with those of the nation..." (Wallerstein 1979, p. 104). Sklair (1991, 1994), on the other hand, rejects the comprador bourgeoisie terminology in favor of "transnational capitalist class" (TCC). He identifies this class as a combination of four groups: transnational executives and their local affiliates; globalizing state bureaucrats; capitalist-inspired politicians and professionals; and the consumerist elite. This definition captures the increasing interconnectedness of the global economy and, as Sklair (1994, p. 175, emphasis in original) writes, "[T]his implies that there is one central *transnational* capitalist class that makes system-wide decisions, and that it connects with the TCC in each community, region, country, etc". This definition is just about the transnational capitalist class, so while analyses following it may take apart the relationship between the TCC and economic nationals, it does not provide a definition of the capitalist class in a single country.

For the purposes of this dissertation, I modify the traditional Marxist definition in order to recognize the separation between ownership and control. Firstly, capitalists are those people who live off the income that is generated by owning the means of production and employing wage-laborers to produce commodities as stated above. But, along with this group, I include high-level managers when two conditions are met: the enterprise they manage is engaged in production for profit; and, the managers are able to obtain a claim upon a substantial flow of surplus value from the enterprise. This claim may be because of legal ownership relations or due to other means. Thus, top managers from private companies are included as part of the capitalist class, but also, top managers from legally state-owned enterprises may be included if those firms are profit-seeking and if the managers are able to exert sufficient personal control to obtain surplus value. These top managers may have substantial wealth and may own shares in the firms which they direct but they do not necessarily own even a majority of the firm. They are capitalists because of their control - they are key decision-makers in production.

B. Statement of themes

Simply defining the bare bones of the capitalist and state socialist systems draws out many interesting questions about transformation between the two systems. This dissertation studies transformation in Hungary mainly by analyzing how a particular trajectory of accumulation formed in Hungary in the late 1980s and early 1990s. Firstly, I present an overview of Hungarian economic development. The analysis is presented in order to understand Hungary's historical position in the international economy and to give an explanation of the rise and demise of the state socialist system. It is the demise of state socialism that gave rise to the origins and formation of a capitalist class and Hungary's relocation in the global economy. How and why a particular accumulation strategy evolved is analyzed, and finally, I examine who gained and who lost through the adoption of the accumulation strategy.

Scholars of Eastern Europe often argue that state socialism "collapsed" because it was an economically inefficient system. I argue that in the case of Hungary, the system did not collapse, nor do I believe that speaking of "collapse" with respect to the Soviet Union or Central and Eastern Europe is at all helpful. In Hungary, the political-economic system was peacefully dismantled from inside the workings of the state. State socialism in Hungary contained internal contradictions which gave rise to an elite that not only stopped defending the system against detractors, but actively dismantled it once the external force of the Soviet Union was no longer a threat. Party officials, civil servants, intellectuals and managers were all pushing for reforms, but these reforms were concerned with expanding the role of the market. But markets have a logic which leads to their expansion, and eventually the expansion of markets and the push for reforms lead to the dismantling of state socialism and the rise of capitalist relations of production. Events in the Soviet Union meant that the Soviets were preoccupied with what was going on there, and so they exerted less control and threats of force over countries like Hungary and so reforms became more radical.

The role of ideology also gained a renewed importance in the 1980s. Janos Kadar and his generation adhered to Marxist-Leninist ideology. But when that generation grew old, and became marginalized due to age, the younger generation absent of Marxist-Leninist ideology rose in importance. Ideology did not become unimportant. On the contrary, ideologies supporting capitalism became important for those in positions of economic and political power. The intellectuals and people from the media who traveled abroad believed that capitalism would bring their living standards up to that of the West and that they would enjoy complete freedom from censorship. Many high-level civil servants also believed that the pragmatic answer to economic stagnation was to move towards a capitalist economy. For party officials and managers, there was also the potential of personal material gain. Also, it might be argued that in light of the serious debt and the insustainability of maintaining Hungary's consumerism through borrowing, the system might collapse under more hostile circumstances in the future which would pose serious consequences for those in positions of political power.

I argue that the origins of the capitalist class lie with the managers and deputy managers of state-owned enterprises, and with foreign capital. The support of politicians, civil servants and the intelligentsia was crucial in the formation of this class and the adoption of an accumulation strategy, that is, an economic growth model. The accumulation strategy that was adopted, I argue, was neoliberal or what I call a "neoliberal-integrationist" strategy. This strategy formed not with the consensus of all parties in Hungarian society, but as a result of the forces of global capital and what Sklair refers to as globalizing state bureaucrats, and capitalist-inspired politicians and professionals, and the internal support from the Hungarian capitalist class, politicians, civil servants and the intelligentsia.

The main reason for telling the story of the coming together of interests in the formation of an accumulation strategy is because it has obvious consequences. While transformation brought significant material advantages to the "winners", there are many "losers". It could be argued that inflation and the massive drops in gross domestic product which emerged as a result of transformation are temporary, and growth and development will follow as long as the reform process is not reversed. I argue the contrary. Hungary will suffer from continuing stagnation and will exist on the semi-periphery of the global economy if it does not change course and pursue a different strategy. This is not to argue that certain parts of the population have not become rich as a result, and that sectors of the economy will not enjoy growth; it is merely claiming that growth and development will continue to be uneven and growth will not benefit the majority of the population.

I will also argue that the adoption of the liberal-integrationist accumulation strategy will not necessarily be stable. Already there have been fierce protests by segments of society who may push the trajectory in a different direction. Even by 1997, when economic growth had clearly resumed, fierce protests had taken place such as the street blockades undertaken by farmers. This suggests that the neoliberal policies being pushed on Central and Eastern European countries are not amenable to the circumstances of those countries.

C. Methodology

The theoretical approach in this work might be described as slightly eclectic, but most importantly, the approach emphasizes institutions and uses Marx's theory of history, the materialist interpretation of history. This may at some level seem ironic. Afterall, the countries adopting state socialism were inspired by Marxian analysis and the breakdown of their political-economic system is attributed to their Marxian roots, but as it will be discussed below, this theoretical framework provides a useful approach to understanding transformation.

Two different approaches, the social structure of accumulation (SSA) approach (cf. Kotz, McDounough and Reich 1994b) and the regulation school (cf. Aglietta 1979; Altwater 1993), have influenced this work. The former developed in the US while the latter is associated with French thinkers. Although there are differences between the two, both are influenced by Marx in terms of class and the materialist interpretation of history.

The social structure of accumulation approach was developed to explain the historical observation that capitalist economies have gone through alternating periods of stability and steady economic expansion, and instability and decline (Kotz, McDounough and Reich 1994a, p. 1). These are usually referred to as long-swings. An SSA is a complex of political, social, legal, cultural and economic institutions that provides the environment for capital accumulation to take place (Gordon, Edwards and Reich 1994, pp. 14-15). The set and nature of the institutions evolves through intra-class struggle--competition between factions of capital--and inter-class struggle--conflict between capital and labor and/or other classes. A period of sustained growth will happen if the institutions of the social structure are operating such that a secure, stable environment enables capital accumulation. Eventually, though, contradictions become evident and the institutions begin breaking down and a long period of economic stagnation follows. Another cycle may be set off if a new set of institutions - a new SSA - is set in place which can foster capital accumulation.

Like the SSA approach, the regulation school rejects the neo-classical theory of economics.[2] Aglietta, the father of the regulation school developed the theory in part as a reaction to the two major failings of neo-classical economics:

> ...firstly, its inability to analyze the economic process in terms of the time lived by its subjects, in other words to give a historical account of economic facts; and secondly, its inability to express the social content of economic relations, and consequently to interpret the forces and conflicts at work in the economic process.
>
> (Aglietta 1979, p. 9)

Historical experience indicates that economic development is not a straight line graph increasing over time, so reducing the economy to rational actors within a

[2] For a thorough comparison of the SSA approach and the French regulation school, see Kotz (1994).

pure state of nature absent of social relations cannot tell us much. Instead, economic theory should be "...the study of the social laws governing the production and distribution of the means of existence of human beings organized in social groups" (Aglietta 1979, p. 16).

Like the SSA approach, the regulation school posits different formations of capitalism at different historical periods. One formation undergoes radical economic and social change because of a great crisis, a rupture. The crisis is resolved by a new set of institutions "regulating" accumulation, a new social formation. Whereas the SSA approach describes a social structure of accumulation governing accumulation, the regulation school uses the terms "mode of accumulation" (or "process of accumulation") and "mode of social regulation". The articulation between the two forms a particular "regime of accumulation".[3] The mode of accumulation is the production-distribution-consumption relationship, and the mode of social regulation is the combination of institutions which regulate accumulation. The regime of accumulation is a particular path of capitalist development under which the propensity for crisis in the process of accumulation is contained and delayed such that stable economic growth proceeds. Crisis is, however, still immanent, but crisis can once again be resolved for a new period of sustained growth. Hence, capitalism, although

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[3] Scholars writing within the regulation school use quite a varied vocabulary. My choice follows Thrift (1994), Boyer (1990) and Tickell and Peck (1995).

crisis prone, is more sustainable than earlier Marxian theory suggested, taking on new forms, in a sense, reinventing itself.

The obvious criticism against applying either of the above frameworks to the study of transformation in Central and Eastern Europe is that both of them, like their mainstream counterparts, have been developed to theorize capitalism. Theorizing capitalism implies the existence of a capitalist class, a wage-labor class, the existence of markets and institutions regulating capital accumulation. However, these theories can still be adapted to theorize transformation to capitalism. Since the underlying principle of both approaches is Marx's theory of history, they are still appropriate to study changes between modes of production. According to the materialist interpretation of history, within a mode of production there are forces of production - how society materially reproduces itself - and relations of production - the social arrangements directing production and allocating the output of production. Classes are defined according to people's relationship to production and distribution. Inherent to the system is class struggle, and through class struggle, social change takes place. This happens in ways which advance and change the forces of production, which in turn advances and changes the relations of production. Historical materialism offers a general argument about social evolution which provides a valuable framework for studying a transformation between modes of production.

Notwithstanding the criticism and the rejoinder, I believe that the regulation school offers a useful method to understand transformation in

Hungary, if a certain dose of theoretical self-consciousness is applied. I hope this is apparent throughout the following work and represents not a completely new theory but perhaps a footnote upon existing theory. Regardless of whatever name is given to the theoretical framework, I find the most important elements of theory used here are the emphasis on an economic system as a mode of production; the importance of class relations in defining the mode of production; the inherent nature of class conflict and the defining role it plays in social evolution; and the importance of institutions in relation to capital accumulation. At this point, I refer to the regulation school instead of the social structures of accumulation approach mainly because the regulation school has incorporated a more useful approach to the state. Instead of viewing the state as a single institution, regulationists define the state as a *network* of institutions which plays a role in the evolution of a strategy of accumulation. Hence, the writers in the regulation school, and the vocabulary they use has been more influential upon this work.

My methodology examines the process of transformation firstly by characterizing the state socialist mode of production, then identifying the formation of classes and their respective interests and, finally, analyzing how these interests are being articulated to define a new strategy of accumulation. While I take the post-WWII era in Hungary to be a regime of accumulation (in other words, a long swing where relatively stable economic growth proceeded), I do not identify a new regime of accumulation in Hungary taking its place in the

1980s and 1990s. Instead, there is a *strategy* of accumulation but it is not clear that stable growth will follow.

This dissertation might also be considered a case study in transition. While I believe it provides some insight into transition processes generally, Hungary is a particular case of transition. The country has a history of reforms that did not exist in other Eastern European countries, and while the strategy that evolved during the 1990s may be a similar story across the region, the details are different.

D. Empirical sources

I have consulted different sources for the empirical work of this dissertation. I carried out a number of interviews with state officials, managers, representatives of special interest organizations and academics. Published and unpublished documents from the Hungarian Central Statistical Office, Ministry of Finance, the State Property Agency, the State Holding Company, the State Privatization Agency,[4] the World Bank, IMF, OECD, and private polling agencies have been used for data on economic variables, public opinion and other qualitative and quantitative information presented in following chapters. Relevant academic research has also been used.

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[4] The State Privatization and Holding Agency created in 1995 became the successor organization of the State Property Agency and the State Holding Company.

This research is an analysis of institutional change and hence is inherently qualitative and not quantitative. In order to find information for answering the questions posed, interviews with people who have knowledge of the events which have taken place was the most useful methodology, especially because interviews add human content to the existing documentation. The "story" of transformation becomes more real, more human, because that is exactly who it is affecting - people. Quantitative information has been used in a number of places to more thoroughly examine the evidence regarding various claims. This form of triangulation is necessary when both examining institutional change and trying to describe the impact of change on the population.

E. Structure of work

The next chapter examines the debates surrounding transformation in Central and Eastern Europe with specific emphasis on the literature covering Hungary. The third chapter takes a step back and gives an overview of Central European and Hungarian history. The point of the chapter is to establish Hungary's lagging development and semi-peripheral status with respect to Western Europe, and to discuss the characteristics of the Post-World War II era in Hungary in order to have a better conceptual framework for the initial process of transformation in Hungary. Chapter 4 discusses the origins and formation of a capitalist class in Hungary and the links between domestic and foreign capital. Chapter 5 examines how a strategy of accumulation evolved in the 1990s and how the liberal-integrationist strategy became dominant over other strategies. This chapter also looks at the role of international organizations, mainly the IMF and World Bank in the transition process. Chapter 6 then examines the implications of the above trajectory and answers the question of who won and who lost out in the transition process.

CHAPTER II

LITERATURE REVIEW

A. Introduction

There has been an enormous amount of academic literature produced on Central and Eastern Europe over the past several years. Before the advent of significant changes in 1989-90, interest in the region was limited. Academics within those regions obviously produced material about their own systems, but in Western academic circles as well as in other non-Soviet allied countries, attention to the region was limited to a self-selected minority of academics who were interested in socialism usually because they were on the left and wanted to understand socialist alternatives, or, being on the right, they wanted to tear down any notions that real existing socialism might have some advantages over Western capitalism. But the events of 1989-90 changed all of that. Now there is an abundance of academics busy writing up research, giving conference papers and working as consultants to the new governments of the region.

Most of the "economic transition" literature accepts without question current mainstream economic theories, in other words, neoclassical and neoinstitutional economics. While often insightful, mainstream approaches to studying economies are ahistorical and static and therefore obscure historical factors and institutional differences between individual countries and between state socialism and capitalism. Since this dissertation is engaged with challenging the orthodox manner of studying transformation in Central and Eastern Europe, this chapter examines two areas of the existing literature with an attempt to explain how theory informs the discussion.

Firstly, I look at explanations for the "collapse" of state socialism. It is impossible to understand the nature of a transition away from a state socialist political-economic system without understanding the workings of the system. In the case of Hungary, state socialism lasted for almost 50 years and brought about relatively high rates of growth. Growth rates were high in comparison with its own history of stagnation and were comparable to the high levels of the post-war boom in many Western economies. It is necessary to understand why the once thriving system broke down in order to understand what is propelling the formation of a new system.

Secondly, I examine theories of transition from state socialism to capitalism. Suprisingly little has been written directly on *theories* of transformation between state socialism and whatever comes after, but all the work discussing more specific aspects of transition tends to be underpinned with some type of theory. Generally, economists have selected the familiar theories of neoclassical, neoinstutional, and Austrian economics to underpin their work. But are theories that are designed to understand market economies useful for examining transition? The literature review concludes that a more insightful approach would be one that includes historical factors, recognizes institutional differences between countries, and places the study of a country in the context of the global economy.

B. The demise of state socialism

Many commentators would argue that "real existing socialism" in Central and Eastern Europe was an inferior economic system to that of capitalism. Much of the work written on the politics of the region before 1989 was critical of the lack of democratic representation and the repressive nature of the single party-state. The economic literature tended to be fiercely critical of the inefficiency of the coordination mechanisms. Explanations of why state socialism eventually ended in the former Soviet Union and Central and Eastern Europe usually begin from this starting point -- that the economic system was inefficient and therefore collapsed. Simply put, state socialism could not deliver the goods like its main rival, capitalism. Lipton and Sachs express this view succinctly:

> The intense desire to rejoin the economies of Western Europe reflects both an attraction to the obvious achievements of Western Europe and a revulsion against the failure of communism...It is one thing to be poor, but it is quite another to have become impoverished needlessly as a result of the failure of the communist system.
>
> (Lipton and Sachs 1990, p. 76)

The "intense desire" belongs not only to the powerless masses, but also to the many "committed communists" that have "turned their backs".[5]

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[5] According to footnote number 5 (p. 76), Lipton and Sachs seem to be influenced by a lecture given by Adam Michnik in which he stated that committed communists also shifted attitudes because the decline in living standards was universal. Even the highest levels of the party were adversely affected.

Like Lipton and Sachs, many who write on the transition from state socialism to capitalism do not even discuss why the changes may have been brought about because they find it self-evident that Western-style capitalism has proven itself to be more robust. It was only rational for people in positions of power as well as those with no power, to decide that it was time to make some changes. The above hints at two sources of agency and two theses on why state socialism gave way to capitalism: society-based explanations argue that what happened in these countries was a revolution in which the masses overthrew an unpopular political and economic system; elite-based explanations argue that the agents moving state socialism to capitalism were actually the elite rulers themselves.

A common view of communism was that it was a good idea but was not well implemented. Kaminski's (1991, p. 3; emphasis in original) work on Poland twists this view about the theory and practice of communism when he argues that state socialism "was a *terrible idea but awfully well implemented*". With a logic derived from Adam Smith he points to institutional deficiencies which made state socialism incapable of channeling self-interest into social harmony. According to his argument, the individual's motive for gain and the role of competition are the endogenous sources of economic growth and technological innovation that drive capitalism. Without these two fundamental features, state socialism was doomed to stagnation.

Similar to this analysis, Murrell (1991b) and Hillman (1994) attribute stagnation to the lack of Schumpeterian innovation. In the absence of the dynamics of creative destruction which, for Schumpeter and others, can only be present in capitalist systems, a socioeconomic system will inevitably stagnate. Put another way, state socialism lacked the incentive structure of capitalism which fosters innovation which in turn fuels growth.

But institutional deficiencies do not necessarily lead to the breakdown of a system. It is not clear why a reformulation of institutions did not take place; in other words, why was state socialism not simply reformed? Why did the internal contradictions give way to what the Hungarians call "system-switch", a change from state socialism and one-party rule to capitalism and paliamentary democracy? Human agency, and not just references to institutional weaknesses, is necessary in any explanation.

For Kaminski, the answer lies in the legitimation of the system. He claims that state socialism was alien to the political traditions of Poland (and some of the other countries in the region as well). The political system was legitimated only by increasing living standards because the Communist party-state could not succeed in infusing new values into the populace. Any period of economic stagnation would produce the conditions for the loss of authority of the party-state. In Poland, this turned into a spiral as the state tried to avoid political crisis by postponing necessary austerity measures. Without the austerity measures, the economic system was prone to further stagnation. The final collapse in

Poland was brought about by continuing economic crisis, and as the state introduced austerity measures, the party-state lost complete authority. In order to avoid anarchy, the party-state negotiated for shared rule with representatives of the "masses", Solidarity (Kaminski 1991).

The above points to the necessity of understanding certain dynamics which may be absent or inferior under state socialism. What does not seem to be clear from these explanations is why state socialist systems so quickly distintegrated after having a long period of sustained growth followed by a slow-down not unlike those of Western capitalism. What is also apparent from the above institutional deficiency explanations is that at their root they presume the state socialist countries would have achieved similar results to the advanced capitalist countries had they followed a capitalist trajectory. Kaminski writes:

> State socialism was too well implemented. It managed to survive beyond a point when accumulated shortcomings made economic recovery extremely difficult to obtain. Although it was based on an institutional design doomed to failure in the world of rapid change, it lasted long enough to destroy the economies and natural environments of countries that had lived under it, to ruin the lives of millions before its final collapse, and to spoil the moral environment...
>
> (Kaminski 1991, p. 3)

Yet, it is unclear how state socialism "destroyed" economies given the rapid growth and development achieved during the post-war period.

A longer term perspective would point to the implementation of state socialism as a development strategy which became possible because of the peripheral status of the Central and Eastern European economies.[6] The paths of economic and political development in Western and Eastern Europe had split in the fifteenth and sixteenth centuries, not in the 1940s as many academics such as Lipton and Sachs presume. Up until the period of state socialism, the region remained mainly the agricultural reserve of Western Europe with very little industrialization. It would be more apt to compare the performance of countries within the region over the past 50 years with countries that were in a similar economic position in the world during the 1930s and 1940s but did not pursue a state socialist strategy.

Other countries that have pursued a capitalist strategy but have not developed up to the levels of Western Europe have not overthrown the capitalist system because it has not proven dynamic enough. For example, other peripheral European economies such as Ireland and Portugal did not catch up to Western European standards. It is only recently, with the infusion of European Union monies that those economies have experienced rapid growth, but even still, this is much more the case with Ireland than with Portugal which still remains far behind the European average. Other examples abound in Africa and Latin America (although many of these countries do experience severe political instability and war because of the lack of economic development).

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[6] The countries of the region were less developed in comparison with Western Europe with the possible exception of regions within the former Czechslovakia which are in the present day country of the Czech Republic, and regions within the former GDR.

Arguments based on lack of incentives and other institutional deficiencies of state socialism use an ideal model of capitalism. The ideal type does not, however, conform to any actually existing capitalism.

Stagnation developed in the Western market economies at approximately the same time it did in the state socialist countries. In fact, capitalism has survived a few different periods of crisis which involved stagnation, falling standards of living, high unemployment and other serious consequences without succumbing to a complete break with the capitalist mode of production. Instead, the institutions of capitalism became reformulated leading to another period of sustained growth. This is most clearly apparent in the Great Depression of the 1930s and the subsequent postwar boom period.

Also, the ruling elite of social systems have normally defended the system over which it holds power even if the system appears inferior. Explanations of economic inefficiency do not take this into consideration. Cases abound in the twentieth century, even in countries that were poorer and had more repressive political systems, where the elite have been willing to use any means necessary to defend the system. In situations where the ruling elite had negotiated a transition to greater democracy, such as in Chile and Spain, there was not a threat of anarchy. Since the ruling elite do not normally abdicate power, the analysis of the breakdown of state socialism in Central and Eastern Europe has to explain why the elite appeared to so quickly abandon the systems over which they presided.

Murrell and Olson (1991) go some way to recognizing the motivations of the ruling elite. They provide an explanation of institutional sclerosis but concentrate specifically on encompassing interests. In a Soviet-type society, the country's leader has an encompassing interest which means that his interest in the overall success of the society is large relative to the other members of the society. His encompassing interest is total since he can dispose of the economy's product as he sees fit. This is in contrast to other societies where the encompassing interest in the productivity of society may be shared between various groups or classes. The leader's encompassing interest gives him the incentive to ensure economic growth since he directs the benefits of it. Instead of a single leader, the politburo can be thought of as having the encompassing interest since its membership is small and stable and can easily overcome the problem of collective action. Using a devolutionary model, they argue that although Soviet-type economies initially achieved high growth rates due partly to high levels of investment, over time the formation of coalitions and interest groups slow growth rates.

In order to push economic growth, the leader, or politburo, needs a vast amount of information from the various productive units in order to determine the optimal allocation of resources. Firm managers and others who need to transmit information to the leader have an incentive to conceal mistakes and productive potential in order to best preserve chances at promotion and perks, and to diminish chances of demotion. Yet, if this incentive was not countervailed by another force, the Soviet-type economies would never have had a period of growth comparable to Western European market economies. Bureaucratic competition, according to Murrell and Olson, is the countervailing factor which permits substantial growth, gains in productivity and so on, for a period of time. Eventually, though, collusion evolves between high and middle-level ranking bureaucrats and enterprise managers. Workers, likewise, collude to keep information from managers. Collusion evolves more slowly than it would in a non-authoritarian state because organizations independent of the state are prohibited or otherwise discouraged. The collusion of restricting information to the leader gives the subordinate group significant power and erodes the power of the leader and his encompassing interest. Ultimately, the subordinates' gain in power means that they will determine who becomes the leader. A new form of rule evolves, "rule by a rather large aristocracy of upper level bureaucrats" (Murrell and Olson 1991, p. 260). Since the encompassing interest of the leader devolves down to the new aristocracy, and this new group is too large to successfully overcome the problem of collective action, there is no longer an incentive to make society work and the economy continue to grow. Hence, the system stagnates.

Murrell and Olson contend that their theory of encompassing interests indicates the main reason why state socialism devolved. The authors do not explain why state socialism gave way to capitalism *per se*, but they are trying to answer the question of why "centrally planned economies decay over time" (Murrell and Olson 1991, p. 253).

But again, why would the institutional sclerosis give way to fundamental changes? System-switch may have been the only "cure" to the institutional sclerosis brought on by encompassing interests but an explanation needs to include how the fundamental change is brought about.

Murrell and Olson introduce agency through "testable predictions" of the theory. The theory predicts that the advocates of market reforms would be the leaders along with the consumers and the intellectuals who are not in a position to appropriate surplus value. Not only will they be the pro-reform advocates, but they, Murrell and Olson assume, will have the most to gain from reform. The theory also predicts that the upper-middle and middle levels of administrators in each industry and sector, along with planning officials, will oppose competitive market reforms and will have the most to lose by reforms. This is the crux of their argument. According to the theory of encompassing interests, it is the latter coalition of management and administrators who have colluded, causing the institutional sclerosis, and have slowly replaced the authority of the top level (the leader, politburo and other top officials) in determining the distribution of the economy's product. Since they do not want to lose control of the power to distribute the product, they will oppose the reforms.

The above predictions, however, do not accord with the empirical research carried out for this project. In Hungary, the advocates and opponents of reform did not fall along the lines Murrell and Olson would claim. Managers and deputy managers, for the most part, did not oppose reform and did gain significantly from it. Administrators also threw their support behind pro-market reform. If the word "consumer" is interpreted as referring to the bulk of the population, then consumers may be viewed as having been the significant losers of reform if the drop in real wages and the increasing rate of poverty are taken into consideration. Moreover, privatizing state property was viewed by the average consumer as having benefited the elite and foreign capital. This resulted in an attempt by a section of the ruling elite to widen domestic participation in order to appease the consumers and ensure that transition would continue. Although the average person may have supported the more general concept of political and economic reform, when processes such as privatization actually were underway, popular dissatisfaction was the result.

Szalai (1991) discusses the case of Hungary in a similar vein to Murrell and Olson. She presents a well-researched and fascinating analysis of the Hungarian economic mechanism from the 1968 reform period to the dissolution of one-party rule. According to her analysis, the economic system was unable to integrate special interests. The struggle between the party, state bureaucracy and large companies led to decomposition of the system. While Szalai's research is great step forward, her public choice theoretical framework does not provide a clear explanation. Under capitalism, there are also many social and class groups with competing agendas and the system operates with inherent conflict. It is not clear when we can know that special interests are integrated and when they are not. Why would conflict in the case of Hungarian state socialism lead to dissolution and under Western capitalism, the system has remained in place for more than two hundred years? For example, Szalai (1991, p. 290) claims, "[I]n the system of interest representation operating since 1968, the interests of large companies and their leaders have become overrepresented". Many would argue the same is true in the system of interest representation in the US. Despite this criticism, Szalai's analysis is helpful for highlighting the power of managers to obtain increasing proprietary rights over their companies.

Other theorists attibute the loss of ideology as the key factor in the demise of state socialism. For example, Poznanski (1991) considers economic difficulties to be a contributing factor, but the primary force of the collapse was the abandonment of ideological principles which supported the communist system. His main claim is that an evolutionary process led to the decay of state socialism and simultaneously laid the foundations for liberal capitalism because the elite questioned its ideological principles and determined that it could most benefit by giving up political power and usurping economic power.

Admittedly, Poznanski's account is only a preliminary thinking through of the possible explanations of the demise of state socialism in an effort to dispel the common wisdom of society-based explanations. But perhaps the loss of ideology or faith in the system was an important factor. Better put, this loss was an enabling factor for the demise of the system, not the "primary force" that he describes.

In a mirror image of Poznanski's theory, Kolakowski (1992) instead discusses the relationship between ideology and economic failure. However, to Kolakowski, it is doubts within the ruling elite about the legitmacy and durability of the system that created the state of mind that was necessary to initiate changes. In other words, the economic shortcomings of the system that encouraged the leadership to reconsider the ideology of state socialism. But as Kolakowski (1992, p. 22) argues, "[I]f we could explain the timing, we could predict it, which we certainly did not do".

All of the above explanations do identify particular features and events that have contributed to the demise of the state socialist system in Central and Eastern Europe. But these explanations often raise more questions than they seek to answer. Society-based explanations which place power in the hands of the people to overthrow a ruling regime and a particular socioeconomic system do not explain why previous, more revolutionary uprisings emanating from the grass-roots such as 1956 in Hungary did not lead to such fundamental institutional changes as 1989-90. An easy response is to explain that the regime could no longer use such force, or that leaders of the Soviet Union no longer had the political will or ability to suppress an uprising. But these explanations do not account for the fact that in Hungary the vast majority of the population was mainly passive actors in events. To view actions taken by the working classes and rural peasantry as exhibiting the desire for liberal capitalism would be a misinterpretation of actual events. But probably the most significant problem with society-based explanations is that they imply revolution and not negotiation. What happened in Hungary during 1989-90 was peacefully negotiated and supported by the ruling regime. Not only were there round-table negotiations over the future political system, but the Foreign Minister at that time, Gyula Horn, was elected as Prime Minister in 1994, and his political party, the Hungarian Socialist Party, is the successor party of the Hungarian Socialist Workers Party. If revolutionary events took place in Hungary, a ruling class would have been disposed of in some way. Instead, the change of political system bears more similarity to events such as Pinochet's resignation from power in 1990, which, while not a revolution, was an event which had important consequences for the governance of Chile.

The crux of the problem with explanations about the demise of state socialism in Central and Eastern Europe seems to lie with the movement from crisis to transition. While it can be debated as to whether there was a crisis, and if there was, which factors were the most important cause of the crisis, it is necessary to explain how a crisis becomes a transition. It is not simply the shortcomings of state socialism that are the issue; it is also how and why a socioeconomic system was dismantled and a completely different socioeconomic system became the model for the future trajectory.

Kotz and Weir (1997) address many of the above issues in their book *Revolution from Above: the Demise of Soviet system*. According to them, the story of the Soviet Union is more complex than the common interpretations put forward by Soviet specialists:

> After 10 years of minor adjustments had failed to improve economic performance, a new leadership under Mikhail Gorbachev set off on the path of major structural reform, the aim being to democratize and renew Soviet socialism. However, unforeseen by Gorbachev and his fellow reformers, the economic, political, and cultural reforms they carried out unleashed processes that created a new coalition of groups and classes that favored replacing socialism with capitalism.
>
> (Kotz with Weir 1997, pp. 7-8)

Instead of finding that the reason the Soviet Union changed dramatic courses was because of economic inefficiency, Kotz and Weir find that state socialism is inherently unstable as a political-economic system because its elite has no property ties to the economy, must limit its privileges, and thus will at some point shift its allegiance to capitalism and its larger, legitimated privileges. Their story about the Soviet Union has been a useful guide for my work on Hungary.

C. Theories of transition

Many scholars have recognized the uniqueness of the transition in Central and Eastern Europe. The events of 1989-90 have provided a rare opportunity for numerous experts to offer advice to new governments that were, at least initially, receptive. For economists, as well as those in other disciplines, transition has stimulated much debate, but that debate has mainly confined itself to the realm of policy prescription. While policy prescription is necessary, the need for a discussion of what happened and why has mainly been glossed over. Moreover, policies not based on an in-depth, historical analysis of economic change are bound to have shortcomings.

There are two major camps in the policy debate: the neoliberals, otherwise known as "shock therapists", and the "gradualists". As the labels of the two groups suggest, the shock therapists advocate a rapid transition to a market economy and the gradualists favor a slower transition. The theoretical framework informing the shock therapists is neoclassical economics. Neoinstitutional (or evolutionary) economics informs the gradualists. Since the vast majority of the literature in economics is confined to the policy prescription debate, it is mainly these two mainstream economic theories that have underpinned the literature around economic transformation in Central and Eastern Europe.

The most prominent of the shock therapists are Lipton and Sachs in their work advising Poland; Kornai, who writes generally about the region but most knowledgeably about Hungary; and of course, advisors from the IMF and World Bank. The suggested policy package consists of: first, eliminating excess demand through macroeconomic austerity; second, creating market competition through the deregulation of prices, legalizing free trade, and demonopolization of the state sector; and finally, privatization (Lipton and Sachs 1990). The IMF's policy recommendations are usually simply stated as the three-pronged strategy of liberalization, stabilization and privatization. The third prong is sometimes also labeled "institution building".[7]

The provocative term "shock therapy" is used not because of the controversy over the policy prescriptions *per se*, but because of the speed at which these reforms must be implemented. Kornai, for example, writing before the 1990 elections in Hungary suggested that:

> ...these measures must be taken *in one stroke*...It should be possible to complete a package of measures within one year of the government's inauguration. The "surgery" must begin on a stated date, and ought to be basically completed within another year. Certain predictable elements of the operation must be made known to the public in advance; others will develop only during the course of the operation.
>
> (Kornai 1990, p. 102-03, emphasis in original)

Likewise, Lipton and Sachs advocate "a rapid, straightforward, and sharp program of economic reform" (1990, p. 87) because there will be tendency to reverse reforms as populist pressure builds against governments.

One of the primary tasks and main concerns of shock therapy is eliminating excess demand. Lipton and Sachs claim that shortages in state socialist countries were the result of excess demand and that:

> The origins of excess demand lie deep within the system and include: the planners' drive toward rapid growth through heavy investment; the soft budget constraint of enterprises engaged in constant negotiation with the financial authorities; the planners' fear of unemployment; and communist regime's lack of legitimacy to impose strong austerity measures with public support and *its unwillingness or inability to do so by brute force.*
>
> (Lipton and Sachs 1990, p. 86; my emphasis)

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[7] Rodlauer (1994) who works for the IMF labels the three prongs of the IMF recommendations as liberalization, stabilization and institution building.

It might appear that the analysis presented by the shock therapists is also shocking in the sense that the historical understanding of state socialist regimes is that they were too soft on people. What really is needed is austerity, they say. In fact, Lipton and Sachs (1990, p. 85; emphasis in original) also claim that "...in a shortage economy, a fall in real wages can simply mean the elimination of queues, and therefore a *rise* in living standards". Ironically for shock therapists, a decrease in real wages which ordinarily would mean a decrease in living standards does not hold for Central and Eastern Europe because it is better not to be able to afford goods and not have to wait in line than the reverse.

According to the neoliberal position, capitalism can be created. The belief that creation from above can happen is evident in the titles and writing of the neoliberal/shock therapy literature. Adam Smith's invisible hand will guide the future. All the government of a country has to do is follow the straightforward advice.

The advocates of gradualism criticize the radical economics of shock therapy as yet another attempt to construct a utopian vision (cf. Poznanski 1995a, 1995b). The form of evolutionary theory, or neoinstitutionalism,[8] that underpins gradualism relaxes the neoclassical assumption of perfect information and instead posits the gathering of information as the central feature of activity of rational economic agents. Individuals act in a trial-and-error fashion, and the

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[8] See for example, North (1981).

process of institutionalization is an organic process driven by the actions of individuals. Thus, attempts to plan and construct institutions are doomed to failure. As Poznanski writes:

> Since such constructivist attempts are generally not practical, they cannot be fully implemented according to the preconceived model. Even at the time of inception, when reform fever is at its highest, some major compromises are being made, bringing ideals closer to the reality of what is possible. Thus, by their own idealized standards, radical institutional changes begin with a "failure" of implementation. This initial compromise is followed by other compromises, so that the real fate of constructed - as opposed to self-grown - institutions is to decline and give way to something else.
>
> (Poznanski 1995b, pp. xi-xii)

However, gradualism underpinned by neoinstitutional economics is not a large advance over the analysis presented by shock therapists. Van Brabant (1995) argues in his critique of gradualism that while evolutionary models assume that individuals are largely unable to act effectively in a market setting because they are lacking a market ethos, gradualists merely suggest that reform can proceed at the pace of the spread of market ethos. But pacing reforms in sync with the spread of the market ethos, leaves "the reader to wonder how...one is to determine when the public's ethos is sufficiently advanced to free it from the petty tutelage of the paternalistic state" (van Brabant 1995, p. 196). In other words, policy-makers are still lumbered with the dilemma of determining the correct speed at which to implement reforms.

Van Brabant also argues that the gradualists' attention to the need for capitalist institutions does not lead to any specification or conceptualization of the set of institutions. Perhaps it is here where van Brabant's critique misses the point. Gradualists do not specify any more or any less the institutions necessary for a capitalist economy than the shock therapists. The dispute is not over the general institutions of a capitalist economy such as the mechanisms to enforce property rights, free market determination of prices and so on. But gradualists argue that capitalist institutions are shaped by the particular societies in which they evolve and, instead of imposing ideal types, institutions should be permitted to *emerge*. They argue that as organizations have routines, memory and productivity (cf. Nelson and Winter 1982), radical reforms act to undermine and stigmatize existing organizational structures, destroying the productive aspects of existing behaviour. In other words, radical reforms do not salvage routines in the society that could undergo innovation (Murrell 1995, p. 82). Specifying the capitalist institutions is not the job of the policy-maker; instead, the necessary task is to allow institutions to evolve as individuals interact within the market. Unlike the shock therapists' claim that reforms must be rapidly implemented in order for them not to be reversed, gradualists claim that on the contrary, reforms are more likely to be reversed as the public experiences the large initial costs of reform and does not experience the benefits. Costs will be larger and benefits smaller if indigenous institutions are not allowed to emerge naturally.

Murrell (1995) uses the case of Mongolia to illustrate the problem with rapid reforms. The rhetoric of the leadership was the type of market reforms and their rapid implementation, but the public experienced the large up-front costs which it attributed to these reforms. For example, people may attribute inflation and decreases in the standard of living to the private sector. But the population might not be able to distinguish between the rhetoric of the reforms and the actual implementation. This means that due to asymmetric information, people may put pressure on governments to reverse reforms which have not yet been fully implemented.

But Murrell presents a good example of why gradualists are really no different from shock therapists. While the latter is criticized for its grand designs, the former finds itself in the same trap by preaching similar policies, only recommending that they be implemented more slowly. Language about indigenous institutions is merely rhetoric in the face of the assumption that capitalist relations of production are ultimately the most desirable. The two groups are debating over the pace of reforms and sometimes the sequencing of reforms, but only marginally, if at all, the content of reforms. The essential features of liberalization, stabilization, and privatization are the same. The goal of free markets remains the same and any alternative visions are not considered possible or desirable.

If the style of reforms are indeed set in stone, then the question is which side of the debate has the politically more practical view of the possibilities to implement reforms. While gradualism sounds politically sensible, shock therapists may be right in the sense that bearing the brunt of the costs of reforms might be easier for the population during the energetic optimism at the beginning stages of transition. Governments can delay or change reforms marginally, but even the unpopularity of the first post-communist governments in the region has not led to a reversal of reforms. This would indicate that regardless of how implementation proceeds, the growth of capitalism has some internal dynamic which a government or state cannot necessarily alter even if it desires to do so.

The policies implemented in Central and Eastern Europe have their defenders and their detractors. The devisors of policy bundles such as the IMF claim success. As Rodlauer (1994, p. 95), who works for the IMF, stated: "The basic three-pronged strategy of rapid liberalization, stabilization and institution building proved to be correct..." This is claimed in spite of the huge drops in output and decreases in standard of living experienced across the region. A few scholars such as Nove (1994) and Gowan (1995) have argued that economic decline was at least in part due to recommended policies. Even Rodlauer (1994, p. 95) from the IMF stated that: "...actual progress has been more difficult than expected..." As Kabaj and Kowalik (1995, p. 8) responded to Sachs, "...impoverishment has increased so much that it could not be compensated by the benefits of a balanced market, the reduction of waste, and second economy employment..."

Others, including Amsden, Kochanowicz and Taylor (1994, p. 4) argue that "...Eastern Europe's below-potential performance (and thus political instability) has stemmed from copying the wrong capitalist model..." While suggesting that post-socialist countries learn from their past, the authors also suggest they look to the successful late-industrializers such as South Korea and other East Asian countries. Groups such as AGENDA have also published their criticisms of transformation policies (Kregel, Matzner and Grabher 1992). They, too, look to East Asia for lessons on "governing the market".

Many scholars argue that whereas Poland has undergone shock therapy, Hungary has undergone gradual transformation (e.g. Abel and Bonin 1992; Koves 1992) because reforms to central planning had begun as early as 1968, and the pace of liberalization picked up in the 1980s, when private ownership of enterprises and Western foreign investment became permissable.[9] Hungary has even been credited with having an easy transition, as expressed by Aslund:

> Even if there is an ideal gradual path, it may be so difficult to identify that it would be better to go for a more robust approach that will lead in the right direction. Only the relative success of Hungarian gradualism seems an exception to this rule, and Hungary is in many ways a very special case: much has been accomplished by many years of reform, and the transition is relatively easy in such a small and reasonably well-organized country that has managed to excape external shocks.
>
> (Aslund 1992, p. 91)

However, Hungary did undergo a type of shock therapy, or as Bokos (1994, p. 1193) describes it, "hidden shock therapy". This can be argued by examining the rather comprehensive reforms that were undertaken from 1990 onwards and their results. For example, 90% of imports were liberalized by 1992; privatization of land broke down the agricultural production system which was previously considered efficient; almost all agricultural subsidies were

[9] See Berend (1990) for a comprehensive review of the reform process from 1953-1988.

decreased considerably or eliminated; a severe bankruptcy law legislated in 1992 instructed managers to declare bankruptcy within eight days if the firm has payment arrears in excess of 90 days; and the list goes on. The combination of policies, the collapse of the Council for Mutual Economic Assistance (CMEA) and worsening convertible trade deficit had serious effects on the economy: GDP, real wages, and private consumption fell dramatically while unemployment and poverty soared.[10]

Reaction to reforms by the public have prompted scholars from the West such as Sachs (1995, p. 2) write about the "politics of entitlement" and "pensioner's power" as if political competition is characterized by a group of senior citizens pulling the strings of government policy and free riding off the system. The great irony is that many of the consultants favored a strong state immune from popular pressure in order to enact their recommendations, as might be suggested by many of the writings and actions by consultants, but at the same time, they condemn state intervention.

It is perhaps the desire to create a blueprint, as if a Central and Eastern European country could be a lab experiment, that interferes with understanding what is happening in these countries. Instead a theory of transition needs to be historical and take into account the competition between social and class groups in society.

[10] The effects of transition will be discussed further in Chapter 6.

Since the debates over transition in Central and Eastern Europe are confined primarily to the realm of policy prescription, there is not a well-developed economic theory that explains how processes of transition work. Instead, theorists have been concerned with how economies *should* look. What Hoen (1995, p. 74) argues about neoclassical economists is true for most of the economists studying the region as they have "restricted themselves to defining the desired economic order".

Stark, who comes from the field of sociology and has been a student on Central and Eastern Europe for over ten years, has critically raised the issue of theory within the general literature. He describes the theorizing of transition as "futurist transitology" (1992, p. 22) and attacks the policy-driven literature as wanting to impose capitalism with a blueprint. He rejects even the term "transition" because it implies an endpoint, as if we could forsee the end result of the myriad changes taking place.

Economists treat as a generic concept the "market economy" that they are trying to create; the differences between market economies are not appreciated. Stark (1992) and Rona-Tas (1997), on the other hand, view path dependency as the unalterable feature of change. Stark argues (1994) that Eastern Europe is developing a distinct type of capitalism that differs as much from Western European capitalism as does East Asian capitalism. As a rejection of mainstream theorizing, applying the concept of path dependency in order to account for history is a notable step forward. Path dependency implies that processes of change have "an *essentially historical* character" (David 1986, p. 30; emphasis in original). A temporally remote event including historic accidents can induce change. For the study of the development of capitalism in a Central European country, one must understand how previous historic periods have impacted events to shape the current outcome.

There is one final problem with theories of transition as applied to Central and Eastern Europe. The relative position of a country in the global economy is not taken into consideration other than in discussions of whether a country has the comparative advantage in production. For example, recommended policies have often been based on the notion that the region should compete in terms of cheap labor (Amsden, Kochanowicz and Taylor 1994). Other than to reinforce a peripheral position in the global economy, analysis has not provided a long-term historical view in the context of an emerging global economy.

D. Conclusions

Most of the literature on transition in Central and Eastern Europe presumes an end-point, an ideal type of capitalism that should exist if recommended reformist measures are followed by governments. This obscures the understanding of two features of capitalism. Firstly, that from the field of comparative capitalism and economic history, we know that capitalist systems can vary enormously over time and space. Just the simple contrast of US capitalism and Japanese capitalism illustrates this point. A comparison of pre-war versions of Western capitalism and the remarkable post-war boom in Western countries also demonstrates how a capitalist system can be reformulated over time.

Secondly, advisors themselves, whether they are independent or from an international institution such as the IMF or World Bank, impact the process of transition. This may appear to be an obvious point but the implications are subtle. The ideological underpinning of advisors tends to be neoliberal. The extent to which their policies are implemented will create or mediate conflict which will affect the processes regulating capitalism.

It is to the historical trajectory of Hungary that we now turn. It is within this context that a theory of the current transformation must be based.

CHAPTER III

HUNGARY IN RETROSPECT: CRISIS, CRISIS AND MORE CRISIS

A. Introduction

This chapter presents an overview of Hungarian history until 1989. It does so broadly within regulation theory focusing especially on socio-political struggles and the international position of the country.

The reasons for examining the historical backdrop are plain: it is impossible to understand transition from state socialism to capitalism and evaluate prospects for development without fully comprehending the path up to the point of transition. The development of capitalism in Hungary is not happening on a blank slate; the transition is conditioned by Hungary's history of socio-political struggles, and its historic position in the global economy. As has already been discussed, the literature on transition for the most part treats Central and Eastern Europe as if its economic history had only diverged in the 1940s with the communist takeover. The pretense that the region is somehow rejoining its natural path in the heart of Europe is mistaken. As we will see, Hungary has been peripheral - or perhaps, semi-peripheral - for hundreds of years.

While almost all of the material used in this chapter is from secondary sources, the distinction here from other work on Hungary's economic history is in presentation. I attempt to present the historical development of Hungary within the framework of regulation theory. Although regulation theory has developed as an analysis of capitalism as discussed in the last chapter, it is also useful for an analysis of economic history in Hungary even though capitalism has only become the dominant mode of production in the 1990s. Regulation theory is useful in the analysis of Hungary because it is a *dynamic* theory of crisis and transformation applicable to any modern system. The theory is underpinned by a materialist interpretation of history which offers a general argument about social evolution. Also, it is an *historical* theory. Unlike mainstream economic theories, history matters in regulation theory because it is what conditions the present and the future. Regulation theory is useful in an analysis of Hungary because it emphasizes *institutions*. This is important because it allows for comparisons between cases and does not assume that experiences with capitalism or other modes of production are the same in different countries. Hungary is a country that has experienced a great number of crises and transformations. Regulation theory is more insightful than other theories because it assumes that crises can and will happen rather than assuming, like mainstream theories, that crises do not happen or are the exception in economic growth. Whereas neoclassical theory assumes the crises can only arise from forces external to the process of economic growth, regulation theory posits that economic growth has an inherent tendency to eventually give rise to crisis.

B. Feudalism in Hungary

The economic, social and political history of the modern Hungarian nation-state places it between the East and the West. The nomadic Magyar tribes originated in Asia began settling the Carpathian basin during the ninth century, eventually adopting a similar social and economic system to that of other European peoples. A Hungarian state gradually formed out of the several tribes which settled the region. Although the extensive raids into Western Europe by Magyar tribes indicated that were not yet settled in the Carpathian basin, their heavy defeat near Augsburg (Germany) in 955 changed the outlook of the Magyar leaders. The chief-prince Taksony made efforts to obtain a missionary from Rome as a foreign policy measure, and more importantly, implemented a settlement policy to alter the nomadic life-style. These efforts increased trade and began the development of a single Magyar ethnic unit. Taksony's son Geza made further efforts at eroding tribalism and encouraging settlements (Makkai 1990, pp. 15-16). But Geza's son Istvan, who became the first King of Hungary in 1000, completed the unification of Hungary and the adoption of European feudalism. The Magyars were no longer pagans and nomads. Christianization had been used by three generations of chief-princes as both a foreign policy to achieve Western integration, and a domestic policy. More generally domestic policy sought to erode of tribalism, settle people into permanent settlements and create a population ethnically unified. The social and economic system of Hungary was fundamentally changed. These policies represented the first of many top-down efforts that were to follow which were thrust upon people by the rulers in order to change the social and economic structure. It was also the first of many top-down efforts which attempted to consolidate the Hungarian nation-state and prevent it from destruction by foreign competitors.

Between the 11th and 13th centuries, the Magyars took up agricultural production and the feudal system emerged out of a settled tribal economy and society. Feudalism in Hungary, as elsewhere in Europe, had two main classes, serfs and aristocrats, and underwent a similar path of development to that of Western Europe up until the 15th and 16th centuries. From that point on, Hungary, along with most of Eastern Europe, diverged from Western Europe's developmental trajectory. There are two main reasons for the divergence. The first reason is that unlike the changes taking place in Western Europe, the Eastern European nobility had the motive and was able to restrict the development of capitalism.

During the 15th and 16th centuries, feudalism began breaking down in Western Europe and capitalism slowly took root, as a growing commercial bourgeoisie developed and urbanization took place. In Hungary, however, the bourgeoisie was politically weak and towns remained medieval in character. Although peasants had won the right of freedom of movement at the end of the thirteenth century, the landed aristocracy was able to gain the upper hand and legislatively revoke this right (Berend and Ranki 1974, p. 14). Manorial bonds loosened in the 15th century but were tightened again in the 16th century. The spread of money rents and peasant agriculture had been halted and the manorial estates exacting feudal dues were reinstated. This of course meant that the method of cultivation was in stark contrast to agriculture practiced in the West, which had become dominated by peasants employing wage-labor. In other words, agriculture remained feudal in Eastern Europe, while it was transformed in the West.

The ability of the landed aristocracy to defeat the weak bourgeoisie and revoke free movement of labor was aided by international conditions. Firstly, trade routes and the composition of traded goods had changed. The commercial center of trade in the medieval period was located in the Mediterranean and involved primarily luxury goods such as silk and spices for princes, lords and other members of the feudal elite. This trade in luxury goods, however, remained "outside the mainstream of economic activity" (Stavrianos 1981, p. 64). It was not on a scale large enough to affect economic and social processes. But by the late medieval period, trade patterns had shifted. The commercial center of trade moved from the Mediterranean to northwestern Europe. The economic development of the West caused a massive increase in demand for two main products, lumber and grain, which were imported from the East. Growing construction and shipbuilding industries required lumber while urbanization and conversion of lands to sheep production increased the demand for foodstuffs. Hungary's role in providing exports of raw materials and foodstuffs to growing Western markets was primarily to sell cattle and copper. These goods were traded for textiles from the West, not the luxury textiles previously traded, but new textiles which were cheaply produced in Flanders, England and the Netherlands. Unlike earlier medieval trade, the trade in the late medieval period was on a large scale and fundamentally affected the economic and social processes of Europe (Stavrianos 1981, pp. 62-65). However, until the second half of the 1500s, Eastern European imports were significantly larger than exports and so resulted in the massive flow of gold and silver out of the region in order to pay for imports. This was certainly the case in Hungary where the significant gold and silver deposits were to a large extent depleted to pay for imports.

The mid-1500s were potentially a turning point in Eastern European economic development. The terms of trade had shifted greatly in favor of Eastern Europe due to the increased demand for foodstuffs as urbanization and conversion to pastures continued in the West. However, the fact that Eastern European monarchs depended upon lords to staff their armies meant that the state refrained from intervening in lord-serf relations. This ensured the unregulated tightening of manorial bonds.

It also ensured the unfettered ability of the nobility to exercise power to the detriment of the peasant. Nobles used legal and extralegal processes to take away common and abandoned land and even the peasants' hereditary land (Stavrianos 1981, p. 66). Without any recourse, the peasants were powerless to resist such expropriation and thus the growth of peasant production was ultimately inhibited.

The nobility also used its power against the merchant class. For example, the Polish Diet passed a law in 1565 which prohibited Polish merchants from buying or selling goods abroad. The nobility enjoyed privileges of avoiding taxes by engaging in foreign trade. However, this privilege was not extended to the native merchant class, which meant that the price received by the nobility from native merchants would be lower to compensate for taxes. By using foreign merchants, taxation could be avoided and the highest price achieved. According to Stavrianos (1981, p. 67), this law was not enforced, but it reveals the lengths the nobility would go to in order to ensure its dominance to the detriment of any other. The actions of the nobility also fostered the growth of the Western merchant class. The Eastern merchant class was all the more discriminated against by having to compete with a wealthier, larger Western merchant class.

In sum, the monarchs of Eastern Europe needed the nobility to provide for the military. Because of this, the monarchs would rule in favor of the nobility to the detriment of other classes - the peasants, the serfs and the tiny merchant class. Peasants lost their land; serfs were bound more securely to the manor; and merchants were discriminated against in favor of foreign merchants. Taken together, the results of changes in trade were to reinforce feudalism and stifle the emergence of capitalism in Eastern Europe.

Another reason for the divergence of Hungary and parts of Eastern Europe from the economic path of Western Europe is the Ottoman occupation. The Ottoman Empire grew stronger and through warfare was able to occupy land through the Balkans up to the gates of Vienna. Hungary was occupied for 150 years during the 16th and 17th centuries. This halted progress, and also had the effect of integrating Hungary within the Ottoman Empire rather than with Western Europe.[11]

The time period beginning in the 15th century and lasting well into the 19th century is often called the "second serfdom" of Eastern Europe. The potential for the demise of the feudal mode of production was halted. In fact, even as late as the 19th century, feudalism in Eastern Europe was actually on the rise. In the case of Hungary, as was the trend for the rest of Eastern Europe, the number of statutory parcels enfiefed to serf tenants steadily rose from 1787 to 1848 (Janos 1982, p. 56). The decline in the price of wool in 1830 contributed to the rise in feudalism in Hungary. Falling prices caused landowners to replace raw wool production with grain production, which was more compatible with serf labor, thereby revitalizing feudal relations. At the same time, peasant production continued to be stifled by the landowners:

> The plight of the peasants was further aggravated by persistent and often successful attempts on the part of noble landowners to increase rent, services, and above all, the local taxes to finance a plethora of new budget items, including expenditures for the maintenance of roads, the per diems of public officials, and the costs of converting hitherto honorary posts into salaried administrative offices. Faced with these increasing burdens and little prospect for improving their material standard, many marginal peasant farmers dropped out of the rural

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[11] The emphasis that I am giving to a particular set of class relations is important for Hungary and parts of Eastern Europe, but not for all of the region. For example, the landowning class in the Balkans was destroyed in the 15th century by the Ottomans, so if I were to recount the economic history of the Balkan region and why capitalism did not emerge (as in Western Europe), the story would be different.

economy, and, in the absence of large urban centers of a viable industrial economy, simply took to the roads, moving from one locality to another.

(Janos 1982, p. 44)

Although feudalism was clearly not dissolving in Hungary during the 18th and 19th centuries, the occupying power of the country changed. In the 18th century, Hungary was freed from Ottoman occupation only to be integrated into the Austrian Empire. Although Austria was industrializing rapidly and might have had a modernizing influence upon feudal Hungary, Austria, as ruler, was able to create policies favorable to its own development. Hungary remained an agricultural servicer delivering foodstuffs to the industrializing regions of the Hapsburg Empire. The effects of integration with the Hapsburg Empire were contradictory. On the one hand, integration had its modernizing influences as Hungarian agricultural markets expanded, but on the other hand, this created a dependency relationship and stifled industrialization in the Hungarian lands of the Empire.

Up until the revolution of 1848, 80-88% of the population in feudal Hungary earned their living on the land (Berend and Ranki 1974b, p. 40). Feudal institutions inhibited economic development and there was a great disparity between Hungary and the ruling, richer, more industrialized country of Austria, as well as Western Europe. It was this economic backwardness that instigated the failed revolution of 1848.[12]

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[12] Janos (1982) gives an excellent detailed account of the politics of the 1848 revolution.

The gentry played the leading role in the revolution, but they were joined by some notable exceptions from the aristocracy. These reformers were influenced by their travels in Western Europe where they noted the substantial differences in wealth and progress. They were influenced by French and British liberal writers, and also learned and were inspired by nationalist ideology coming from French intellectuals. Whereas German was the language used by the elite, the reformers believed that it was necessary to encourage the use of the Magyar language. Although most of them did not even speak the language, they learned it and debated in the Hungarian Diet whether it should be established as the official language, replacing German as the means of communication for business and public administration.

The influence of nationalist ideology extended beyond officially adopting Hungarian as a national language. The idea that there was a unique Hungarian culture was promoted; a national consciousness was created. This happened to such an extent that even prominent figures who were not ethnically Hungarian such as Franz Liszt proclaimed themselves to be Hungarian. The spread of nationalism across classes helped unite and mobilize Hungarians against the Austrians.

Although influenced by certain ideologies of the West, the Hungarian gentry were different from their Western counterparts. As Janos (1982, pp. 64-69) points out, this class was *not* a group of up and coming agrarian entrepreneurs wanting to abolish feudal institutions because they interfered with the development of the market. Instead, this class was practically in financial ruin and "was searching for alternatives to economic entrepreneurship" (p. 65), and advocated a strong state that would protect it from the vagaries of the market. The reformers were in favor of protectionism and national autarchy, not laissez-faire economics.

The 1848 revolution had important implications for Hungarian development. It was unsuccessful in the sense that the Austrians, assisted by the Russians, put down the revolution and firmly re-established their rule over the country.[13] The crushing defeat led to a period of repression commonly referred to as the age of neoabsolutism. Many of the revolutionaries were executed or fled the country and lived in exile. The reins by which Austria ruled Hungary were tightened.

The revolution did, however, have its successes. Many of the liberal social and economic reforms that were passed by the Hungarian Diet in 1848 were maintained after the military defeat. The most important of these reforms was the emancipation of the serfs. They became free citizens of the state although the regulations making this possible were only worked out in 1853. This established a necessary condition for the creation of a wage-labor class. The market for land was also made possible as land became private property and could be bought and sold.

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[13] The assistance given to the Austrian forces by the Russian armies is significant for Hungarian nationalist history: The resentment of Russians began and would last until the present day.

The emancipation of the serfs implied some redistribution of land and might have led to a shift in agricultural techniques. However, peasant production remained stifled and the large landowners did not have the capital to invest in modernization.

Peasant production was stifled because few peasants received enough land to farm. Almost half of the peasant families formerly tied to landlords did receive land. But, in addition to the majority of families that did not receive land, there were also numerous families living in rural Hungary who were cotters and servants and remained landless. In all, three-fifths of the rural population remained landless and one-fifth obtained a parcel too small for self-sufficiency (Berend and Ranki 1974b, p. 77). In other words, 80% of peasants formed a rural proletariat, moving from estate to estate looking for work, or were tied to a village by a few acres of land trying to eke out an existence. The size of the agrarian proletariat even by 1900 exceeded the industrial proletariat. Their absorption into industry was slowed for many decades for two main reasons. For one, industry was not quickly developing so there was little pull to the towns. For another, landlords were able to use their political power to a limited extent to prevent industry absorbing much of the agrarian proletariat. The latter had the obvious benefit of keeping agrarian wages depressed (Seton-Watson 1956, p. 14).

Landlords also had difficulties adapting to a new era. Although many of the large landowners retained substantial estates, they lacked the capital for modernization. The conspicuous consumption of the gentry and aristocrats that began early in the 1800s (or even earlier) prevented the accumulation needed for modernization. As Janos (1982, chapter 2) points out, many of the gentry managed to impoverish themselves through reckless status consumption.

The lack of capital might have been alleviated by the compensation that landowners were supposed to receive from the state for the loss of serfs, but delays in issuing indemnification debentures meant that many did not receive the compensation for decades (Somogyi 1990, p. 239). These families then turned to either sharecropping which in taking advantage of the large rural proletariat effectively retained feudal obligations, or they rented out the land. With the loss of serfs and the corvée to provide draught animals, and without capital for modernization, landlords were unable to effectively change. Although for many decades agriculture was stuck in the transition period between feudalism and capitalism, some landlords - many of whom had switched to wage-labor production before 1848 - were able to receive indemnification debentures quickly and had access to capital. These landlords were better prepared to participate in a capitalist economy.

Aside from the above considerations, other conditions for modern agriculture were absent. Markets for goods and credit, and infrastructural necessities such as railways providing access to markets did not exist or were limited in their development.

The European cereal boom of the 1850s and the elimination of customs barriers between Austria and Hungary expanded the market for Hungarian agricultural products and had the effect of creating a mini-boom in Hungarian agriculture. This period generated increasing sales of cereal but did not lead to modernization in the agriculture sector and merely preserved the dominance of not only an agriculture-based economy but a cereal one at that. Furthermore, while the elimination of the customs barrier had in the short-run positive effects, it reinforced Hungary's dependency relationship to Austria and the rest of Western Europe.

This unified customs area bolstered the pre-1848 division of labor. For example, Hungarian wool was taken to Bohemia and Moravia for textile manufacturing, preventing the development of a Hungarian textile industry. Use of machines was also limited; very few machines even existed in the country (Somogyi 1990). Food processing was to an extent stimulated but even this was a limited development. For example, the sugar industry could not fully develop due to a lack of capital and the imperial tax structure. Hungary became an outpost producing cereals to feed the industrializers.

To some extent, this would change in the last third of the century. The age of neoabsolutism came to an end in 1867 when tensions between Hungarians and their Austrian rulers intensified but resulted in political consolidation. Each class in Hungary became hostile to Austrian rule. The conservative aristocracy who opposed - or at least did not support - the revolution resented the centralization of neoabsolutism as they were pushed into the background and had very little power. Liberal minded gentry and aristocrats had either been executed, escaped into exile, or were pursuing a strategy of passive resistance in which they would refuse to pay taxes, pretend not to understand German and would refuse to give information under any circumstances. Without fundamental change in the economy, there was nothing to change their individual economic fortunes, or lack thereof. The peasants meanwhile anxiously awaited the return of Lajos Kossuth, the leader of the revolution, who represented better land distribution. Austria also received unfavorable foreign press for its persecution of the Hungarians following the revolution.

Tensions were ameliorated when the elite of both countries formed the Compromise of 1867, which created the Dual Monarchy, giving Hungary independence in its internal affairs. The economic importance of the Compromise was that the modern nation-state emerged in Hungary, creating conditions for economic change.

The emergence of the modern nation-state led to the transformation of legal services and procedures, the judiciary, the legislative process, and administration into structures that would support capitalist development (as opposed to supporting feudalism or some other mode of production). The modern nation-state may not be a precondition for capitalism, but certainly it facilitates its development. For example, the modern nation-state provides for legislation guaranteeing and enforcing (capitalist) private property. Although the reforms made in 1867 were less radical than the social, political and economic reforms attempted in 1848 (Frank 1990, p. 256), they nevertheless advanced the emergence of capitalism.

Along with the spread of capitalism, industrialization proceeded. Until 1867, agriculture made up two-thirds of economic activity; only a very small portion of the population was engaged in industry. After the Compromise, foreign capital was easily attracted to Hungary because of economic conditions, including the period of growth - the mini-boom - which immediately preceded the Compromise. But the moderate expansion and political consolidation were not the only factors in attracting foreign capital. The state supported the expansion of private railways by guaranteeing a minimum return of 5% on investment for 90 years (Berend and Ranki 1974b, p. 36). The certainty of railroad investment stimulated private railway companies to expand the network to the point where railroad density in Hungary approached Western European standards. The railroad firms were foreign, primarily Austrian.

Improvements in transport and greater access to Austrian markets due to the elimination of customs barriers encouraged further expansion in agriculture. Coupled with the political consolidation ensured by the Compromise, these conditions allowed for a significant inflow of foreign capital, especially Austrian capital (Berend and Ranki 1974b, p. 29). As credit became more available, agriculture became more mechanized, and by the end of the 1860s, the agricultural sector was undergoing rapid commercialization (Berend and Ranki 1974b, p. 41).

Industries that developed were very much linked to the developments in agriculture and the expansion of the railroads. The most significant development in industry was in the food-processing sector, especially flour milling but also the sugar industry. Some heavy industry developed, mainly in coal and iron ore mining. Iron and steel works, along with the machine industry, were driven by the demands of railroad building. Machine production was also closely linked with agriculture and food processing (Berend and Ranki 1974b, pp. 52-54).

At one level, the Hungarian industrial revolution might have indicated that Hungary was catching up to Austrian levels of development. Hungary's post-Compromise rate of growth was higher than that of Austria. The ratio of industrial production between Austria and Hungary changed substantially: Hungary's industrial production rose from 19% to 32% of that of Austria (Ranki 1981, p. 172). In the mid-19th century, Hungary's per capita national income was approximately 58% of Austria's; just before the First World War it reached 75%

However, the last few decades of the 19th century demarcating the industrial revolution were not as smooth and promising as the above figures might indicate. The panic on the Vienna stock exchange of 1873 "condemned most Hungarian capitalist enterprises to death" (Frank 1990, p. 259). The economic crisis that ensued was Europe's most serious depression before the

First World War. The rise in production costs, the drop in agriculture prices, and the protectionist measures taken by European countries caused an agrarian crisis in Hungary. Its fledgling industries likewise suffered.

It was in this context of growth, modernization and crisis that the labor movement developed. As industry grew, workers were drawn from the agrarian proletariat into the industrial working class where wages were higher and living standards were improving. However, the pool of unemployed laborers in the countryside served to depress increases in wage levels in industry so that the average wage of industrial workers was 40-50% lower than the average wage in Western Europe during the period of the Hungarian industrial revolution. At the beginning of the century (1905-1909), real wages in Hungary are estimated to be only 30% of what they were in England (Berend and Ranki 1974b, p. 84).

The labor movement that developed was socialist perhaps in large part due to the high unemployment levels, poor wages and dangerous working conditions. It followed the traditions of Ferdinand Lassalle, founder of the German socialist movement, and was also inspired by the Paris commune. Leo Frankel, one of the commune's leaders, came to Hungary to assist with union organization (Frank 1990).

The attempt to create a modern bourgeois-liberal state was also pursued after the Compromise. The government that came to power in Hungary following 1867, led by (Count) Gyula Andrassy, had created numerous pieces of legislation that were bourgeois-liberal, and that reflected the intentions of the

1848 revolutionary government. Although Andrassy's government had made much less radical reforms than its 1848 predecessor, the feudal remnants of the socio-political system were finally eliminated. By the turn of the century, the modern nation-state existed in Hungary.

C. Turn-of-the-century capitalism

The end of the nineteenth century and beginning of the twentieth century can be characterized as early capitalism in Hungary. While the United States and Western Europe countries were much more developed by this time by having an extensive regime of accumulation and Taylorism (cf. Aglietta 1979), Hungary was just starting. However, the foundations existed: the modern nation-state had emerged; a wage-labor class had formed; and markets for land and credit were developing. As accumulation took hold in late 19th century, industry was beginning to grow and agricultural production was gradually modernizing. Hungary had been transformed by the end of the nineteenth century: the remnants of feudalism were finally disposed of and a growing capitalist economy was in place.

Early capitalism in Hungary was driven by agricultural exports. The export of agricultural goods to the industrializing parts of the empire - Austria and the Czech lands - provided most of the profits used for capital accumulation. As Austria and the Czech lands industrialized, and transport to these markets improved, agricultural production in Hungary increased significantly. As exports increased, more land was brought into cultivation. Although there was some emigration from rural areas, the overall population increased by over a third between 1870 and 1910 so that employment in agriculture was still over 60% of total employment by 1910.[14]

The profits of agricultural production landed in the hands of merchants who then used them for investments initially in flour milling and then in other food processing industries.

Economic growth and industrialization, however, reinforced the existing dependency relationship with Western Europe. Growth was driven by foreign demand: as Austria and the Czech lands industrialized, Hungary's industry was mainly confined to the subordinate role of supplying foodstuffs and raw materials for export to the more sophisticated industrializers. Manufacturing was mainly limited to primary processing. More advanced goods were imported. For example, only 20-25% of Hungary's machine tools and industrial equipment was produced in the country (Berend and Ranki 1974b, pp. 58-59). Also, products such as Hungarian wool did not lead to the development of textiles, but were instead used in the textile industries in the Czech lands.

Another aspect of the dependency relationship was that Hungary was dependent upon foreign capital, particularly Austrian. Foreign capital was

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[14] Agricultural production had increased between 1870 and 1910 by 285% for wheat, 250% for barley and 360% for maize. See Berend and Ranki (1985, chapter 1) for pre-war production and employment statistics.

important for the development of modern banking and for many of the industries that started. This was particularly true in mining, which was a significant development of Hungarian industry. Physical foreign capital was also important. Although a machine industry existed in Hungary, the import of machinery remained crucial to the Hungarian economy. The development of industry was dependent upon foreign technologies to a large extent. However, perhaps this dependent relationship was inevitable given Hungary's late development.[15]

State intervention was also critical for early capitalist development. Due to the customs union and the inability to enact protective tariffs, the state gave subsidies and interest free loans to industry and sometimes founded industries. After 1907, it targeted particular industries such as textiles. The amount of subsidies for investment was, however, relatively trivial - about 2% of total private investment, according to Berend and Ranki's estimates (1974b, p. 55). Much of the growth can be associated in one way or another with the railways, which were a state-guaranteed investment. Moreover, the railroads were later nationalized and so the state had a much more direct role in their development. The state was also a major purchaser of industrial goods. Perhaps the state's most important function, however, was the role of attracting foreign finance "by making investments secure and profitable" (Berend and Ranki 1974b, p. 70).

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[15] Other late developers such as Japan and the US were also dependent on foreign capital for a period of time.

Early capitalism in Hungary fueled class tensions and led to the birth of social movements which played influential roles throughout the 20th century. Peasant movements developed out of the large numbers of landless peasants and the persistence of large estates still possessed by the nobility. Land distribution in Hungary was the most uneven in all of Europe (Berend and Ranki 1985, p. 17) so it is unsurprising that peasants, unable to enjoy the benefits of limited growth, would eventually organize and become a social and political force. Poor wages and working conditions in industry radicalized much of the labor movement. Democratic-socialist thought was prevalent in industrial centers. But according to Jeszenszky (1990), the most vocal groups were the dissatisfied and increasingly poor East Hungarian nobility and small entrepreneurs who could not compete. These groups laid the basis for a sort of anti-capitalist thought that bore hostilities in particular against Germans and Jews who were more successful in entrepreneurial activities.

By the eve of World War I, Hungary had fundamentally changed. The "long 19th century", as Hobsbawm (1987) and other historians have called it, had taken Hungary from feudal past into an era of early capitalism. The peripheral regions of Europe had changed considerably, as well. The Scandinavian countries had caught up with the core countries in levels of economic development and although integrated with the emerging global capitalist economy, they did not have a dependency relationship with the earlier developers.

Countries such as Italy and Hungary appeared to be on a similar trajectory. Being backwards did not have to imply that a country would remain on the periphery. However, after World War I, it became evident that Hungary would not catch up. The problem was not that Hungary was so far behind Austria and the core countries in terms of development; after all, it had a faster growth rate and potentially could catch up like the Scandinavian countries had. However, Hungary was not an independent sovereignty. It remained an agriculture and raw materials producing region within a larger economy. The form of integration within the Hapsburg Empire and the disintegration of the Empire were to prove critical for Hungary. With over 20 million people, rich agriculture land and raw materials, Hungary had the potential to become a rich country. However, peace after World War I stripped Hungary of most of its resources.

D. Interwar Hungary: crisis in capitalist development

The Treaty of Trianon following World War I is known as the third of the three great tragedies of Hungarian history. The signing of the Treaty in June of 1920 by Hungarian representatives followed a period of revolution and counterrevolution, and permanently altered the Hungarian state. The period immediately following the war and the implications of the Treaty are discussed below because they have significant and lasting affects on the interwar period, World War II and the rise to power of the Communist Party.

The loss of the First World War by the Austro-Hungarian Empire not only destroyed the Dual Monarchy but in the midst of political uncertainty, set the conditions for a potentially radical revolution. After the war, the king, still acting as head of state, appointed Count Hadik to lead the government in Hungary. Count Mihaly Karolyi, leader of the democratic Party of Independence, had already formed the Hungarian National Council only days before Hadik's appointment in the hopes of a democratic coup. Hadik had hoped anti-Karolyi feelings in the parliament along with the military presence would prevent a coup or revolution. Nevertheless, with worker and soldier support, the Council was successful in gaining power in the so-called Aster Revolution.

Although the revolution was relatively peaceful and initially popular, Karolyi quickly lost support. By January 1919, Hungary had already lost half of its territory through Romanian and other foreign aggression. Wartime pacts against Hungary had become publicly known and it was inevitable that Hungary would lose much of its territory as a consequence of peace. The passive stance of the Karolyi government in this turbulent time further undermined its authority as initial optimism for the revolution waned. Although more radical reforms (than initially desired) by the Karolyi government were intended to assuage the peasants and the radicalized workers, the reforms had the opposite affect. The Social Democrats, participants in the Karolyi government, had aggravated the situation by preaching patience with the economic situation. Bela Kun, who had formed the Hungarian Communist Party in late 1918, had attracted a large number of followers as workers became disenchanted with the Social Democrats. Even left-wing Social Democrats who would not leave the Party fell under Kun's influence (Hajdu and Nagy 1990). Karolyi never had the wide support of any particular class in Hungary. After all, much of the nobility, including most of his family, considered him a class traitor, and for the peasants and workers, he was a member of the class that had oppressed them for so long. His lack of loyal popular support by workers and peasants was to prove fatal.

The Soldiers' and Workers' Council on 21 March 1919 had declared the dictatorship of the proletariat. The Social Democrats and the Communist Party joined forces and formed a new government led by Kun with Sandor Garbai as Prime Minister. Matyas Rakosi, who later became Hungary's leader after World War II, was appointed deputy to the trade minister.

Although the Hungarian Soviet managed to unify the radical workers, the Social Democrats, and many radical intellectuals, this was not enough to prevent its downfall. The new Hungarian Soviet had the insurmountable problem of being invaded by the Romanians. Later the Czechoslovakians invaded. The Hungarian Red Army was far weaker than the Romanian forces and defeat was imminent. The Hungarian Soviet abdicated on August 1, 1919 to a unionist government.

The unionist government did not last as a Romanian-supported coup d'etat took power five days later. The coup d'etat put in place a counterrevolutionary government which was formed at the request of Archduke Joseph of the Hapsburgs and led by Istvan Friedrich.

The counterrevolutionary government was responsible for the White Terror. Thousands were executed, interned or fled the country. The Friedrich government had no popular support, lacked recognition by the Entente and was limited in actions by the Romanian Army. Hungarian instability became an international problem as the peace settlement awaited agreement. British diplomat Sir George Russell Clerk came to Hungary and helped set up a coalition government to stabilize the situation. Elections took place in the beginning of 1920 for the unicameral National Assembly. With the support of Britain and other foreign powers, the National Assembly elected Admiral Horthy as regent. Horthy had the loyalty of the army, so loyal that they had killed two Social Democratic journalists for criticizing the White Terror (Hajdu and Nagy 1990, p. 313). Horthy also enjoyed international support, especially after he prevented Charles IV from reclaiming the throne.

The counterrevolution significantly altered the political map. Left-wing revolutionary forces were defeated for the time being. With that defeat, politics was divided into three main camps. There were the large landowners, capitalists and the majority of the middle classes who supported the old form of government and state. Another faction was made up of the army, smaller landowners and the Christian lower middle classes who supported a strong state and a dictatorship at the exclusion of both the traditional powers (large landowners and capitalists) and the liberals and leftists. The third faction was composed of the liberal bourgeoisie, Smallholders and Social Democrats who wanted a liberal democratic system.

The immediate period following World War I had several implications. The radical workers' movement had at least temporarily been decimated as many of their leaders had been killed or fled the country during the White Terror. Many who left the country, such as Matyas Rakosi, found asylum in the Soviet Union and, like Kun, were tutored by the Soviets, including Stalin, who came to power in the USSR a few years later. Within Hungary, the political scene was dominated by center to radical right factions until World War II.

In June 1920, the Hungarian representatives finally signed the Treaty of Trianon. Hungary lost 70% of its territory and 60% of its population, a significant portion of which were ethnic Hungarians. The loss of territory and population reduced Hungary from a medium-sized country to a small country lessening any chances of playing an important role in Europe. The breakup of the Austro-Hungarian Empire and the reduction in size of the country also meant that foreign powers potentially could play an even greater role in determining the future of the country. The immediate result of this was to ensure that a military person could come to power as regent. The country also lost most of its raw materials in the territories that were awarded to Czechoslovakia, Romania and other countries. Perhaps even more importantly, significant transportation and communication links were disrupted. What was left is now referred to as "rump" Hungary.

A stable mode of regulation was not in place during the interwar period. Hungary, weakened by political instability, experienced continued economic stagnation until 1925, and then after a brief period of recovery, suffered the Great Depression from 1929-34. In Hungary, the Great Depression peaked in 1931 when the failing of a major Viennese bank caused the failure of the Hungarian banking system and the depletion of all its foreign currency and bullion reserves (Ormos 1990, p. 330).

Hungary was still predominantly an agricultural economy, and this sector in particular was stagnant. Recovery after the war was slow and agricultural production decreased so dramatically that production fell below, and remained below, pre-World War I levels into the late 1930s. Agricultural development was hindered by two conditions: the state of land reform and the state of international trade.

Land reform carried out in 1920 gave less than one hectare of land each to 250,000 landless peasants, leaving 43% of the land in the large medieval estate system. The uneven distribution of land had two consequences. For one, the large estates were not eliminated, and since they were owned by a class of people who, for the most part, lacked interest in agricultural entrepreneurship, they continued to use backward agricultural techniques (Berend and Ranki 1974a, p. 192). Secondly, small-scale agriculture was also unable to develop to the same extent it had in other parts of the world. Many of the peasants who managed to acquire land did not have large enough plots even for self-sufficiency and certainly could not participate in the accumulation process.

The protectionist policies enacted by Western European countries during the 1920s served to further frustrate Hungary's agricultural sector. Moreover, the limited supply of foreign currency available for the purchase of industrial raw materials and capital goods slowed the development of industry. Prior to the enactment of the protectionist policies, exports suffered from the drops in agricultural production following the war, but after the isolationist strategies of other countries were put in place, exports could not expand due to market conditions.

However, unlike agriculture, industrial production had grown in the inter-war period. By 1938, it had increased by one-third (Ranki 1990, p. 359), but over a 20 year period, that is still a very low yearly growth rate. This growth, however, did imply structural changes in the economy. Agriculture, although still dominant, was reduced in significance relative to industry.

Light industry developed, but heavy industry stagnated. For example, the share of the machine-building industries shrank as a proportion of total output. This tendency was unlike that of Western countries where much heavy industry was developing. In Hungary, light industries such as textiles, leather products, and paper developed (Ranki 1990, pp. 360-62). Although these tendencies were already established in the 1920s, these structural changes became even more pronounced during the Great Depression.

Food processing, which was the engine of the industrial revolution in Hungary, had suffered. After an initial recovery, sugar refining fell to 50% of pre-war levels and distilling fell to about one-fourth. Milling capacity was over nine million tons before the war but annual harvests averaged only 2.5 million tons in the 1930s. Furthermore, no major investments had taken place in railways and communications (Ranki 1990, pp. 360-62).

The rate of annual per capita growth in gross national product in Hungary from 1913 to 1938 was 0.78, which was below that of Europe as a whole (including Russia/USSR), which had a rate of 0.92. The rate of growth in Hungary was also below that of pre-war levels in the Austro-Hungarian Empire (Bairoch 1976). Hungary did not resume a trajectory of potentially "catching up" with the core countries as Scandinavia did during the pre-World War I period (Berend and Ranki 1982). Instead, Hungary fell further behind in growth and development. The gap between core and periphery in Europe, for the most part, widened.

Conditions of the working class did not improve over this time period. During the peak of economic growth between 1927-29, the average real wage for a worker was 20% lower than the average pre-war wage and fell a further 15% between 1934-37 (Berend and Ranki 1974b, p. 159). Social legislation to alleviate working class conditions was also very limited although some movement was made in this area.[16]

Consumption was below pre-war levels between the years 1919-24, and fell below that mark again between 1929-34. Consumption of foodstuffs was significantly lower than in the pre-World War I era. Consumption of foods such as meats and dairy products were 10-20% lower in the peak years of interwar prosperity compared with 1913 (Berend and Ranki 1974b, p. 161). Drops in consumption tend to be experienced more by the working classes and the poor than the middle and upper classes. This era in Hungary was no exception.

Decreases in the average real wage and consumption along with little social legislation to alleviate conditions sharpened class differences and conflict. A wave of strikes by unions and the unemployed arose which were mercilessly put down. Unemployment had risen to one-third of the labor force with the onset of the Depression (Berend and Ranki 1974b, p. 165). The union movement, which had been gaining strength with industrialization, weakened due to the rise in unemployment. By 1932, almost 28% of all trade union members were unemployed (Berend and Ranki 1974b, p. 165). Along with state repression of unions, other leftist organizations were targeted. The Communist Party was declared illegal and other political parties and organizations were harassed.

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[16] Berend and Ranki (1974b, chapter 5) deal with changes in great detail.

The economic crisis also led to growing discontent among capital and agrarian interests, who made repeated attempts to establish a neo-corporatist state. During 1932-36, Prime Minister Gyula Gombos attempted to form a one-party corporatist state. During the two years that followed the Gombos government, the radical and conservative right formed a coalition and the first Jewish law was enacted limiting Jewish participation in business and professions. In 1938-39, another attempt was made to establish a one-party corporatist state and the second Jewish law was passed. These anti-liberal and anti-capitalist movements were made with the support of the right-wing of the mainly peasant Populist Movement, the Arrowcross, and the populist writers of the New Intellectual Front. These groupings gave their support to the government believing that it would introduce land reform and limit capitalist activity (Tilkovszky 1990, p. 346).

After World War I, Hungary was no longer included as a region in the Hapsburg Imperial economic system. However, the brief interwar period of relative economic sovereignty came to an end as gradually Hungary became articulated into the Nazi war economy. Talks with Nazi Germany starting in 1933 began to tie the Hungarian economy to the German economy.

The articulation of the Hungarian economy with the German economy led to a boom. Total agrarian exports doubled in 1934 due to the promotion of agricultural exports to Germany (Berend and Ranki 1974a, p. 279). By 1937, 50% of all foreign investment was German, and industry was altered to munitions production. This integration did not lead to long-run development but did lead to short-run prosperity for agrarian and non-Jewish capitalist interests, and greater employment opportunities for the working classes.

Not only did collaboration with Nazi Germany have immediate economic benefits, but also made nationalist aspirations of regaining territories lost in the Treaty of Trianon become real. In 1938, Hungary commemorated the 900th anniversary of the death of Saint Istvan (the first King of Hungary) and celebrated gaining possession of Slovakia. In 1939, Hungary commemorated the 20th anniversary of the right-wing counterrevolution and celebrated gaining possession of Ruthenia. In 1940, Hungary commemorated the 500th birthday of King Matyas Corvinus (a much honored king in Hungarian history) and celebrated territorial gains in Transylvania.[17] In April of 1941, Hungary began war against Yugoslavia and recaptured other lost territory. Co-operation with Nazi Germany was a dismissal of the vision of democratic reforms and peaceful co-existence with neighboring countries; instead, the concept of "Saint Istvan's Empire" fueled Hungarian nationalism (Tilkovszky 1990).

Once the path of allying with Germany was taken, it could not be escaped. The Hungarian government did try to break with Germany during the winter of

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[17] Transylvania is the most cherished territory lost in the Treaty of Trianon even today because under Ottoman rule, the principality of Transylvania enjoyed greater independence. Hungarian culture is said to have flourished and developed more in this region and during this period of history than in other regions of Hungary and so is believed to reflect a purer version of Hungarian culture.

1943 and again in the autumn of 1944, but support within the officer corps for remaining allied was strong and Germany easily resisted the break. The generals, who were often ethnically German and had traditionally worked with the Austrians during the Dual Monarchy, argued that Hungary would lose the northern part of Transylvania to Romania if it broke with Germany, and might gain as a reward the southern part if they continued fighting hard on the German side. Regent Horthy, who was also an admiral in the navy, went along with the officers' arguments (Seton-Watson 1956, pp. 98-99).

The continued alliance with Germany created winners and losers. Clearly rallying people around the nationalist cause served the elite as it garnered more power over territory. Richer peasants definitely benefited from the boom in agricultural production; many of the industrial proletariat obtained work after a long period of unemployment or sporadic employment as a consequence of the Nazi war economy.

But the long experience of the horrors of war changed public opinion. In 1944, the Germans occupied Hungary, arrested Admiral Horthy and installed a puppet government of the Hungarian Arrow Cross. In late 1944, a provisional government was set up in Debrecen (in eastern Hungary) and in January of 1945, the provisional government signed an armistice with the Allies. The Soviet liberation of Hungary followed soon after.

E. The rise of state socialism

As in World War I, Hungary was once again on the losing side of the war. Unlike the earlier war, the aftermath of World War II involved a major transformation in the political and economic system, including an almost complete replacement of the ruling elite. Some question whether Hungary - or other countries in Central and Eastern Europe - would have become state socialist if not for the presence of the Soviet Red Army, but its presence in and of itself is not enough to explain the events which followed. These radical changes came about as a function of both the events of the war and pre-war history.

Before the war, there was not a stable regime of accumulation in place. Initially, capitalist development happened as a function of being articulated into the Hapsburg Empire's division of labor. There was a small bourgeoisie and an absence of pro-capitalist ideologies as many of the feudal elite were reluctant to change into entrepreneurial capitalists, yet held most of the wealth available for capitalist investment. The period of instability which followed the breakup of the Austro-Hungarian Empire may have witnessed greater capitalist development but actually represented a decline in economic conditions both in absolute terms and in relative terms. Per capita national income was half of the European average and one-fourth to one-fifth of the most developed European economies (Berend and Ranki 1974a, p. 310). Moreover, unlike Western Europe, standards of living were falling, not rising, and many indicators would suggest economic decline. The articulation of the Hungarian economy into the Nazi war machine restored the accumulation process temporarily, but did not resolve the problems of the absence of stable social and political institutions to regulate accumulation.

By the end of the war, the accumulation process was disrupted, and it was through social groups vying for power that a regime came into place.

War shifted the balance of power among classes and, more generally, had a radicalizing effect on people. War destroyed the legitimacy of the *ancien regime*, especially after the Germans installed a puppet government. Much of the bourgeoisie, a small weak class even before the war, had been driven out of the country by the Hungarian government and German forces. These developments indicated that the potential for radical change was once again present because the natural defenders of the status quo were rendered impotent.

As the traditional rulers of the country lost power and legitimacy, other forces gained strength. The resistance against Nazi Germany was weak for most of the war because the war economy had provided jobs and some growth after a long period of crisis. But by March 1944, the resistance finally began developing. Although the resistance never reached the strength of the more extensively developed Yugoslav or Bulgarian movements, the shift in public opinion against the war played an important role in support for left-wing causes. The Communist Party, which was central to the resistance movement and was supported by the Soviet Red Army, gained support because of their anti-Nazi actions. The Party's steadfast opposition to the *ancien regime* also helped it increase support as it capitalized on the *ancien regime*'s loss of legitimacy. As Schopflin argues:

> Just as during the First World War, the population had been radicalized by war; expectations of massive change, often of a messianistic nature, were widespread in 1944-45. There was an expectation that a new political order, based on a more equal distribution of power, would be created...their [the communists'] record of uncompromising hostility to the *ancien regime*, coupled with the prestige they earned from their activities in the resistance and their association with the Soviet liberator, were strongly placed to benefit from this state of affairs.
>
> (Schopflin 1993, p. 60)

In addition to having the foreign occupiers' support, the Communist Party was the best organized and had made allies out of the Social Democrats and the National Peasant Party, which was a party of radical intellectuals.[18]

While it is true that the Smallholder Party had the most popular support, the party suffered from disorganization and disarticulated interests. The party garnered support from a wide array of groups in society such as the non-radical urban intelligentsia and peasant farmers. The party was home to anyone who was not on the Left. This in itself was a problem for the party because it could not form a clear strategy. The Smallholders embodied various groups of people which had inherent conflicts. The disorganization of the party only made it impossible to resolve these conflicts.

[18] However, the support of the Soviet liberator, while important, was not as much of an advantage for the communists as it was in other countries of the region. The Soviets were held partly responsible for the suffering of the Hungarian troops during the liberation. And, perhaps more importantly, Hungarians never forgave the Russians for coming to the aid of the Austrians during the failed 1848 revolution.

In the 1945 parliamentary elections, the Smallholder Party garnered an absolute majority with 57% of the vote. The Communist Party and the Social Democrats each obtained 17%, and the National Peasant Party had 7% of the vote. Because of strong co-operation between the Communists and Social Democrats, and because the Smallholders lacked a concrete agenda, the process of "sovietization" proceeded relatively smoothly.

Seton-Watson (1956) characterizes the process of sovietization - the take-over of Eastern European countries by communist parties allied with the Soviet Union - in three stages: Firstly, there is a genuine coalition. In Hungary, the genuine coalition was the above four political parties that retained independence from each other. At this point, the Communist Party began its attempts to break the Smallholder Party and purge the bureaucracy of anti-communist civil servants. By 1947, the Communist Party with the help of the Soviets was able to oust the leadership of the Smallholder Party. This began the second stage of sovietization - that of a bogus coalition which lasted for another year. The final stage of monolithic regime was obtained when the Social Democrats and the Communist Party officially joined in the Fusion Conference in the spring of 1948.

Although the process of sovietization had fundamentally altered the trajectory of Hungarian development, it must also be remembered that there was a certain continuity. Firstly, with respect to nationalization, many of the large enterprises had been state property since the end of the nineteenth century, or, were nationalized during the war. This happened for two reasons: for one, the mobilization effort and for another, because encroaching anti-Semitic legislation dispossessed Jews of property which led to the nationalization of Jewish-owned enterprises. Post-war nationalization began with the banks and mines and then proceeded with other industries. By March 1948, all factories employing more than 100 workers had been nationalized along with international trade and domestic retail. Hungary was not unique in post-war nationalization; capitalist countries such as the UK nationalized industries because there was public support for doing so, and to rescue various key industries that had suffered from under-investment and damage during the war.

Hungary also had the tradition of a strong state. State intervention was not unusual by any means. There was certainly no tradition of anything vaguely resembling laissez-faire capitalism. The population, having been radicalized, also demanded a better life and the only possibility was through state intervention and the provision of social protection.

In addition to a traditionally strong state, democratic traditions were weak if not absent. In 1910, only 10% of the population had the right to vote and there was no provision for the secret ballot in the countryside, so not only could very few people vote, the ones who could were constrained by having to vote in accordance with more powerful people in the locality. After World War I and the 1919 communist revolution, the Allies pushed for elections on the basis of wider suffrage and the secret ballot. While those elections took place, Prime Minister Bethlen re-imposed the restricted suffrage and open balloting in the countryside in 1922. It was only in 1935, when a new Prime Minister (Duranyi) was chosen, that the franchise was extended and the secret ballot was put in place. But according to Schopflin (1993, p. 12), the strong state precluded parliamentary sovereignty; the state was able to "make" the elections. From 1900 to 1939, the government had not lost any elections except for one in 1905, and this was because the ruling elite was divided, a division which only lasted about one year.

Hungary was not alone in this respect. Failed attempts at parliamentary democracy happened almost everywhere in Eastern Europe. The only parliamentary democracy not to have collapsed before World War II was Czechoslovakia. Indeed, Szacki (1995) argues that liberalism is completely foreign to the region and that it is only during recent times, the late 1980s and early 1990s, that liberalism has once again been *imposed* on Eastern Europe.

Given the role of the state in economic life, and the absence of liberal traditions and liberal democracy, the turn towards state socialism does not appear as such an imposition from the outside as it does a continuity of internal relations. The ruling elite may have changed, but the manner of ruling was consistent with Hungary's prior history.

Structurally, the emergence of state socialism in Hungary was a modernization strategy. With the destruction of the ruling elite and the elimination of the few bourgeoisie, in addition to the economic stagnation and falling living standards of the interwar period, the only *apparent* viable strategy was state socialism. Berend and Ranki (1974a, p. 349) describe the immediate post-war economic system as a "peculiar state capitalist economy". In practical terms, the state was needed to play the role of the bourgeoisie in order to stimulate growth. In other words, since there was no other economic agent who could take over the role of investment in the immediate postwar period, the state had to step in. From there, it was not a far step to state socialism if private property were eliminated. Since private capital did not prove itself to be a dynamic force before the war, and investment would have to be mainly directed by the state anyway, private ownership hardly appeared to have a purpose. Moreover, it was private ownership *not* being a driving force behind modernization that permitted living standards to drop and economic stagnation to continue for most of the interwar period. By eliminating it, the state would have a greater pool of resources to redistribute which could then bring about greater equality.

Not only could certain changes appear to be logical for the emerging ruling elite, but the Soviets, having experienced modernization and growth before World War II, had a working model. At the time when capitalist economies were experiencing depression, the Soviet economy was thriving like never before. An alternative to capitalist modernization existed.

F. 1956: a crisis in the system of regulation

The armed struggle of 1956 indicates that the adoption of the Soviet model of socialism was insecure. Central planning was capable of restoring accumulation, but the system of regulation necessary to ensure stability and longer-term accumulation was never fully put in place.

Rapid industrialization, urbanization and an expanded industrial proletariat marked the post-war period. As Table 3.1 shows, industrial production recovered and surpassed pre-war levels by 1950. More generous estimates indicate that it may have recovered even more quickly. According to Berend and Ranki (1974a, p. 361), the index of industrial production reaches 107 by 1948 and 137 in 1949 where the base year, like the indices in the table, is 1938=100. Even conservative estimates indicate postwar recovery in industrial production.

Table 3.1: Calculated indexes of industrial production, 1938 and 1946-56 (1938=100).

Year	Large-scale Industry	Small-scale Industry	Total Industry
1938	100.0	100.0	100.0
1946	45.9	91.3	59.2
1947	70.0	93.1	75.7
1948	94.1	85.3	92.2
1949	110.8	69.7	99.3
1950	141.9	49.0	116.3
1951	170.3	29.8	131.6
1952	202.6	16.1	151.1
1953	215.0	12.4	159.2
1954	219.7	20.9	164.9
1955	234.2	27.9	177.3
1956	213.3	26.9	162.1

Source: Czirjak, L. (1968b, p. 18).

Table 3.1 also indicates the emphasis on large-scale industry. Large-scale industry more than doubles in size in the 1950s while small-scale industry drops to about one-quarter of its 1938 level.

The recovery in industrial production, particularly large-scale, was fueled by increases in investment. As Table 3.2 shows, the fixed capital investment in 1949 is significantly higher in 1938. Increases continued and, although levels were still much higher than before the war, there was some stagnation after 1953.

Table 3.2: Index of fixed capital investment, 1938 and 1949-56 (1955=100).

Year	Total Fixed Capital Investment
1938	38.9
1949	57.5
1950	75.5
1951	90.0
1952	109.1
1953	109.8
1954	96.6
1955	100.0
1956	95.5

Source: Czirjak, L. (1968a, p. 14).

However, the growth of investment and industry did not mean that disposable income or consumption kept pace. Table 3.3 indicates that recovery in disposable personal real income happened more quickly per capita than per person employed. The per capita disposable personal real income had recovered in the non-agricultural sector and surpassed both 1938 and 1949 levels by 1954. But, if the disposable personal real income is considered per employed person (instead of per capita), it can be seen that incomes dropped considerably until

1954. By 1956, incomes per person employed were only around 90% of the 1949 level. The different levels between the two measures reflect more persons entering the labor force; hence, it would not necessarily appear on an individual level that any real gains had been made in the initial years of state socialism. Household income may have increased but if so, it is the result of more family members working as wage-labor.

The table also demonstrates that real incomes in the non-agricultural sector rose more rapidly than in the agricultural sector. In fact, by 1956, per capita disposable personal real income in the agricultural sector was still significantly below the 1938 level even though it was above the 1949 level. Also, agricultural incomes were significantly below non-agricultural incomes.

Table 3.3: Disposable personal real income (per capita and per person employed) in agricultural and non-agricultural sectors, 1938 and 1949-56 (1949=100).

	Per Capita			Per Person Employed		
Year	Agriculture	Non-agriculture	Agriculture as a % of non-agriculture	Agriculture	Non-agriculture	Agriculture as a % of non-agriculture
1938	148.1	99.1	100.4			
1949	100.0	100.0	67.4	100.0	100.0	60.8
1950	103.3	104.5	66.6	107.2	93.9	69.5
1951	124.7	96.1	87.4	134.7	79.8	102.7
1952	95.6	89.5	72.0	109.1	69.4	95.6
1953	83.7	90.2	62.5	99.7	67.1	90.5
1954	89.2	107.9	55.7	107.8	79.1	82.9
1955	99.3	112.5	59.5	118.5	82.8	87.1
1956	105.4	121.8	58.3	125.1	90.5	84.1

Source: Czirjak, L. and P. Marer. (1973, pp. 24-25).

The standard of living experienced by Hungarians in the time period can also be illustrated by personal consumption as shown in Table 3.4. While there is mostly steady growth in per capita personal consumption, it declined in 1952. The pre-war levels are not achieved until after 1956. After almost two decades, per capita personal consumption only reached about 93% of what it was in 1938.

Table 3.4: Index of personal consumption and per capita personal consumption, 1938 and 1947-1956 (1955=100, market-priced weights).

Year	Personal Consumption	Per Capita
1938	111.5	117.8
1947	66.7	68.1
1948	75.8	76.7
1949	84.9	85.1
1950	86.4	85.8
1951	89.0	92.7
1952	84.4	87.3
1953	84.6	86.6
1954	92.9	94.0
1955	100.0	100.0
1956	110.7	109.7

Source: Holesovsky, V. and G. Pall. (1968, pp. 24-25).

However, we cannot conclude on the basis of these indicators that economic hardship was the cause of the 1956 uprising. Changes in personal consumption do not necessarily indicate that the average person's consumption had declined. Hungary's pre-war elite, as mentioned above, participated in conspicuous consumption on a greater scale than elite in other countries. The decline in personal consumption may reflect the elimination of particular excesses. For example, with the base year of 1955=100, per capita consumption of "household operations" was 479.1 in 1938 and 117.9 in 1956. That consumption in this category is less than 25% of pre-war consumption might easily be explained by the elimination of a very wealthy stratum who spent large sums of money operating a household. Consumption of recreational activities had also declined but the reasons for this are ambiguous. On the one hand, many persons had to work harder, but on the other, many forms of recreation were nationalized and had reduced prices or were free and would in that case falsely indicate reduced consumption.[19]

The above examples do not suggest that we can easily dismiss the calculations presented in Table 3.4: they suggest only that a clear conclusion cannot be reached regarding increases or decreases in standard of living. It is safe to say that with a state socialist strategy, increases in personal consumption in the short-term were sacrificed for increases in investment to stimulate longer-term increases in production. It can also be argued that stable employment and increased social provision would have improved some persons' standard of living.

Hungary was also not the only country to suffer decreases in production and consumption after the war. All countries in Europe that participated in the war required long periods of recovery. In fact, Central and Eastern Europe, by liquidating bottlenecks, more easily attained levels of pre-war production than

[19] For example, Margit Sziget, a large, pleasant island in the middle of Budapest, could only be visited with the purchase of admission pre-war. Now it is free to the public.

Western Europe (Berend and Ranki 1974a, p. 361). This is especially remarkable given that war damage was more severe in Eastern Europe and, unlike Western European countries and Japan, the region had not benefited from the Marshall Plan.

In considering the standard of living, it is also important to take into account the social and political environment. Although Hungarians had often suffered from repression, the immediate postwar era was different in some respects. The leader, Matyas Rakosi, was particularly ruthless. He proclaimed himself to be Stalin's best student, which gives some indication of his respect for Stalin and the Stalinist method of rule. Under Rakosi's leadership, police terror was widespread and affected at least one-tenth of the population. According to the resolution passed by the Central Committee meeting of the Hungarian Workers' Party in June 1953, the police had imposed penalties in 850,000 cases between the beginning of 1951 until 1 May 1953. The same document discussed at length critically the "mistakes" made by the party leadership "with Comrade Rakosi at the helm" and claimed that, "Comrade Rakosi is largely responsible for the associated cult of personality".[20] While this document might seem to appear early in the criticism of Rakosi, it was in response to instructions from Moscow, which was attempting to undertake de-Stalinization in the USSR and across

[20] The resolution is quoted at length in Litvan (1996, pp. 25-26). This document was not published until 1986 when it appeared in an internal party journal.

Eastern Europe. The document called for a reinstatement of "collective" leadership.

Rakosi also attacked other party members who were not part of the "Muscovite" group. The Muscovites were the Communist Party members who lived in exile after the aborted 1919 revolution. Laszlo Rajk, a non-Muscovite but a devoted communist and Minister of the Interior, was tried and executed as a Titoist. The nature of the charges were farcical: Rajk and others had fought in the Spanish Civil War but ended up interned in France. After escaping internment, they fled back to Hungary by travelling through Yugoslavia. According to Rakosi and his supporters, this indicated they were Titoists who must be discredited and eliminated. The Hungarian show trials demonstrated the lengths to which Rakosi would go to ensure that he would not face internal power struggles in the Party and would obtain Stalin's approval.

Many of the middle and lower ranks of the Party were also affected by Rakosi's rule. According to Schopflin (1996, p. 19), 350,000 lower and middle ranking party members were purged between 1948-56.

Hungary was not the only country to suffer from a Stalinist leader. This type of leader, the Stalin-trained "Muscovite", had been imposed on nearly every Eastern European country. After Stalin died in 1953, there were mass workers' demonstrations in East Germany; in 1956, workers' demonstrations took place in Poland. Waves of strikes occured in Eastern Europe as countries adjusted to the new state socialist mode of production.

Hungary's 1956 armed struggle - an attempted revolution - differed from those other examples of class struggles. In the case of Hungary, 1956 was an attempt to break with the existing system and establish something new. As Lomax argues in his book *Hungary 1956*:

> In the West, the uprising was presented as a national rebellion against communist dictatorship, while in the East the communists saw it as an attempt to overthrow socialism and restore Western-style capitalism. Both these viewpoints ignored the real issue of Hungary - that it was a social revolution aimed not at restoring a previous regime but at creating a radically new social order, one that would be both more democratic than the capitalist West and more socialist than the communist East.
>
> (Lomax 1976, p. 17)

In 1953, at the beginnings of de-Stalinization, Soviet leaders insisted that the Hungarian leadership be re-organized and that the government's worst policies be publicly criticized. Imre Nagy became Prime Minister and announced the "New Course," a program that included social and economic reforms, and the release and rehabilitation of the victims of Stalinist/Rakosi purges. Nagy was mostly alone in his efforts at reform; he had little support inside the party although many journalists had rallied to support him. When a mild heart attack removed him from public life early in 1955, Rakosi and his supporters used the opportunity to expel him from the Central Committee and the Politburo, and to replace him in office with Andras Hegedus, a Rakosi pupil. By the end of 1955, Nagy had been expelled from the Communist Party altogether.

The consolidation of the old Stalinists did not last. On October 23, 1956, students called a demonstration in Budapest to demand reforms and the formation of a government under Nagy. The demonstration did not remain peaceful. Fighting broke out and the Hungarian government called in Soviet troops for reinforcement. By this time, Erno Gero had replaced Rakosi as party leader and, although the change of personnel was meant to placate the public, he was also a Stalinist. At the same time, so-called moderates such as Janos Kadar had been brought into the government.

The attempted revolution was widespread. Outside of Budapest, there were several centers of provincial activity. Workers' councils were founded in the industrial sites along with revolutionary committees. But on November 11, several days after Kadar had been secretly called to Moscow, the armed struggle was finally put down by Soviet troops. It was the working class centers - the mining regions, the iron and steel production areas and "Red Csepel", the large industrial island in Budapest - that put up the most resistance to Soviet troops (Lomax 1976). Even after the Soviet occupation, the workers maintained some power: they continued the formation of workers' councils and remained on strike until November 19.

The uprising of 1956 represents the climax of a crisis. It was a crisis that most closely resembles the third type in the Boyer typology for capitalist crises (1990), a crisis in the system of regulation. This type of crisis occurs where the social structure to regulate accumulation is not in place so that class struggles are heightened rather than diminished. It is possible that, given a different social and political environment, class struggles would have been contained and the uprising would have never happened. One possibility for an alternative social structure would have included less repressive leadership. Rakosi did not have legitimacy to rule other than by repressive force. Popular support for his rule was practically non-existent and, given the changes in Moscow after Stalin's death, which diminished his Soviet base of support, his ability to maintain leadership was untenable. As there appeared to be a realistic alternative to his rule - in other words, a government headed up by Nagy and his allies - the lack of legitimacy was all the more important. In other words, divisions between the ruling elite, ambiguous support from Moscow for the Rakosi repression, lack of popular support, and the availability of an alternative created the conditions which increased the struggle between the working classes and the Stalinist faction of the ruling elite.

What is also interesting about the existing social structure is that the struggle between the ruling elite and everyone else was so sharp that struggles between agricultural and non-agricultural workers faded into the background. It might be the case that because agricultural workers were paid much less than industrial workers (see Table 3.3), unity between the two groups would be difficult to achieve. However, antagonism towards the ruling elite superceded the struggles between classes.

The events leading up to the 1956 uprising are important in the configuration of the social structure which was to evolve later. Class struggle, which in this case became violent, led to the solidification of the accumulation process and a functioning mode of regulation. For the purposes of this work, I will call the regime of accumulation which evolved "goulash communism". Khrushchev was the first to dub the Hungarian state socialist system by this name. Goulash, of course, is a well-known Hungarian specialty - a hearty soup which is eaten as a main course. Although this label is not as illustrative of the Hungarian version of state socialism as for example, the other common label, "Frigidaire socialism", Khrushchev's designation will be used here.

G. Goulash communism: a regime of accumulation

A regime of accumulation is the coming together of a mode (process) of accumulation and a mode of social regulation, which lead to long-term stability and prosperity. As applied to capitalist economies, the regime of accumulation describes a particular path of capitalist development under which the propensity for crisis in the process of accumulation is contained and delayed such that stable economic growth proceeds, although crisis is still inevitable.

By the term "goulash communism", I am arguing that in the late 1950s and early 1960s, a regime of accumulation came into place in which the conditions for stability and prosperity existed into the 1980s. This regime, however, did have its internal contradictions which led to its demise as has happened in other (capitalist) regimes of accumulation. Although this analysis has been applied to capitalist economies, I argue that a regime - where we can see stable growth over a long period of time - did exist although it was not capitalist. I am also making the distinction between the traditional Soviet model of state socialism which had been practiced to a greater or lesser degree in Eastern European countries besides Yugoslavia, and the Hungarian model. While the Hungarian model shared many features with the Soviet state socialist model, it had an accommodation which included two key features: a commitment to increasing living standards; and an opening for debate over the economic system and willingness to experiment with reforms. The opening for debate, however, did not include debate over the political system. The commitment of increasing living standards might be thought of as affecting the mode of accumulation, in other words the production-distribution-consumption relationship. Permitting greater debate over the economic mechanisms might be thought of as part of the mode of social regulation, in other words, the combination of institutions which regulate accumulation.

Many of the characteristics, techniques and results of centrally planned systems have been greatly elaborated elsewhere and will not be repeated in any depth here.[21] Much has also been written on the differences between Hungarian state socialism and other Eastern European countries, but two features which did not alter should be repeated: Soviet hegemony and the drive for rapid industrialization.

In common with other Eastern European countries, the Soviet Union was the hegemonic power in the region. This had been proven militarily in the

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[21] See, for example, Ellman (1989).

Hungarian Uprising of 1956 and later was also violently demonstrated in Czechoslovakia in 1968. This relationship did not change in the post-1956 Hungary. The continued military hegemony of the Soviet Union can be illustrated by the presence of Soviet troops in the country and Hungary's continued participation in the Warsaw pact.[22] The Soviet Union was also Hungary's major trading partner. It imported raw materials and exported manufactured goods. Of course, Hungary's other important trading partners were members of the Warsaw Pact and Comecon. Hungary participated in the state socialist division of labor and, by this means, it was integrated into the world economy.

As in the Soviet model, the growth strategy of Hungary was rapid industrialization centered primarily on the promotion of large-scale industry. The growth of large-scale industrial production and the continuous shrinkage of small-scale production from 1957-1965 can be seen in Table 3.5. Large-scale industry is easier to plan and co-ordinate than small-scale.

[22] This included participating in the invasion of Czechoslovakia in 1968.

Table 3.5: Calculated indexes of industrial production, 1938 and 1956-65 (1938=100)

.Year	Large-scale Industry	Small-scale Industry	Total Industry
1938	100.0	100.0	100.0
1957	234.9	35.1	179.8
1958	260.0	36.1	198.0
1959	282.2	31.5	213.1
1960	309.6	25.7	231.4
1961	339.6	22.5	252.1
1962	364.9	20.4	269.9
1963	383.4	18.5	282.8
1964	412.6	17.7	303.7
1965	435.8	18.2	320.7

Source: Czirjak, L. (1968b, p. 18).

1. Overview of reforms, 1950s to the New Economic Mechanism of 1968

The opening for debate and the actual implementation of economic reform is something that distinguishes Hungary from its northern and eastern neighbors. It might be suggested that the beginning point of debate is actually when economic reform was initially discussed and was even temporarily put in place under Nagy's government as the "New Course" between 1953-1955. While this period is important, the beginnings of debate and reform are better characterized in December 1956, when the Provisional Central Committee of the Hungarian Socialist Workers Party passed a resolution stating that the *central principle of economic policy* would be the *improvement of living standards*. This position was reinforced by Kadar's famous New Year's statement in 1962, "Those who are not against us are with us," which was to say that the previous regime of enemy hunting would not continue.

The above claims may be somewhat symbolic, but they suggest most profoundly what was different about Hungary during the period of state socialism: the country would be run in such a way as to "deliver the goods" as well as possible within a modified Soviet model and under continued Soviet hegemony, and, as many people as possible would be co-opted through compromise.

The Provisional Central Committee in late 1956 rejected sacrificing the living standards of the present generation for that of the future. Living standards were to grow correspondingly with the economy. It was also decided that personal incomes would grow substantially. From 1956 to 1959, per capita real income grew dramatically. This is indicated by the growth in per person employed disposable real income for the nonagricultural sector as seen in Table 3.6. It should be noted that persons employed in the agricultural sector did not see similar gains. Increases in per capita personal consumption were also reasonably steady as can be seen in Table 3.7.

Table 3.6: Disposable personal real income per person employed in the nonagricultural sector, 1956-1959 (nonagricultural, 1949=100).

Year	Index
1956	90.5
1957	107.7
1958	109.8
1959	129.0

Source: Czirjak, L. and P. Marer. (1973, p. 25).

Table 3.7: Percentage change in per capita personal consumption (change in index at market-price weights), 1957-65.

Year	Percentage change in per capita personal consumption
1957	2.2
1958	1.7
1959	8.4
1960	0.4
1961	2.3
1962	1.7
1963	4.3
1964	3.3
1965	2.7

Source: Holesovsky, V. and G. Pall. (1968, p. 13).

Although the Economic Committee that was formed in late 1956 planned a comprehensive radical reform package, it was not put in place, in part because the reform process was viewed by some as following the road of national communism. The world communist movement rejected the idea of national communism and rejected the validity of any efforts in that direction. The most important indication of this was Yugoslavia which was once again dismissed as being revisionist. Decision-makers also felt that reforms as radical as proposed would transform the economic system back to capitalism. Furthermore, it became apparent that the Kadar government was firmly in charge and so there was less pressing political need for reforms (Berend 1990a, pp. 389-390).

Nevertheless, changes were made which especially affected the agricultural sector. Collectivization proceeded under much more favorable conditions than those of pre-1956. The household plot system was introduced in which all peasants would possess 2.5 acres for household production and could maintain their own animals as well. They also received rent for land that they brought to the collectives and other benefits such as pensions. Industries that had been previously neglected were promoted. For example, chemical industries were promoted over the previous policy of developing metallurgy. The changes in industrial policy, however, made Hungary increasingly dependent upon imported oil as more was required to sustain the newly developing industries (Berend 1990a, p. 391). The greater need for importing oil went against the general strategy of autarchy.

The 1960s brought a new wave of reform. It became apparent that growth achieved through additional labor resources was no longer possible by the mid-1960s (Berend 1990a, 1990b). In 1964, a Central Committee resolution called for the study of alternatives for comprehensive reforms. The package of reforms introduced in 1968, which fundamentally altered the central planning process, was called the New Economic Mechanism (NEM). The reforms were planned to be much more radical than what was actually implemented. The events in

Czechoslovakia in 1968 caused decision-makers to temper the reforms, but nevertheless, given the context, the reforms were fairly dramatic.

The main principle of the reforms was the elimination of *detailed* five-year and annual plans. And as one of the economists involved in the design of the NEM wrote, "direct, administrative control of enterprises by plan indicators and plan directives issued by the ministries has ceased with January 1st, 1968" (Friss 1969b, p. 18). National economic planning was instead carried out through a set of policies which would indirectly influence decision-making in order to achieve objectives. These policies are grouped by Friss (1969b, pp. 18-21) in his discussion of the NEM as:

1. Price policy
2. Policy regarding the development of personal incomes
3. Investment policy
4. Credit policy
5. Foreign-trade policy
6. Fiscal and budgetary policy

a. Price policy

A key reform that the NEM introduced was the extensive decrease in the use of price controls. As Berend (1990b, p. 171) explains, "...the essence of the price reform was to create prices which better expressed the social costs of production, the value relations and the changes in prices on the world market".

Although 70% of raw materials and semi-finished goods had fixed or ceiling prices, only 3% of manufactures had fixed prices, and an additional 19% had ceiling prices. A full 78% of finished products were sold at free-market prices. A few years after the reforms were introduced, only 36% of goods in the industrial producer-price system[23] had fixed or ceiling prices (Berend 1990b, p. 173).

Firms were supposed to be guided by price signals in their choices of range and quantity of output. Enterprises became free to choose to whom to sell regardless of whether the choice was other domestic enterprises, foreign enterprises or to consumers.[24] Likewise, enterprises could decide from whom to purchase supplies (Friss 1969b, p. 22).

The introduction of the use of price signals, normally something associated with market economies, is part of the reason that Hungarian state socialism was sometimes described as a type of market socialism. Although it could be argued that there is no such thing as "free market prices" in a state socialist economy, the price reforms meant that economic agents - producers and consumers - played a greater role in the determination of prices. In fact, it is clear that policy-makers had fully intended to introduce and give wide berth to the market mechanism. As Csikos-Nagy claims:

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[23] Producer prices include such things as semi-finished products, energy, timber and other raw materials.

[24] Of course foreign exchange and trade regulations still affected buying from and selling to foreign firms.

> With the price reform of 1968 we attemtped to approximate a price system where *the price is determined by the market mechanism.* This is a consequence of the twin principle which served as a foundation for the Hungarian reform, namely, that
> –there can be no purposeful economic development without a national economic planning by the state,
> –there can be no rational economic organization without the market mechanism.
>
> (Csikos-Nagy 1969, p. 146, emphasis in original)

b. Policy regarding the development of personal incomes

In the same vein as enterprises deciding on their suppliers and customers, they could also determine individual incomes. Enterprises were free to increase or decrease individuals' wages although they could not increase or decrease their total wage bill at will (Friss 1969b, p. 19).

Since the reforms introduced free wage-labor (and internal migration was no longer regulated), workers could choose to leave a position and accept another. Free labor-markets, however, had the potential to lead to excessive wage growth. Higher wages were one method of attracting more skilled workers. Although an initial control of the wage bill was to monitor the *average* wage per worker, increasing wage rates for certain workers were covered up by hiring low-wage unnecessary workers. This practice led to changing the dominant method of wage regulation by the 1970s to that of monitoring the total wage bill (Berend 1990b, p. 264).

Enterprises also had a tendency to excessively increase wages because of paternalist attitudes of enterprise managers. As one managing director had said to me, "they [the workers of the enterprise he managed] were my family".[25] By the late 1970s, taxes were levied for enterprises that increased the wage bill by more than the tolerated amount which depended on the growth in performance of the firm.

Another aspect relating to wages and salaries that was introduced by the NEM was profit-sharing. Enterprises would put part of a share of profits into a sharing fund. This fund would then be used to cover increases in the wage level, profit-sharing, and employee perqs.[26] The highest executives of the enterprise could have a maximum of 80% of their salary as profit-share and their salary would be guaranteed up to 75%. In other words, the remaining 25% should have been made up of profit-sharing, but given high profits, they could achieve a substantially larger salary with the addition of profit-sharing. Lower level executives were guaranteed up to 85% of their salary and 50% of the salary as a group could be augmented by profit-share. Workers were guaranteed 100% of their wages but they could receive an additional 15% in profit-share (Sulyok 1969, p. 170). The use of profit-sharing as an incentive mechanism is usually associated with capitalist economies. However, as other incentive structures in the NEM relied on the market mechanism, wages and salaries to some extent did as well.

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[25] Interview with Istvan Trembeczki, September 2, 1996.

[26] For example, it was the norm in Hungary for an enterprise to have at least one holiday resort where employees and their families could go for inexpensive vacations.

It should also be added that the NEM rejected unemployment. If someone could not find a job, the state still maintained the responsibility of locating employment for the individual. This was consistent with other state socialist economies, but also consistent with the need to guarantee financial security at the level of the individual.

c. Investment and credit policy

The NEM altered investment decision-making. Certain large infrastructural developments were still carried out by the state, but the vast majority of investments were de-centralized to enterprise level.[27] Enterprise decisions were then influenced by the size of their development fund, which was in a sense a pool of retained earnings, and, access to credit. The development fund could also be used as a type of collateral in order to obtain credit.

Since investment decisions often relied upon access to credit, the use of credit policy was a method of the state retaining influence over investment decisions. Sources of credit included state loans and bank loans. Banks would grant credit to those proposed projects which would achieve the highest profitability and be repaid the most quickly according to competition with other projects within a branch of industry. Banks followed state directives in granting

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[27] And to other bodies such as local councils but these investments are related to such areas as culture.

more favorable terms such as a lower rate of interest or longer repayment schedule (Sulyok 1969, pp. 173-177).

Investment decisions did have to correspond to some extent with the national plan. However, access to credit was also determined by enterprises competing with each other on the grounds of profitability and speed of repayment. As Sulyok (1969, p. 164) writes at the time of the NEM's implementation, "it [credit policy] will be selective, flexibly following the market relations, in conformity with the requirements of profit maximization". Credit decisions were fully intended by policy-makers to be mostly driven by profit considerations, and even to prioritize short-term profits over longer term.

d. Foreign-trade policy

Foreign trade was of particular concern to policy-makers of the NEM because of the small size of the country and the importance of particular imports necessary for growth and development. The main thrust of foreign-trade policy was to liberalize it, however, foreign-trade policy was viewed as being a long-term process which would involve the gradual liberalization of foreign trade.

Some individual enterprises were permitted to directly import and export goods. The plans for the NEM assumed that this would account for 5-10% of total foreign trade, but that this would expand over time (Sulyok 1969, p. 182). Foreign trade firms were used to conduct 85-90% of trade, and that foreign-trade firms were also profit-based and were to act as an agent of the producer enterprise (Sulyok 1969, p. 183). This represented another aspect of the decentralization of economic decision-making, but also the profit-motive playing a role and producers and agents bargain for the most favorable prices.

In order to regulate the trade conducted by the import-export enterprises, foreign-trade policy maintained a use of customs duties. Duties varied considerably, for example, most materials could be imported duty-free if paid in the domestic currency. As for consumer goods, each import-export enterprise was allocated a lump sum of money with which it could freely choose what to import.

The allocation of foreign exchange was also liberalized and the exchange rates were manipulated in order to bring about a closer linkage between domestic and international prices. The exchange rate system was simplified by reducing the number of exchange rates to three, one based on gold which had no practical purposes, a commercial rate, and a tourist rate (Berend 1990b, p. 263).

What is most striking about the NEM's foreign-trade policy was that it was predicated on the assumption that reforms would continue which would eventually make the Hungarian forint fully convertible. As the Economic Policy Committee of 1969 stated:

> In preparing the policy concept on prices we must assume that convertibility of the forint and a currency reform will be placed on the agenda in latter years...In further [moves towards] perfection of the price system, effort must be made to ensure that the domestic price relations reflect world-market price relations better, and so exert an influence on transformation of the structure of production.
> (quoted in Berend 1990b, p. 195)

Plannners appeared to have presumed in both the elaboration of the NEM and the subsequent debates over further reform immediately afterwards that price reform, and in connection, foreign trade reform, was concerned with the full liberalization of the economy, or at least to approach a position close to complete liberalization. Although adopting world-market prices would have been detrimental to Hungarian enterprises at the time (Berend 1990b, p. 172), it is clear that the opening of the economy to the non-socialist world was viewed as being a desirable and obtainable goal.

e. Fiscal and budgetary policy

In order to give more control to enterprises and cooperatives under the NEM, the share of profits retained by these economic units increased significantly. Instead of retaining 15% of profits as was the case in 1967, enterprises and cooperatives retained almost 40% (Friss 1969b, p. 30). This meant that the share of social income flowing to the state for state expenditure was reduced significantly, even though it was believed that 80% of state revenues would continue to be from enterprises and cooperatives (Friss 1969b, p. 30).

With respect to specific expenditures, the importance of consumer subsidies "considerably increased" under the NEM (Friss 1969b, p. 31).[28]

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[28] Although, as Friss (1969b, p. 31) comments, it is possible that under the NEM, the true size of consumer subsidies became apparent.

Producer subsidies, which were slightly more in the percentage of the budget than consumer subsidies, continued to retain some importance.

One interesting feature of the NEM is that some aspects of financial regulation were viewed as "transitory" and that for one to two years, the economy would be in "transition". Part of the transition included "a strongly restrictive credit policy" and "also public consumption and budget expenditure had to be severely restricted" (Sulyok 1969, p. 191).

However, the brief transition period of the NEM was not combined with an austerity program. The NEM prioritized the improvement in the the standard of living: "The primary point of view was here to carry out consistently the policy of raising living standards" (Sulyok 1969, p. 166). And, although consumer prices were modified, making relative consumer prices in line with costs of production would lower the standard of living for parts of the population, so, "...none of these modifications [in relative consumer prices] was permitted to conflict with our living standard policy" (Sulyok 1969, p. 166).

2. The aftermath of the New Economic Mechanism

In general, the NEM accomplished a few very radical tasks. It abolished the centrally planned economy of the Soviet model and replaced it with a system whereby the market mechanism featured in regulating the economy. The scope of state intervention was significantly reduced in scope, but numerous regulators as elaborated above, were used to continue to achieve particular economic objectives. But by 1973-74, the tide turned against the reform process. The worsening international economic environment had had repercussions on the Hungarian economy. Internal criticism also resulted from the increasing importance of the profit motive in regulating the system.

The year after the 1968 reforms, managers had under-reported firm costs and so profitability was on average 9.4% even though it was believed by planners that the average profit level would be 6.5% (World Bank 1984, p. 34). Because managers' salaries were partially linked to profits, they received large bonuses. The ratio between the highest and lowest salary pre-1968 had been 3:1; the year after the reforms it dramatically increased to 9:1 (Berend 1990a, p. 397). Workers criticized the system for giving excessive remuneration to management and more generally, going against socialist principles of egalitarianism. While in comparison to capitalist countries, the disparity in relative wages was minor, in socialist Hungary it implied capitalist ideologies since it used incentives of personal material gain via profits. "Instead their [the critics'] spokesmen cried out for reinforcement of "socialist ownership", an egaliterian, "socialist" incomes policy and a collectivist, "socialist" way of life" (Berend 1990b, p. 203).

The international situation was also worsening by 1973-74. The first round of oil shocks had a grave impact on the economy. Hungary is a small country reliant on international trade. Having practically no natural resources, it is dependent on imported oil and other raw materials. The price hikes in oil caused severe deterioration in the terms of trade for Hungary and so the balance of trade and balance of payments went into deficit. The trade gap widened to such an extent that Hungary borrowed $8 billion during years of the oil price shocks (Berend 1990b, p. 232).

Criticisms of the NEM and a worsening economic climate pushed a re-centralization in 1973 and 1974. In 1973, 50 firms accounting for half of industrial production were ordered to be centrally supervised (Berend 1990b, p. 210). Also in the year, the State Planning Committee was set up to reinforce the importance of planning (Berend 1990b, p. 213). Centralization was increased with respect to investment decisions, and price reforms were implemented in order to raise producer costs. These tendencies towards re-centralization were confirmed in the fifth five-year plan, 1976-80.

The state also attempted to increase its role in the re-distribution of income. Inheritance and gift taxes were increased, and property taxes on second homes with more than two rooms were increased. Other forms of property taxes, taxes on secondary salaries and other related measures were undertaken to lessen differences in wealth.

However, a new price mechanism was introduced in 1979 and 1980 which was actually a further development of the 1968 price mechanism. The system attempted to link producer prices to fluctuations in world markets. Between 1979 and 1980, the prices of raw materials and semi-finished goods increased considerably. The overall price rose by 57%. Moreover, except for energy, these goods were allowed to adjust freely with convertible-currency import prices. Energy remained centrally set and was only periodically adjusted for world price fluctuations (Berend 1990b, p. 260). Consumer prices were also reformed such that by 1980, 50% of retail turnover was in goods which did not have controlled prices (Berend 1990b, p. 262).

Whatever problems existed in the Hungarian economy, the GNP grew at rates that were comparable to the US between 1965-79, as shown in Table 3.8. From 1965-1975, average annual rates of growth in GNP per capita were higher than the US averages. In 1976, Hungary underwent a recession while US growth was quite strong, however, growth resumed in Hungary in 1977 and continued for 1978 and 1979, but the rates in 1978 and 1979 were lower than the that of the US.

Table 3.8: Average annual rates of growth of GNP per capita in Hungary and the US, 1965-1979 (at constant prices, in percent).[29]

	1965-70	1970-75	1976	1977	1978	1979
Hungary	2.7	3.0	-0.7	5.6	2.5	1.3
US	2.0	1.8	5.0	3.9	3.3	2.3

Source: Alton, T.P. et al. (1980, p. 18).

The return to reforms continued in the 1980s. In 1974, Rezso Nyers, a key advocate and defender of the 1968 reforms was replaced as Central Committee secretary responsible for economic affairs by Karoly Nemeth. Nemeth's working

[29] Berend (1990a, p. 387) states that GNP growth was 5-6% a year from 1958 until the end of the 1970s.

committee eventually came to the conclusion that there should be a return to the reforms. By the early 1980s, a near consensus evolved among policy-makers that a return to the reforms was necessary, or as the president of the Materials and Prices Office, Bela Csikos-Nagy (who was cited above in the discussion of the NEM's economic regulators) said, "...it is not a matter of how to apply the principles expressed in the economic reform of 1968 but of how to develop its concept further" (quoted in Berend 1990b, p. 245).

In 1984, a Central Committee resolution called for the increased independence of state companies and that enterprise councils should be set up and elections should determine top management. It envisaged in the long run changes that could give employees an interest in the profits and growth of the company. In 1985, the Central Committee passed legislation which gave enterprise councils much more decision-making power over the enterprise with respect to organizational structure, mergers, de-mergers, joint ventures and so on. Enterprise councils were mostly composed of the firms' management.

In 1988, the Corporation Act enabled enterprises to transform themselves into joint-stock holding firms. Act VI established the enterprises' ability to take on private persons as co-owners but did not set down regulations regarding the transformation.

3. Economic reforms and consumerism

The main plank of the reform process as evidenced in so many of the Central Committee resolutions and five-year plans was the improvement of people's standard of living. The measurement of standard of living was material consumption. Although it is not clear that "consumerism" was the result of the reform process, it was viewed as "causing the spread of bourgeois attitudes and habits" (Berend 1990b, p. 224). Certainly, though, personal consumption was, other than the reactionary period during the 1970s, viewed as key to promoting living standards.

However, the economy was not strong enough to support continuous increases in private consumption. Between 1971 and 1978, private consumption grew by 4.2% a year (World Bank 1984, p. 14). In the 1970s the terms of trade had worsened for Hungary because of the state of the global economy, especially the oil price shocks. In non-ruble trade, it had decreased sharply in 1974 and 1975 to recover only slightly by 1980 as shown in Table 3.9. In ruble trade, the terms of trade deteriorated more gradually.

Table 3.9: Terms of trade by currency, 1970, 1975 and 1980.

	1970	1975	1980
Ruble	100.0	88.5	79.8
Non-ruble	100.0	77.8	80.7

Source: World Bank (1984, p. 23).

Instead of parlaying this into a time of austerity, the commitment of planners to increases in consumption is demonstrated through the planned rates of consumption, even though the actual rates of increase fell below the plan. Between 1979 and 1981, private consumption grew by only 2.0% a year. Although this rate is less than half of the growth rate for the previous several years, it was only maintained by cuts in investment so that the ratio of investment to GDP dropped from 41% of GDP in 1978 to 30% in 1981 (World Bank 1984, p. 17). The 1981 ratio had dropped down to the 1968 ratio.[30]

The economic reforms also did not imply that the Hungarian economy was performing better than other Eastern European countries as can be seen in Table 3.10.

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[30] But as the World Bank (1984, p. 17) report points out, the ratio of investment to GDP is higher than the average of 27% for middle-income developing countries.

Table 3.10: Eastern Europe: average annual rates of growth of GNP per capita, 1965-91 (at constant prices, in percent).[31]

Years	Bulgaria	Czecho-slovakia	Hungary	Poland	Romania	Yugo-slavia
1965-70	4.0	3.2	2.7	3.0	3.2	N/A
1970-75	3.9	2.7	3.0	5.7	5.2	4.6
1975-80	0.9	1.5	1.9	0.0	1.9	4.9
1980-85	0.7	1.1	1.0	0.3	0.1	0.6
1985-90	-1.9	0.6	0.1	-1.6	-3.0	-2.0
1990	-11.1	-2.3	-6.4	-10.1	-10.4	-7.8
1991	-21.1	-17.1	-6.7	-6.1	-15.3	-10.9

Source: Alton, T.P. et al. (1992, p. 33).

Although the Hungarian economy did not perform particularly badly in global terms, it could not withstand the hikes in oil prices and continue to provide increases in consumption. This situation led to increased foreign borrowing as seen in Table 3.11. In 1970, gross debt was 1.5 billion dollars, but by 1980, it had climbed to over 10 billion dollars. While it stabilized in the early 1980s, it began increasing again and doubled by 1987.

[31] The growth rates became negative in 1985-90 in most countries because of the poor economic performance from 1989 onwards, and these should not be viewed as reflecting recession in the late 1980s. GNP per capita was negative beginning in 1988 in Bulgaria, 1990 in Czechoslovakia, 1989 in Hungary and Poland, 1987 in Romania and Yugoslavia, although certain countries did for one year experience negative growth earlier, for example, Bulgaria in 1980.

Table 3.11: Gross debt (in billion USD).

Year	Hard Currency	Non-convertible	Gross
1970	1.12	0.38	1.50
1975	3.93	0.30	4.22
1978	7.59	0.76	8.35
1979	8.31	0.91	9.21
1980	9.09	1.22	10.31
1981	8.70	1.33	10.03
1982	7.72	1.27	8.99
1983	8.25	1.37	9.62
1984	8.84	1.26	10.10
1985	11.76	1.23	12.99
1986	16.91	1.02	17.93
1987	19.59	0.95	20.54
1988	19.63	0.58	20.21
1989	20.61	0.36	20.97

Sources: Based on World Bank and Economic Intelligence Unit reports.

By 1989, Hungary's debt/GDP ratio was 71.3%, its debt/export ratio was 239.8%, and its debt service/export ratio was 40.3%. By international standards, Hungary was considered a heavily indebted country (OECD 1991).

4. Growth of the private sector

Unlike Poland, which had a significant portion of agricultural production in private hands, Hungary had finished collectivization by 1962. Nevertheless, agriculture had a strong component that was private in a sense since collective workers were give 2.5 acres on which to grow their own produce and keep animals. They were able to sell their produce through the marketing of the collective and in this sense, private and collective agriculture were complementary. Household production accounted for one-third of agricultural production and helped Hungary meet its food requirements and produce for export so that on balance, Hungary was a surplus producer in agriculture. Szelenyi (1987), in his well-known book *Socialist Entrepreneurs*, describes this type of agricultural production and puts forth his thesis that it led to a process of embourgeoisement.

Small-scale private enterprise also took place in the retail sector. In 1957 state-owned shops were leased out. Private individuals kept the businesses so that, although they did not own the real estate associated with the shops, they managed and owned the actual businesses.

Small private businesses took on a more important role in the 1980s. Much private activity had been legalized by Political Committee resolution in February 1980. The resolution estimated that between 16 and 18% of total time spent working was in the second economy. The new attitude towards private activity can be summed up by this:

> By and large useful activity is being pursued within the second economy: it relieves shortages [and] it is a major supplementary source for our development. A proportion of the real demand and needs are being met, alongside the socialist sector, by the secondary economy.
>
> (Political Committee 1980, quoted in Berend 1990b, p. 281)

A greater amount of private activity was not only tolerated but promoted. The working week was reduced from 44 hours to 40 in order to increase the standard of living, but this action also created the space for the development of second economy activities as a larger amount of time could then be spent in second jobs. Self-employed artisans increased from 36,000 in 1975 to 43,000 in 1985; self-employed shopkeepers increased from 9,000 to 20,000; and caterers from 900 to 5,000 (Berend 1990b, p. 284). The number of leased units of state-owned shops also increased and leases were awarded in a competitive bidding process.

It should be noted that this small, private, service sector still accounted for a relatively small percentage of economic activity and had virtually no weight in the economy. What it does show perhaps more significantly is that individual enterprising activities with materialistic objectives were not condemned. Socialism in Hungary did not preclude petty bourgeois behavior. In fact, delivering increasing standards of living by improvements in the service sector and opportunities to increase household income was deemed a worthwhile method of development.

A further type of economic activity led to an incredible paradox. Through "intra-company economic working partnerships", workers within large industrial firms could set up partnerships and small co-opertatives. They would then perform contractual work in non-working hours for the firm. By 1985, there were 168,000 workers belonging to a working team (Berend 1990b, p. 287). As might be imagined, the productivity during working hours was considerably lower than the productivity of the partnerships. This activity, which was firm-initiated (the first one by Csepel Auto in 1981), could be seen in two ways. For one, it was a way of avoiding obstacles regarding wage increases. Enterprise management could enable workers to receive higher incomes while still following central wage guidelines. For another, it might be viewed as a way of using a type of profit sharing to improve productivity which, broken down to small enough units would avoid the free rider problem.

5. The beginning of the end

The period of state socialism in Hungary was the first time in Hungarian history that growth and development were achieved over a sustained period of time. While the economy had relatively strong, continuous growth in the post-war period, and industrialization and modernization proceeded rapidly, the well-being of the population gradually improved.

But, as is suggested by Regulation theory, regimes of accumulation do not last forever. Goulash Communism in Hungary was no different; in the 1980s the regime broke down. The break down of this particular regime of accumulation, however, begs two questions: Firstly, why did it break down? And, perhaps more importantly, why did its demise give way to the evolution of capitalism?

In the late 1970s, growth in Hungary began to slow. The average annual growth rate between 1975-1980 was 1.9%. The 1980s, however, were even worse. Between 1980-1985, growth slowed to 1.0% per annum on average, slowing even further in the late 1980s. Meanwhile, debt in the 1980s skyrocketed. In 1980, the hard currency debt was $9.09 billion. By 1989, it reached $20.61 billion.

H. The dismantling of state socialism

But the apparent crisis in the 1980s - slowed growth and stagnation only propped up by increased borrowing from Western lenders - did not in itself cause the demise of state socialism and the turn towards capitalism. It was the nature of Goulash Communism which undermined possibilities for continuing state socialism in Hungary and the subsequent turn of the economic system towards capitalism.

I take the Hungarian dismantling of state socialism to be somewhat unique in Central and Eastern Europe. Poland experienced an increased class struggle in the 1980s which led to the elite being forced from power. Czechoslovakia's opposition had been able to take advantage of the time period in which its neighbors were changing. Countries like Romania and Bulgaria had divisions within the political elite in which one faction was able to usurp power due to external conditions such as the changes in the USSR, Poland and Hungary.

Hungary, however, was known as "the happiest camp in the barracks". Socially and politically, it was a much more liberal country than its neighbors, especially in comparison with such countries as Czechoslovakia, headed since 1968 by Husak, or Romania under the repressive Ceausescu regime.

All countries in Eastern Europe had a dramatic slowing of growth in the mid-1970s due to external shocks. For the most part, slow growth continued through the 1980s. However, economic performance cannot explain why state socialism seemingly collapsed. Growth did not stop altogether and become negative until 1989 and after, and then the economic results are much worse, as will be presented in later chapters. More importantly, many economies have poor economic conditions, periods of stagnation and negative growth, but that does not mean the mode of production is completely replaced. There have been much more serious crises in the developed capitalist economies which did not result in the abandonment of capitalism. Even in the Great Depression of the 1930s in the US when unemployment was 25% and there were significant drops in production, the system remained largely intact. Accusations of "economic mismanagement" also do not hold water as the economic performance of Hungary as well as other Eastern European countries are the equivalent of or better than other peripheral European economies such as Greece and Portugal.[32]

Instead, reforms during goulash communism undermined state socialism in Hungary. The reform strategy was market oriented and had a logic of its own which led toward capitalism. Moreover, the practice of reform and open debate over reforms led to the development of an apparently pro-capitalist coalition which called for a transition to capitalism and bourgeois democracy.

The 1980s had seen a number of changes that unleashed the development of a market economy in Hungary. Along with the encouragement of the private

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[32] See for example, Tokes (1996), or anything written by neo-liberals. As for comparing peripheral countries' development in the late twentieth century, the picture becomes clouded because countries such as Portugal, Greece, Spain and Ireland developed through the mass infusion of European Union monies.

sector as discussed above, and changing the wage relation to promote incentives based on the profit motive, other reforms had been implemented making for the full development of capitalism. In 1982, a fledgling securities market was started. In 1987, the banking sector was modernized, creating a two-tier banking system with the central bank, the Hungarian National Bank and 13 commercial banks that specialized in everything from personal savings and mortgages to international trade. When the securities market exploded in 1987, doubling in value, the commercial banks and other financial institutions decided to form an organized capital market. The government also hoped that the creation of joint-stock holding companies (mentioned above) would help the new capital market.

In September 1986, a bankruptcy law was passed which reformers hoped would help to eliminate loss-making state enterprises.

In 1987, the Central Committee adopted a new platform which stated that:

> ...commodity and money relations, supply and demand, credit, prices, exchange rates, profitability and profit must play an active part in the economy...a price system and price mechanism expressing international competitiveness must be established...wage relations that express the social usefulness of work should be created in the longer term...a diverse combination of forms of ownership...[auxiliary farm activities] and private activity, constitute an integral part of the *socialist* economy...
>
> (quoted in Berend 1990b, p. 256, my emphasis).

It is hard to believe that the Central Committee was still describing a socialist economy. Already by this point, the Committee had committed itself to using supply and demand and the profit motive as governing forces over the economy. Moreover, the price system, which had always been a method of maintaining the socialist principle of keeping goods that met basic needs such as foodstuffs at a low price, would be eliminated. The creeping inflation of the 1980s increased to 16% in 1988 [Economic Intelligence Unit (EIU) 1990] when the prices of many goods were "freed".

In keeping with the developments of a modern economy, Hungary also introduced VAT and income tax on 1 January 1988. It was the first country in the region to do so.

Foreign investment was also sought out. While in 1972, there was legislation allowing joint ventures with foreign capital, fewer than 60 were set up (EIU 1990). In 1986 and 1987, the law was liberalized including a reduced profit tax (from 40% to 20%); further concessions for priority fields; and simplified regulations regarding licensing, registration and accounting procedures. It also allowed Western companies to have a majority share.

In 1989, the Conversion (or Transformation) Law was enacted to establish the conditions of company transformations, leaving 80% of shares to the state property administration as owner although no such body existed at the time. It was clear even before the political changes that Hungary was gearing itself up for privatization. In fact, an unpublished government document had been circulated calling for a radical reduction in state ownership. Although the parliament dissolved itself in December 1989 to prepare the way for multi-party elections, a provision had been made for the setting up of the State Property Agency (SPA), which was established in February 1990. The SPA became the agency responsible for privatizing state-owned enterprises.

On the political front, changes were also planned. The 1987 resolution by the Central Committee referred to above also stressed the relationship between the economic and the socio-political and declared that the system of political institutions needed to be modernized and that socialist democracy had to be developed to achieve the economic and social program. Non-state political groups were also tolerated and were growing in number. While the liberal and left-wing opposition had continued to publish its szamizdat work, reform communists informally established connections with the nationalist opposition. The Hungarian Democratic Forum, a populist group comprised of many historians, formed in 1987. Imre Pozsgay, a key economic reformer within the Party and member of the Central Committee, attended their second meeting of that year.

When Kadar was set to retire at the 1988 Party Conference, Karoly Grosz and his allies (including Imre Pozsgay) took over in what Tokes (1996) describes as a "putsch". The putsch created a Politburo in 1988 which had only three members who were on it in 1985 (one of those being Grosz). Rezso Nyers, a key scapegoat when the 1968 reforms were being reversed, regained his Poltiburo seat in 1988. However, the re-constituted Politburo ended up being an obstacle to negotiations for multi-party elections and, with only a handful of dissenters, voted to disband itself. Before it was disbanded, it suffered a coup by the apparat and was replaced by the Political Executive Committee and a four member Presidium in June 1989 (Tokes 1996).

Whatever the complicated maneuverings of the fight for power within the Hungarian Socialist Workers Party, the preparations for a capitalist course of development had already been laid even before the multi-party elections. The private sector was growing and was being further liberalized; the banking sector had been modernized and modeled after that of capitalist countries; the banks set up organized capital markets; and managers of state-owned enterprises were acting more independently, fostering relations with foreign firms. Perhaps one of the best written representations of this coalition is 'Turnabout and Reform', an article which appeared in 1987 in Kozgazdasagi Szemle (Journal of Economics).[33] This was the product of a number of young economists linked to the Finance Ministry's Institute of Financial Research[34] and was preceded by an internal report which was more radical. The article called for fundamental, radical change to the economy. The supplementary author list contained a who's who of Hungarian economic policy makers.

At least on the surface, a pro-capitalist coalition formed. Various elite had acted independently or within the political institutional framework to change the technical base of the economy. With an elite mostly committed to market reforms, the path leading up to the transition period was complete in 1989. Soviet troops began withdrawing on April 25, ending over 50 years of Soviet

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[33] The English translation was printed in the Hungarian journal *Acta Oeconomica* in 1987.

[34] The Institute is still in existence but has since been "privatized" and operates as an independent think tank.

hegemony. The opening of the Iron Curtain took place on 10 September 1989 and was ceremonially led by Gyula Horn, then Foreign Minister, who became the Prime Minister in 1994. This symbolic action informed the world that Hungary was leaving the "barracks".

It might also be added that the timing of symbolic and fundamental actions that put Hungary on the road to capitalism unfolded rapidly after the onset of changes in the Soviet Union. As it became clearer that the Soviet Union would not put a stop to the processes taking place in Hungary, reformers could take on more radical and more rapid steps to further the development of capitalist relations of production.

Nevertheless, the natural logic of the reform strategy is not enough to explain why reformers fostered it. The above discussion indicates that political leaders had undertaken decisions that sped up the rate of change, that brought upon the country more rapid, radical change than might otherwise happened. To begin with, these leaders believed that capitalism was the only way to bring about further development of the country. This is clear from many of the quotes above where people in decision-making power only wanted to develop the concept of the market further. It is possible that they envisioned the continuation of a strong, interventionist state steering capitalist development. Although for reasons that will be explained in subsequent chapters, the ultimate economic strategy became neoliberal.

Furthermore, the two elements discussed - the logic of the reform strategy and the reformers pushing towards transition - are linked. The market-oriented reform strategy came about because decision-makers believed that it would bring about improvements in the standard of living and genuine development to the country. Once this economic strategy was put in place, it was difficult to see any other alternatives. Finally, it is important to keep in mind that Eastern European governments did not perceive of any alternatives - there was state socialism or capitalist development. While state socialism had developed these economies, capitalist countries, at least, appeared to be performing more dynamically and leading to better standards of living.

It is also the case that some members of the political, cultural and economic elite were seduced by the possibility of personal gain from the transition process. As will be discussed in Chapter Four, some high-level managers did push for further reforms in order to economically benefit. Nevertheless, this was not the key reason that state socialism gave way to capitalism. The pro-reform coalition did believe that capitalism was the viable alternative. This is made even clearer through the events discussed in Chapter Five.

I. Conclusions

In 150 years of Hungarian history, the country has undergone three major transformations. As a peripheral country of Europe, Hungary never developed a sizeable bourgeoisie even after the first transition from feudalism to capitalism. After the second transition - from capitalism to state socialism - the state played the role of the bourgeoisie, in the sense of modernizing and industrializing the country under state socialism.

The third transition is the transition from state socialism back to capitalism. However, under state socialism, no bourgeoisie existed. The state held almost all productive property. The question then returns: from where did the capitalist class, the entrepreneurs, the engine of growth and revolution come. The next chapter examines this topic.

CHAPTER IV

THE EMERGENCE OF A CAPITALIST CLASS

A. Introduction

The capitalist class as defined earlier includes the group of high-level managers of enterprises which employ wage-labor and are engaged in the pursuit of profits. These managers of profit-oriented enterprises are also able to claim a portion of the flow of surplus value either via legal ownership or other means, for example, profit-linked bonuses. Managers of state-owned enterprises are also included in this group as long as they manage firms which are part of the capitalist production process; in other words, the firms produce for profits and not as part of social production, and the managers have some claim on a portion of the surplus product (as opposed to receiving a civil servant salary).

Many theorists of globalization argue that individual countries do not have a national capitalist class. Instead, they argue, nationals who are capitalist belong to the transnational capitalist class. This grouping of individuals primarily identifies itself with its position in relation to the means of production in the context of a global capitalist economy. In other words, as production has become increasingly globalized, so too have its representatives in belief systems, practices and habits.[35]

The present chapter examines the emergence of a capitalist class in Hungary and demonstrates how this group arose as part of the transnational capitalist class. The breakdown of state socialism and the ensuing transformation processes benefited three main groups - the top managers of state-owned enterprises, their deputies, and foreign capital. Wherever possible, managers, or often their deputies, co-operated with foreign capital and agents of the state to secure a continued privileged position. The outcome was a Hungarian capitalist economy in which foreign capital, by 1997, controlled 35% of non-financial corporate enterprises (according to subscribed capital) and 60% of the banking industry.

The chapter first considers the origins of the capitalist class by examining survey data, primarily from the *Social Stratification in Eastern Europe After 1989* as reported by Szelenyi and Szelenyi (1995) and other academic publications. Along with establishing that a major proportion of the new economic elite arose from the managers and deputy managers, statistical data is used to establish the significance of foreign capital. The chapter then goes on to look at the processes by which the capitalist class emerged.

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[35] See Sklair (1991) for a thorough discussion of the sociology of the global economy.

B. The origins of the Hungarian capitalist class

The first step in telling a story about the emergence of a capitalist class in a transitional country may be to examine the class background of CEOs and others who are considered as capitalists under our working definition. We might also inquire about the class destination of state socialist high-level managers. While the survey data reported by Szelenyi and Szelenyi (1995) and others goes some way to answering questions about class positions, it must be noted that the survey work broadly discusses the "elite". Apparently, only rough and ready definitions were used to determine who is or was the elite. For example, in the survey work on Poland, the "elite" under state socialism included proportionately fewer CEOs than in the survey work on Hungary.[36] These "methodological differences" then account for the greater survival rate of the Polish economic nomenklatura compared to its Hungarian counterpart. But the methodological differences can really be attributed to using less strict definitions than might otherwise have been employed. Although definitive conclusions cannot be drawn from these data, they still are informative.

The results of the survey *Social Stratification in Eastern Europe After 1989* as reported in Szelenyi and Szelenyi (1995) indicate that a significant portion of old nomenklatura economic elite retained its position in Hungary. A small survey with 82 respondents who were part of the old nomenklatura economic elite in

[36] See Szelenyi and Szelenyi (1995, footnote 16).

1988 shows that almost one-third became part of the current elite by 1993. The largest portion of the respondents, however, were retired by 1993 (see Table 4.1).

Table 4.1: Destinations of the old nomenklatura economic elite in Hungary.

Class position in 1993	Percentage of respondents (n=82)
Elite	29.2
Non-elite with subordinates	18.3
Non-elite without subordinates	4.9
Retired	47.6

Source: Szelenyi and Szelenyi (1995, p. 627).

Although the above data do indicate something about what happened to the old elite, it is not necessarily relevant to the investigation as to the origins of the new elite and the emerging capitalist class. What is relevant is the proportion of the new elite that has its origins in the old elite.

The nomenklatura system which existed in the Soviet Union and all Eastern European countries included only those who were politically approved to hold the highest positions. Therefore, the old nomenklatura represent the highest echelon of the Hungarian class system. However, as seen in Tables 4.2 and 4.3, the new economic elite is composed of a broader category of old elite. For the class origins of the entire new elite that were surveyed in 1993, less than 20% did not hold any elite position in 1988. For the *economic* elite, the result is even more overwhelming. Almost 90% of the new economic elite were part of the elite in 1988. In other words, even if they were not part of the political approval system for the very highest positions, they were part of the elite by the nature of their high level jobs.

Table 4.2: The class origins of the new elite in Hungary (1993).

Class position in 1988	Percentage (n=783)
Nomenklatura member	32.7
Other official	47.5
Non-elite	19.8

Source: Szelenyi and Szelenyi (1995, p. 623).

Table 4.3: Origins of the new *economic* elite in Hungary (1993).

Class position in 1988	Percentage (n=489)
Nomenklatura member	34.9
Other official	54.7
Non-elite	10.4

Source: Szelenyi and Szelenyi (1995, p. 628).

Borocz and Rona-Tas (1995), using the same survey data, illustrate how much of the new elite were functionaries or CP members in 1988 as can be seen in Table 4.4. The category "functionary" is confined to those who were party functionaries and members in top state positions in 1988. The second category is broader because it includes those who were members of the party in 1988 and not necessarily in top state positions. While the percentages decrease between old and new elite for both the functionary category and the CP membership category, the data do demonstrate something about the origins of the new elite. It would appear that being a functionary and/or a CP member was an advantage. Even in the privately founded sector where we might expect to see the effects of political capital being significantly less important, the result is informative. Less than 8% of the population were members of the party and yet almost 44% of the new economic elite in the privately founded sector were members in 1988.

Table 4.4: Percentage of old economic elite and segments of the new economic elite (1993) who were functionaries and CP members in 1988.

	old economic elite	new economic elite: state sector	new economic elite: privatized sector	new economic elite: privately founded sector
Functionary	49.0	30.8	35.0	17.2
n=	102	172	200	169
CP membership	73.3	65.3	67.3	43.8
n=	101	170	199	169

Source: Borocz and Rona-Tas (1995, p. 773).

Rona-Tas (1997) presents similar data which can be seen in Table 4.5. From this data, it can be seen that the advantages of officialdom and membership are obvious. Former state and party officials and CP members are over-represented in the new economic elite in comparison with the general population. What the data also shows, though, is that of the elite surveyed, a significant percentage of respondents were part owners.

Table 4.5: The general population, the old economic elite and segments of the new economic elite (1993) that were state and party officials and CP members in 1988.

Position	General Population	State Manager	Privatized Manager	Privatized Owner	Newly Founded Manager	Newly Founded Owner
State and Party Official	2.1	10.6	13.7	10.7	5.0	7.0
CP members	7.9	65.4	67.5	66.2	52.5	42.0
n=	3,492	161	117	75	80	100

Source: Rona-Tas (1997, p. 219).

The survey data also show that the new economic elite originated overwhelmingly from top or other managers as seen in Table 4.6. Of privatized firms, 33% were top managers in 1988 and 52% were other managers. Even amongst the category of privately founded firms, top and other managers from 1988 represent 68.1% of the new economic elite. This survey shows that 85.5% of the state sector new economic elite, 87% of the privatized new economic elite, and almost 70% of the new economic elite of privately founded firms were either part of the party-state elite or were managers in 1988.

Table 4.6 : Occupational background of the new economic elite (1993) in 1988 (in percentage).

Occupational category	New economic elite: state sector	New economic elite: privatized firms	New economic elite: Privately founded firms
Party-state elite	2.3	2.0	1.2
Top manager	29.1	33.0	21.9
Other manager	54.1	52.0	46.2
Other	14.5	13.0	30.8
n=	172	200	169

Source: Borocz and Rona-Tas (1995, p. 767).

Moreover, if we examine the backgrounds of the CEOs of the largest firms, we get a more conclusive picture that at least the new managerial class arose from the communist managerial class. The results of interviews with 570 CEOs in the largest 3,000 economic organizations (as defined by annual turnover yielded) showed that 74% were either part of the nomenklatura or were low-level managers (see Table 4.7).

Table 4.7: Occupation in 1988 of the new economic elite in Hungary (n=570).

Occupation in 1988	Percentage
Nomenklatura	31.4
Low-level managers	42.6
Entrepreneurs	1.9
Professionals	11.6
Workers	11.4
Not in labor force	1.1

Source: Eyal, Szelenyi and Townsley (1997, p. 85).

Rona-Tas (1994), using data from a sample of 1,000 adults interviewed about their backgrounds, income and education levels, also presents findings about the ability of the old elite to retain elite positions. The persons involved in the study were first interviewed in 1989 and then again in 1991. Rona-Tas used the data to examine whether cadres were advantaged under transition. His definition of cadre is someone who was both a member of the Party (HSWP) and reached some position of power. This definition is more inclusive than traditional definitions of the elite because it not only looks at those at the absolute top of the hierarchy but includes persons who may be influential but not have as much power. However, since a person was not required to join the Party except for very high positions, the category excludes certain persons. Rona-Tas believes this is unimportant. Those not belonging to the Party who maintained high positions would not necessarily be indicating continuity in transition because these people would not necessarily support the former regime as indicated by their choice of not joining the Party. Including them in the cadre category by virtue of their position would exaggerate the extent of continuity. For my purposes here, though, the results of Rona-Tas's study are restrictive. The fact that non-Party members were included among the power-wielding set is indicative that a larger proportion of the elite would more likely support the transition to capitalism, and therefore be part of the pro-capitalist coalition than might otherwise have been the case. This simply returns us to the argument presented in the last chapter that it was the reformist nature of the last regime that undermined it and gave way to a particular form of transformation.

Rona-Tas concludes that former cadres maintain their advantageous position during transition in both corporate and non-corporate enterprise. They do especially well in corporate enterprise, achieving advantage through their superior levels of education and their ability to convert political power to economic power. More indicative of how transition has affected classes in Hungary, however, are the estimates of income distribution derived from the survey. Cadres who participated in market strategies more than doubled their income in nominal terms which was a much larger increase than other groups, including noncadres involved in market strategies.[37] Arranged according to income quintiles, the personal income distribution as measured by the Gini co-efficient grew more unequal from .263 (1989) to .297 (1991) between the two surveys.

Although the above survey data paints a picture of a managerial revolution, the story does not end there. Some analysts focus on the ownership of firms for defining the capitalist class and although my definition of the capitalist class is not confined to owners, it is interesting to review the data of surveys done on ownership by managers. In Hungary, around 50% of the managers surveyed by Eyal, Szelenyi and Townsley (1997) had ownership in one

[37] As income derived from market strategies is consistently under-reported, it is expected that these increases are underestimated.

or more firms, but the percentage of ownership was generally fairly low and, according to TARKI data, the size of the firms was small. Table 4.8 shows the percentage of business owned by members of the new economic elite (n=578) in Hungary. A total of 578 members of the new economic elite were surveyed. Table 4.9 shows the percentage of business owned by managers by the size of the firm where 994 managers were surveyed.

Table 4.8: Percentage of business owned by members of the new economic elite in Hungary.

Percentage of business owned	Percentage of elite (n=578)
No ownership	48.6
Less than 25 per cent	30.1
25-49 per cent	8.3
Over 50 per cent	13.0

Source: Eyal, Szelenyi and Townsley (1997, p. 85).

Table 4.9: Percentage of business owned by managers in Hungary, by size of firm.

Managerial Ownership	1-10 employees	11-99 employees	100-299 employees	300+ employees	Total
none	53.3	64.3	78.2	88.9	72.6
1-10 per cent	15.0	17.0	13.7	9.9	14.2
11-49 per cent	15.9	10.5	6.8	0.4	7.6
50-100 per cent	15.9	8.3	1.3	0.0	5.5
number	107	400	234	253	994

Source: Eyal, Szelenyi and Townsley (1997, p. 87).

Furthermore, the survey data on assets including home ownership and house size, ownership of weekend homes and other real estate, and possession of stocks and bonds also does not appear to indicate substantial wealth. Eyal, Szelenyi and Townsley conclude that any property ownership by the managerial class was fairly modest by 1993 (when the surveys were done) and they believe it is unlikely that the "grand bourgeoisie" will develop in Hungary, Poland or the Czech Republic.

The absence of a propertied grand bourgeoisie does not indicate the absence of a capitalist class, as Eyal, Szelenyi and Townsley argue. It may instead indicate the particular form the emergence of the capitalist class is taking in a country. The more salient point seems to fall back to control rather than ownership. New Class theories developed in order to explain the changes that started in the first half of the twentieth century in Western economies when the separation between ownership and control became increasingly apparent. That a country like Hungary evolving into a capitalist economy may also possess a capitalist class that does not own significant portions of the firms it manages is not surprising. As Stark (1996) argues, the diversification and decentralization of property rights is a form of organizational hedging as a response to uncertainty. Moreover, the best way for managers to gain substantial flows of revenue from enterprises, given the highly uncertain transition conditions, may be via other means than ownership. Other methods such as high salaries and profit-sharing may be better alternatives to ownership under the circumstances. It is unsurprising that managers in Hungary would attempt to retain control over assets in such a way as to sometimes gain part ownership but, on the other hand, not assume large liabilities or take on overwhelming risks in an uncertain transition period. It is by doing so that managers used political and social capital to gain the economic support of the state and/or foreign capital. Lack of a class that owns substantial shares in enterprises does not mean that capitalists in Hungary do not exist, only that they may have a co-operative role with foreign capital and possibly institutions of the state.

Furthermore, capitalists do not necessarily have to own substantial shares of firms in order to be capitalists. As long as managers exercise control over the firm and are able to use their position to gain substantial flows from the firm, they are capitalists. In Western countries, top managers fulfill these requirements and there is no reason to treat top managers in Eastern Europe differently.

Also, it is crucial to view survey data on ownership with scrutiny. Interviewees sometimes lie or under-report their material possessions and income because large income and wealth differentials remained unacceptable throughout the 1990s. Moreover, like their counterparts in other countries, Hungarian managers are increasingly likely to have their salaries in part determined by the overall performance of the firm. Even if they do not possess enough shares in the company to comprise a 1% ownership, their salary can still be influenced through profits and dividends.

While the origins of the capitalist class can be found in the elite of the previous regime, the Hungarian elite were not the only beneficiaries of transformation. Foreign capital also gained an important stronghold over economic production. The extent of foreign ownership had grown so much that by 1997, 35% of subscribed capital in non-financial corporations was in foreign hands. This was an increase from 1994 in which just over 20% was foreign controlled and in 1995 when 25% was foreign controlled. Table 4.10 gives the breakdown of subscribed capital according to industry and sub-sector of ownership for 1995. Table 4.11 gives the breakdown for 1997.

Table 4.10: Structure of non-financial corporations by sub-sectors of ownership, 1995.

Industry	Public	National-Private	Foreign Controlled	Total
Agriculture, hunting, forestry and fishing	35,700 12%	254,425 83%	15,777 5%	305,902
Mining	7,482 18%	21,800 52%	12,363 30%	41,645
Manufacturing	292,781 25%	380,393 32%	516,041 43%	1,189,215
Electricity, gas steam, and water supply	869,404 85%	123,903 12%	47,634 5%	1,040,941
Construction	21,744 18%	50,760 41%	50,967 41%	123,471
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	48,648 11%	256,305 56%	154,928 34%	459,881
Hotels and Restaurants	13,709 14%	51,399 53%	31,902 33%	97,010
Transport, storage and communications	260,234 57%	52,230 11%	142,758 31%	455,222
Other activity	202,651 36%	275,522 48%	92,584 16%	570,757
Total Subscribed Capital	1,752,353	1,466,737	1,064,954	4,284,044
Total Subscribed Capital (%)	41%	34%	25%	100%

Source: Central Statistical Office (1997, p. 261).

Table 4.11: Structure of non-financial corporations by sub-sectors of ownership, 1997.

Industry	Public	National-Private	Foreign Controlled	Total
Agriculture, hunting, forestry and fishing	36,816 12%	263,780 83%	18,842 6%	319,438
Mining	13,447 26%	11,031 21%	28,197 54%	52,675
Manufacturing	58,052 4%	495,514 38%	757,570 58%	1,311,136
Electricity, gas steam, and water supply	501,306 57%	170,601 19%	212,448 24%	884,355
Construction	16,165 11%	79,921 53%	55,096 36%	151,182
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	21,089 3%	341,593 55%	256,030 41%	618,712
Hotels and Restaurants	3,420 3%	75,355 59%	49,261 38%	128,036
Transport, storage and communications	387,807 59%	74,512 11%	190,514 29%	652,833
Other activity	187,256 21%	533,159 59%	187,752 21%	908,167
Total Subscribed Capital	1,225,358	2,045,466	1,755,710	5,026,534
Total Subscribed Capital (%)	24%	41%	35%	100%

Source: Central Statistical Office (1999, p. 298).

The foreign-controlled share exceeded the national-private share of industry in both the manufacturing and transport, storage and communications sectors by 1995. By 1997, the foreign sector also overtook the national-private in the mining and electricty, gas steam and water supply sectors. The foreign-controlled share of *all* industries exceeded 20% by 1997 except for one sector, that of agriculture, hunting, forestry and fishing. In fact, if the agriculture, hunting, forestry and fishing sector is taken out of the totals, the national-private share of all non-financial corporations as measured by total subscribed capital is less than 1% more than that of foreign-controlled.[38]

In less than decade, foreign capital has gained control of several industries. Moreover, the foreign-controlled sector of ownership gained proportionately more from the continued rolling back of the state than the national-private sector had. While shares between the three in 1995 showed a still large state with 41% of ownership, a growing national-private sector with 34% and a thriving foreign-controlled sector with 25% of ownership, the 1997 figures respectively are 24%, 41% and 35%. Between 1997 and 1995, the public's share shrunk by 30%. But total subscribed capital had risen by 17%. The national-private sector did well in those two years - its total subscribed capital

[38] Agriculture, hunting, forestry and fishing accounts for approximately 7% of total subscribed capital. Without this sector, the national-private's share is 37.8511% and the foreign-controlled share is 36.8989%.

rose by 39%. However, the foreign-controlled sector showed significantly more growth; its total subscribed capital rose by 65% in those two years.

In order to understand how these outcomes emerged - the formation of a capitalist class from state socialist managers and deputy managers, and the rapid growth of the foreign-controlled sector - the processes shifting enterprises away from production for use to capitalist production must be examined.

C. Capitalist production

The background to large-scale privatization which brought about the formation of a capitalist class is the initial top-down efforts by the state to get firms to begin behaving more like capitalist enterprises. Under central planning, some firms did make profits but this was not the primary goal. Instead, state-owned enterprises were meant to fulfill goals of social production as part of a plan, and in that vein, many firms would receive large subsidies, for example, to fulfill export plans or to make certain basic consumer goods more affordable to the public. Another facet of central planning was that the system tended towards autarkic development because it was easier to plan production in the absence of trade. The existence of the Council for Mutual Economic Assistance (CMEA) and Hungary's small size and lack of natural resources made it impossible and undesirable to be completely autarkic but nevertheless, like all countries, Hungary pursued a variety of different type of production.[39] Also, countries that were members of the CMEA did have substantial trade with Western countries as well as developing countries. For example, Romania had pursued a strategy of trade with Western countries in order to gain foreign exchange to repay its foreign debt. Hungary also had some trade with non-CMEA countries.

In Hungary, the intention of the New Economic Mechanism, and the revival and reinvgoration of reforms during the 1980s, was to create micro-incentives so that firms would more readily respond to price signals and managers would have an incentive to carry out profit maximizing behavior. Due to the requirements of social production and the rent-seeking behavior of managers, this was not entirely possible. Even with the early bankruptcy laws enacted by the Hungarian government, enterprises were rarely permitted to dissolve because of the political problems of unemployment and community disruption. As most firms in state socialist countries were large,[40] employing often thousands of people and having supplier relationships with other firms, a

[39] Some researchers also believe that Hungary pursued types of production in which it did not have a comparative advantage due to the CMEA division of labor. But it is difficult to determine in which forms of production a country may or may not have a comparative advantage. So-called comparative advantage may be determined more by historical factors. Moreover, countries have successfully broken into new industries (e.g. Southeast Asia and the computer industry) which could not have been predicted by guessing about resource endowment or other factors.

[40] Planning was easier with fewer units and competition between enterprises was viewed as unnecessary under state socialism so large monopolistic firms dominated.

bankruptcy of one firm could mean significant unemployment as well as the multiplier effects on other firms.

Early reforms enabled Hungary to be ahead of other countries in some aspects of creating capitalist production, but the effort to make state-owned enterprises geared towards profits was permanently secured by 1991. Many prices, especially for energy and raw materials, were tied more closely to international prices beginning in 1980. Measures regarding price increases were carried out slowly until 1987, but then prices were quickly liberalized in 1988-89. In 1985, 40% of goods and services had market-determined prices; by 1990, that figure had risen to 84%, and many of the items that had prices still set by the state were goods and services such as public transport that are often subsidized by the state in advanced capitalist countries. Price controls were made irrelevant by the accompanying trade liberalization. At the beginning of 1989, a three-year trade liberalization was enacted so that by 1991, approximately 90% of imports were liberalized.

Trade liberalization increased the level of competition that Hungarian firms faced. But price and trade liberalization only went some distance to creating "hard" budget constraints out of "soft" ones. Another method was strict monetary policy, but this led many firms into a position of inter-enterprise debt. In order to adapt to the rapid imposition of tight money, firms used debt as a way of delaying payments to other firms or to the state. However, this made the situation more precarious because so many firms simply took on more debt in order to survive avoiding bankruptcy procedures. In order to make firms more loss-sensitive, the Bankruptcy Law was passed in 1991 to replace the 1986 law. Under the new law, the terms became much stricter: A debtor must file for bankruptcy if it is behind in its debt payments for more than 90 days. If the debtor does not file, the managers are personally liable for any losses incurred from the delay. The law exemplifies how the state was forcing managers to take some responsibility for the losses and profits of their firms.

Furthermore, the state attempted to curb the paternalistic behavior of many managers. As prices were increasing throughout the 1980s, and with the rapid increase in inflation from 1988 onwards, a paternalistic manager would prefer to give workers wage increases rather than witness the deteriorating living standards of his workers. After initial liberalization of wages in 1990, the excess wage tax was introduced in 1991 whereby a growth in wages between 18% and 28% would trigger an additional profit tax on the portion of increase over 18%. If the increase was over 28%, the entire increase in wages would be taxed as additional profit. Hence, managers could not soak up profits or create or exacerbate losses through wage increases. "Excessive" wage increases would force the firm into a tax position as if it had "excessive" profits regardless of its profit level. However, companies with more than 20% foreign ownership were not subject to the restraints on wages, allowing them to attract more skilled labor.

The excess wage tax may have curtailed paternalistic behavior, but it also was a constraint on managers acting as capitalists in the sense that they did not have full decision-making power over the wage bill of their enterprises. But capitalist countries have also made attempts to control rising wages in order to control the inflation rate, so on balance, the effect of the excess wage tax might be considered more as a re-conditioning of managers to think more like capitalists than a control on their decision-making power.

One further effort to curb paternalistic management was "down-sizing". As the privatization process was set in motion, the only real effort at restructuring state-owned enterprises was to force managers to layoff workers. This action, one of the most brutal under capitalism, played the role of a sorting process. Managers who would not comply could be eliminated, thereby strengthening the hard edge of the managerial class. Managers were replaced by their deputies or with political appointments. This was the exact process which happened to one manager that I had interviewed.[41] He was the head of a firm which for years had been the third most profitable firm in Hungary. He became severely distressed after being told to layoff a significant number of workers which resulted in a heart attack. He was replaced by his deputy manager. "The enterprise was a family," he stated. Stories of downsizing were common. For example, Videoton, a large electronics firm employing over 10,000 workers had

[41] Interview with Istvan Trembeczki, September 2, 1996.

thousands of layoffs. Between bankruptcies and downsizing, unemployment in Hungary skyrocketed to 9.3% by 1992.

"Slimming down" the workforce also disciplined workers. Having a job was no longer a right although, until 1995, it was still guaranteed in the constitution. Managers, and the state, could expect rising productivity from a smaller and less secure work force.

D. The privatization process

Budget constraints were further hardened by the privatization process. If firms were privately owned, they would have to behave as profit-maximizers or they would go bankrupt and have very little leverage in lobbying for a state bailout. Privatization was a key process for forcing managers to switch to capitalist production, but it also created a capitalist class. Whereas privatization in countries such as the former Czechoslovakia proceeded on the principle that every citizen could take part and become a partial "owner", Hungarian privatization proceeded along significantly different lines. The underlying principles were to inject fresh capital flows into firms, raise revenues for the state and liquidate the "losers". It is as a result of these underlying principles that two developments were likely to, and did, occur: foreign ownership became prevalent and attained a profound weight in the Hungarian economy and policy-making process; and, out of Hungarian nationals, the managerial class was in the best position to benefit from privatization while becoming part of the emerging capitalist class. Hence, the privatization process, within the space of several years, created a capitalist class that was part of the transnational capitalist class.

The privatization process really began back in 1988 with the Corporation Act and in 1989 with the Transformation Law. The Corporation Act enabled enterprises to transform themselves into joint-stock holding firms. Act VI established enterprises ability to take on private persons as co-owners but did not set down regulations regarding the transformation. The Transformation Law established conditions of the transformation leaving 80% of shares to the state property administration as owner although a state property administration did not exist at that time. These two laws, on top of the pre-existing legislation that gave managers more decision-making power, enabled managers to engage in a process in which they could take advantage of the changes happening around them. Many state-owned enterprises were transformed into joint-stock companies which bear a closer resemblance to the legal structure of private firms in capitalist countries. This is what is commonly referred to as "spontaneous" privatization, but it did not mean privatization as in the transfer of assets from the public sector to the private sector.[42] Instead, it meant that state-owned enterprises were commercialized in the sense that the new owners became banks, enterprises and holding companies. In some cases, firms were broken down into smaller units. The management of the state-owned enterprises themselves

[42] See Voska (1993) for a more detailed discussion of spontaneous privatization.

initiated the transformations. In this sense, it was a bottom-up process and was not state-led other than the provision of the law enabling the transformation. The debts of state-owned enterprises could be dealt with in this way: the firm would be transformed into joint-stock holding and part of the ownership would go to a bank or other enterprises in debt-equity swaps.

Debt-equity swaps did not constitute privatization in that ownership was still concentrated in state-owned institutions. However, it did lead to privatization, meaning the transfer of assets from the public sector to the private sector. But debt-equity swaps also indicated that management had and exercised the right to dispose of the property of the firm. This can be demonstrated in the Tungsram privatization story.

Tungsram is a famous lightbulb producer which had a large market share not only in CMEA countries but also in Western Europe, making it the largest lightbulb manufacturer in Europe. Tungsram was also heavily in debt, mostly to the Magyar Hitel Bank (Hungarian Credit Bank), which agreed to take a major equity stake in place of the debt in 1989. However, the bank did not want to hold on to its equity share and sold almost half of Tungsram equity by April to an Austrian consortium for $110 million. In November, just over six months later, the Austrian consortium sold its share of Tungsram to General Electric (GE) for $150 million. GE was able to acquire additional shares from the Hungarian Credit Bank giving it 50% plus one share interest in the company. This was bottom up in the sense that there was no government agency or state ministry regulating the sale of the controlling interest in a highly regarded firm to foreigners - it was the management of the firm and bank that had brought about the sale. What became publicly controversial was that an Austrian consortium, which did not invest any money into the enterprise other than that needed to sell it to GE, had netted $40 million.

There are other examples of how spontaneous privatization could have or did lead to privatization. For example, Graboplast, a manufacturer, had one-third of its equity sold by a broker to Western investors in 1989. The management of the Hungarhotel chain negotiated a sale of a majority share to a Western consortium (the sale was politically foiled by the Supreme Court after a public outcry). The ability of state-owned enterprises to commercialize themselves enabled the management to divide assets and debts into different holding companies and to begin arranging for the sale of assets. This placed management in a peculiar vantage point. Although the state legally owned the property, the management had the firm-specific knowledge and the ability to use modernizing legislation and a changing environment to its advantage. Moreover, proceeds of sales did not go to the state but to the enterprise. It became clear that the Corporation and Transformation Laws enabled managers not only to sell ownership to foreigners but to strip assets from state-owned enterprises, reorganize debt into holding companies, and emerge from the process as owners of assets.[43] While the attempt to control the process by the state was an effort to deal with controversy, as we will see, "spontaneous" privatization continued.

The State Property Agency (SPA), established in 1990, attempted to exert a more state-centered control over the processes taking place. Initially, it was headed by Istvan Tompe, who was appointed before the Magyar Democrat Forum (MDF)-led coalition had come to power after the first post-communist elections.[44] Because of public outcry and controversy surrounding privatization and also due to the fact that he was not a coalition appointee, Tompe was replaced by Lajos Csepi in mid-1990. Csepi (1993) had described the process of privatization up to the time of the MDF government as being initiated by the buyer or management of the firm. And often the two sets of people were the same or had connections to one another. The appointment of Csepi was meant to reassert state control over the privatization process. While it might be said that Csepi was to slow down the process by declaring less ambitious aims than Tompe, the goals of the latter, to sell 80% of state property within a few years, were unrealistic.

Csepi's appointment was followed a few months later by the First Privatization Program, announced in September 1990. According to the

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[43] This was often explained in the many conversations I had with other economists.

[44] Top positions in the State Property Agency and the State Holding Company are political appointments made by the government of the day.

government document "Property and Privatization", this program aimed to sell 20 to 30 state-owned enterprises using international consulting agencies to receive and examine bids and select buyers for each of the firms. The government discussed other methods of privatization such as open bidding and using the stock exchange, but the most ambitious claim of the government was its intention to sell 500-600 large state enterprises by 1993. The government intended privatization as a means of injecting fresh capital into firms as well as creating revenues to decrease state debt. The firms made available in the First Privatization Program were selected for their suitability for privatization - as declared by government experts - and good recent performance. Such qualities would make them more attractive to potential buyers. However, the new centralized program, like others to follow, was viewed as a failure because only four of the twenty firms slated for sale in 1990 had completed privatizations by the end of 1991.

Moreover, the firms of the First Privatization Program were a sub-set of the "crown jewels" and enabled the public belief that foreigners would be allowed to "cherry pick".

The Second Privatization Program in 1991 included a significantly different set of firms than that of the first. The significance of the program was that its existence indicated how much asset stripping had taken place during early privatization. The program included the shells of firms which were left in the hands of the SPA. During the time of spontaneous privatization, assets were stripped from enterprises and used as non-cash contributions to joint ventures. The remaining assets were left in shell enterprises which remained property of the SPA. The SPA, for its part, wanted to shed the enterprises before the remaining assets deteriorated any further. What became obvious during the program was that during the era of spontaneous privatization, managers had been able to loot enterprises of valuable assets and leave the state holding poor assets and debt. These shell holding companies, predictably, were not desirable to buyers.

The program was far more than a means of privatization. It was a tool to find out what had happened during spontaneous privatization. One of the aims of the program was to trace and define the status of state property. The SPA made it clear in its discussion documents that it, the state's agent, would take control of privatizing firms; managers need not co-operate with the process.

Even though the Second Privatization Program was more investigatory, it moved more slowly than planned. The SPA became caught up in day to day privatizations and, to some extent, the major programs fell by the wayside. The third and fourth programs, announced in April 1991, were targeted at individual industries, particularly construction and wine. These programs also proceeded slowly, suffering the same fate as the Second Program.

Also in April 1991, the privatization of small retail shops and restaurants began. This was the first major program to fit into the changing course of privatization. It was aimed solely at Hungarians; foreigners were not permitted to compete in the bidding for the small shops. The program at some level represents continuity in earlier Hungarian reforms in that the small retail and restaurant business already had a strong private component. The program, instead of just leasing the businesses, actually sold the real estate and capital equipment, and might have created a petty-bourgeoisie whose interests would lay in maintaining the trajectory of capitalist development. The program, however, only managed to sell 1,734 out of a total of 10,240 enterprises by mid-1992. The asking prices were generally too high for the average income and savings of the population, and many of the shops were involved in long-term leases, or the state had unclear property rights. Thus, the actual number of shops available was much smaller, and over time, the asking prices had to be lowered.

Spontaneous privatization not only continued during the early period of privatization, but was encouraged by the SPA. Aside from the continued asset-stripping of firms, the SPA initiated the Self-Privatization Program in July 1991. Under the first phase of the program, firms with less than 300 million HUF in sales, less than 300 million HUF in assets and fewer than 300 employees could be included. These companies, once transformed into share-holding companies, could choose an advisor from the SPA-approved list. The firms and their advisors would work out a privatization plan and the SPA would automatically approve it provided the price was not lower than 80% of the audited value. The program was later expanded in March 1992 when the maximums were lifted to 1,000 employees and 1 billion HUF in sales and assets.

There are two important points to note about the above privatization program. According to the Director of Portfolio Management of the SPA[45], many of the firms were not viable and so few were actually privatized. Secondly, he also claimed that "a type of corruption" existed because the management of the firms advised the advisors. This corruption was not unique to the Self-Privatization Program. The privatization process was rife with conflicts, as the consulting agencies were often advising the management of the enterprise for sale, the potential buyers, and the SPA simultaneously.

The other question regarding firm-initiated privatization is why these privatizations were promoted in the face of attempting to control and centralize the process. The apparent contradiction exposes the two different facets of the ruling elite. One section of the ruling elite retained the notion of a strong state and resented the communist nomenklatura for benefiting from the transition process. Another grouping represented those who directly benefited from a de-centralized process and those who passionately believed that it did not matter who became the owner as long as the action results in privatization.

With the decline in popular support for the government, the privatization process shifted course in 1992 towards promoting *small* Hungarian investors, the "average person". During the first two years of the coalition government, support for the lead party, the MDF, fell dramatically from the 43%

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[45] Interview with Peter Kazar, Director of Portfolio Management, State Property Agency, October 6, 1994.

the party garnered during the 1990 elections to 8% in 1992 (according to poll data). There were two perceptions regarding privatization that led to the MDF's poor polling results: one, foreigners were perceived as "cherry picking", and two Hungarians who held powerful positions were perceived as having the ability to convert political power to economic power.

Both of these perceptions were based in some fact. In 1991, approximately 90% of privatization revenues came from foreign buyers; in 1992, the figure was 80%; and 80% of all privatization deals through the end of 1992 had involved foreign capital. While the structure of privatization and the people controlling it wanted to attract large foreign revenues, foreigners were buying prized enterprises and laying off workers. Even the Director of the Economics Department at the SPA referred to 1991 as "the year of the cherry picking" and said that foreigners had bought all of the good state-owned enterprises.[46]

The second perception, that the communist elite benefited the most from the transition process, was also supportable. Even though there was no official program for management buy-outs (MBOs), they happened on a regular basis. Officials at the SPA acknowledged this to be the case.[47] Management buy-outs were considered perfectly acceptable by the State Property Agency. The only

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[46] Interview with Maria Vanicsek, Director of the Economics Department, State Property Agency, September 3, 1996

[47] For example, my interviews with Agnes Kis Fodor, lawyer dealing with ESOPs, State Property Agency, October 20, 1993, Vanicsek and Kazar.

concern seemed to be that Hungarian managers could not necessarily raise money for needed capital injections.

Much of the controversy was inevitable given the conflicting viewpoints of different groups about the privatization process. This is reflected in the objectives of privatization, which had inherent tensions. The 1990 and 1991 government documents declared that the intentions of the privatization process were to: decrease the state debt and budget deficit; reduce state ownership to no more than 50% by 1994; increase foreign ownership to 25%; sell state assets at market prices; decentralize the process by decreasing the number of decision-making hoops; and make the process transparent. A major principle of Hungarian privatization - earning revenues for the state - was at odds with attempting to divest the state of so much property so quickly because of the problem of setting and achieving an accurate price for property. Also, the guidelines regarding de-centralizing the process were at odds with the attempts to make the process transparent and to achieve fair prices. In addition to conflicting objectives, it is generally agreed that the SPA, at least in the first few years of its existence, was understaffed and unable to keep tabs on what was going on around it, especially since accounting procedures, though modified in

1991, had exacerbated the problem of asymmetrical information between managers of enterprises and the SPA.[48]

In mid-1992, parliament approved a new plan for privatization. Like previous plans, it included a strategy to accelerate privatization. It also aimed to increase foreign interest by instructing that a full survey of state property appropriate for privatization be carried out. The plan differed from its predecessors by specifically declaring that domestic participation should be increased. In that light, Act XLIV, the Act on the Employee Share Ownership Program (ESOP), was passed in 1992 and was further liberalized in 1993.[49] Under this privatization technique, workers could buy out the firm by forming an ESOP organization. The purchase was financed through Existence credits which was another domestic investor support scheme financed by the state. Workers would not have to begin repaying the debt for three years after the purchase and then would have 15 years to repay. Along with the extension of repayment time to 15 years, the interest rate had been lowered to 7% as a way of making the program more attractive. At least 25% of the enterprise's workers had to be willing to participate in the buyout scheme and 40% of the workforce had to give its approval for the buyout to take place.

[48] These types of problems were mentioned by many of the State Property Agency officials that I interviewed. Including the ones mentioned above, also my interview with Katalin Marjanek on July 3, 1996 brought out these issues.

[49] Janos Lukacs from the State Property Agency had visited the United States and studied ESOPs. He was the prime advocate for ESOPs and ESOP legislation in Hungary.

Workers had to provide part of the financing through their own resources. For example, if the purchase price per participating worker was 0 to 5 million HUF, workers in the ESOP organization had to provide 2% of the total purchase amount. For higher prices, a larger percentage was required. The motivation behind this was twofold. It was accepted by politicians and SPA officials that workers should commit proportionately larger amounts of their own resources for larger absolute amounts of state financing. But perhaps more importantly that a financing philosophy was that SPA officials believed that ESOPs were only appropriate for small, professional firms, not large industrial enterprises. Workers did express interest in forming ESOPs in large industrial enterprises that the SPA did not view as financially viable since it was a means of preserving jobs and halting a potentially inevitable bankruptcy. The larger financial commitment that workers would have to make served to discourage the types of ESOPs that the SPA did not want.[50]

The SPA did view ESOPs as appropriate for small, professional firms such as the Antiquvarium bookstores or Mogurt (an import-export firm) which had professional staff and reliable positions in the market. But ESOP was also a tool of the management. Most ESOPs were combined with management buy-outs. If workers could be convinced that an ESOP was a reasonable risk, the management could raise additional capital and thus garner a larger controlling

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[50] Interview with Fodor.

percentage in the enterprise under its control even if to some extent decisions would then be subject to approval of the workers. Under ESOPs, managers tended to hold a proportionately larger share of ownership than workers because they had more possibilities in purchasing arrangements. Hence, ESOPs have been an effective tool for top managers to obtain effective control, since workers of an ESOP firm are less likely to closely scrutinize top managers' actions than are large outside shareholders.

ESOP schemes did not necessarily imply that ownership remained in domestic hands in the short- or long-term. Some ESOPs were combined with foreign ownership, and other ESOPs searched for foreign investors since MBOs and ESOPs did not require capital injections.

Partly because ESOPs were not encouraged and workers had limited personal resources to buy shares, only a few hundred firms were privatized under this scheme. Most of the firms were small. Also, an ESOP does not mean that the workers own the entire firm. As mentioned above ESOPs were often combined with other forms of privatization such as MBOs and foreign purchase, but also municipal governments, the SPA and others continued to hold shares in the enterprise.

Another program was the Small Investors' Share-Purchase scheme (SISP), which was launched in autumn 1993. Under the SISP program, Hungarian citizens could buy vouchers for a nominal administration fee, but unlike other voucher schemes in Eastern Europe, the entire face value of the vouchers would have to be repaid. These vouchers would have been used to purchase shares in firms specially earmarked for the program. Privatization minister Tamas Szabo proposed the voucher-type scheme to increase domestic participation and build a new voter constituency. The initial popularity of Vaclav Klaus' government in Czechoslovakia was partly attributed to the success of coupon privatization and the same result was hoped for by the HDF.

However, the program did not necessarily enjoy the support of the SPA bureaucracy. By the time the program was initiated, the Director of Portfolio Management claimed that the program was economically unsound because he could not put together any portfolios of enterprises that were viable to sell through such a scheme, and it was politically dangerous to sell poorly performing firms.[51] Mihaly Kupa, the Minister of Finance who was politically an independent, also objected to the voucher scheme and was fired.[52] The program never got off the ground. After the election of the Hungarian Socialist Party-led coalition in 1994, the program was scrapped completely as being unworkable and impractical.

The Socialist government also made other changes. The State Holding Company, established in 1993 to manage firms that would remain in state hands, was combined with the State Property Agency to create a new agency, the State

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[51] Interview with Kazar.

[52] Ministers of Finance have been regularly ousted as scape-goats during the difficult economic times of the transition period.

Privatization and Holding Company (SPHC). After the election of 1994, privatization became even more foreigner-friendly. The new streamlined agency offered for sale the utilities that were much sought after by foreign capital. By 1995, the Deutsche Telekom-Ameritech corsortium had aquired a majority stake in the Hungarian Telecommunications Company (MATAV), and most electric utilities were sold. In early 1996, the German consortium of Ruhrgas/VEW acquired a majority stake in the regional gas supplier DDGAZ. By 1997, Ruhrgaz/VEW had a 93% share of DDGAZ. This represented the last sale of the five regional gas suppliers, all of which are majority foreign-controlled. Foreign investors also acquired shares in Mol Rt., the Hungarian Gas and Oil Company, which is the largest company according to annual sales turnover. By 1997, a majority of Budapest Power was sold to a Finnish-Japanese consortium, and a 25% share of Budapest Water was sold to a French-German consortium.[53] A 78.7% share of Ferroglobus, Hungary's largest iron and steel trading firm, was sold to a German firm.

While sales of the remaining utility firms continued at a fast pace, small firm privatization continued in the form of "simplified" privatization. Like self-privatization, simplified privatization applied to firms with less than 500 employees and less than $4 million in equity. By the end of 1995, 37 companies

[53] Although the state retained 57% ownership (according to registered capital) in the electricity, gas steam, and water supply industry, the foreign-controlled share rose from 5% in 1995 to 24% by 1997. See Tables 4.10 and 4.11.

were sold through simplified privatization for approximately $20 million, but the average purchase price was barely half the nominal value.

The state also used liquidations as another way of divesting its assets. In 1995, over $10 million in revenues was raised through liquidations and winding-up of firms, which was more than all other years combined (1990 through 1994). This strategy continued as a way of raising revenues and shedding firms from the privatization agency.

Privatization revenues raised from 1990 to 1995 exceeded HUF 1 trillion although the remaining property that can be privatized had a book value of over HUF 600 billion. Over 40% of foreign investment made in the Central European countries has been in Hungary and three-quarters of that was for privatized state assets. By the end of 1995, 70% of the economy could be considered in private hands depending upon how firms with partial state ownership are accounted for.

Two main conclusions can be drawn from the privatization process. Firstly, managers were in the best position to reap the benefits of privatization. Many had existing connections with foreign firms which could be used to set up joint ventures with assets. Also, they had information about the firm that no one else could possess without their co-operation. Even though the state had attempted to control the privatization process, it was an impossible task. The SPA was understaffed, at least for much of its existence, and had gone through key changes in personnel and was attempting to deal with a large number of enterprises and consulting agencies. Additionally, privatization programs that were designed to enable the average Hungarian met with little success. The only program of its kind to meet with small-scale success, the ESOP program, was usually combined with MBOs. The absence of real programs to distribute state property among the working classes demonstrates the ability of the elite to disproportionately benefit from the process.

Secondly, foreign firms, with their access to capital, were effectively able to purchase the best firms. While the government preferred to gain revenues from the privatization process in order to cope with Hungary's large debt burden, it is impossible to know what the intentions are of a foreign firm in a privatization deal. As the Director of Portfolio Management said, "You can't know whether the potential buyer is buying the market or selling the buildings or is really a strategic buyer...There is no explicit objective to promote competition".[54] While a foreign firm has the ability to inject capital, the short- and long-term strategies of the foreign firm are unclear and the privatization process cannot make any guarantees that these are the wisest sales in the long run..

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[54] Interview with Kazar.

E. The origins of the capitalist class revisited

While it can be established through an examination of survey data that persons in positions of power maintained their elite status by-and-large, what has to be further explained is the so-called "revolution of the deputies". By 1993, a large percentage of the old nomenklatura, 32.8%, was retired; but an even greater amount of the old nomenklatura *economic* elite, 47.6% were retired. As Table 4.3 demonstrates, many of the new economic elite came not from the top managers but from others lower down the ladder. Deputy managers would have, for the most part, become the top managers if state socialism continued. However, we can safely say that the high rate of turnover between top managers and deputies was not due to age composition. As Szelenyi and Szelenyi (1995, p. 626) point out, one-quarter of the nomenklatura that was retired by 1993 were less than 60 years old. This means that a significant percentage of nomenklatura - the highest echelon of society - were retiring much younger than usual.[55]

There are two factors that explain this move to retirement. Generally speaking, massive changes were very stressful, and so, many retired in order to avoid the trauma of actively participating in the transition process. However, many of these persons were also known to take other positions such as consulting, so although officially retired, they were still able to maintain materially beneficial positions. One manager I interviewed even came out of

[55] In fact, a full 80% who were retired were under 70 years of age.

retirement in 1994 when his firm was privatized through an ESOP and MBO and he was asked to join the board of directors.[56] He is still officially retired and his new position requires very little of his time, only having to attend a meeting once or twice a month, but nevertheless, he is an example of those who voluntarily opted out of the transition process.

On the other hand, when the HDF-led coalition government came to power, many managers were forced out. As one former managing-director of a large profitable company told me, the deputy managers were willing to politically back the HDF government. Top managers would not necessarily back the government nor support the policies of the new government.[57] They, being experienced and having international connections, had other ideas of what should happen. He was a typical example of this experience. Having been instructed to lay off a significant portion of his workforce and fundamentally disagreeing with laying off what were to him family members, he experienced increased stress which led to a heart attack. He is now managing director of a subsidiary of his former firm, and the deputy has become managing director of the original firm.

To sum up the privatization process, the creation of a domestic elite happened in two directions. Early decentralization along with the Company

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[56] Rudolf Fekete, former General Director of MMG Automatika Muvek, June 30, 1994.

[57] Interview with Trembeczki. Also Fekete had this point.

Law (1988) and the Transformation Law (1989) gave managers power to re-arrange the assets of state-owned enterprises, in many cases, to their own personal advantage. That this happened is so evident that even the State Property Agency attempted to investigate it through its second privatization program. Secondly, the HDF government had more easily co-opted the deputy managers. This may have also been because of HDF's anticommunist stance and distrust of the top management, but nevertheless, some managers were forced to leave or voluntarily retired during this phase of transition, accounting for the early succession of many deputy managers. Certainly it appears that ideology impacted people differently at the individual level. Deputies were often more pro-capitalist in outlook.

F. Capitalists arising from non-privatization processes

One main process of capitalist class formation in Hungary is privatization as discussed above. This might not be true if there was bottom-up capitalist development, in other words, if there were entrepreneurs possessing or acquiring financial capital who would generate accumulation through new start-ups. But this has not been the case other than some notable exceptions of 1980s entrepreneurs and these entrepreneurs were in retail and trade, not manufacturing.[58] As Trautmann's research (1993) showed, most new start-ups

[58] Interview with Geza Szilagyi, Organization of Small and Medium-sized Enterprises, August 7, 1996.

during the 1990s were primarily in the retail and service sector and only a very small percentage were in the industrial sector. The reasons for this appear to be the lack of access to capital and the short time in which the skills for operating a small retail business can be acquired. Additionally, the rapid implementation of trade liberalization policies and the accompanying flood of imported goods made it difficult for small start-ups to compete with large firms that were already well established and had easier access to cheaper credit and a range of skills in marketing. This does not mean that it is impossible for strong capitalist concerns to develop in the future, but it is unlikely. At any rate, few future capitalists will develop through start-ups.

As is generally the case with small retail and other service businesses, the start-ups that do exist will not be likely to engage in large-scale accumulation. The owners of small service businesses constitute a petty bourgeoisie that may be important for supporting capitalist development, but the leap to becoming capitalists is a large one. As in many Western countries, small services are increasingly competed out of business by large chains. The retail stores of Julius Meinl (Austria) and the introduction of Tesco (UK) superstores along with other service businesses such as MacDonald's (US) and Marks and Spencer's (UK) have effectively taken over the retail and service sector. These heavyweight chains are able to achieve wholesale prices that small firms cannot, and they have the power of international marketing expertise backed up by the necessary finance. The early 1990s witnessed the near death of the *kisvendeglo* in Hungary. This type of restaurant is small and open primarily for lunch; fast-food chains have competed them almost out of the market. Also, many boutiques that were start-ups closed down in a short time. The streets are now filled with large chains.

With respect to industry, small- and medium-sized enterprises suffer due to competition with large monopolistic firms and a lack of supportive government policies. Most of these enterprises were suppliers for large enterprises that engaged in CMEA trade and after the CMEA was eliminated, these small enterprises suffered. Also, many small and medium-sized enterprises were tied to agricultural sector which suffered tremendously during the 1990s. The best visual indicator is the state of the office of the Association of Small- and Medium-sized Enterprises. It is small and dingy and the president of the organization speaks of future prospects in dismal tones.[59]

Globally, it is increasingly difficult for entrepreneurs to compete with large transnational companies and in Hungary, the prospects appear even less hopeful. As New Class theory predicts, the capitalist class has become the top managers of large firms with a monopolistic advantage. The chances of a Hungarian entrepreneur rising to the competition, especially in the context of a rapidly developed capitalist economy, are slim.

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[59] Interview with Szilagyi.

G. Conclusions

The development of the capitalist class in Hungary is perhaps more interesting than the development of other classes. The wage-labor class simply arose from what resembled a wage-labor class under socialism. Skilled and unskilled labor became subject to the rules of the market. No longer guaranteed employment, the average Hungarian became subject to lay-offs and more casualized forms of employment. A land-owning class never emerged.

The emergence of a capitalist class in Hungary, however, is much more complicated. Legislation in the 1980s gave management greater independence over their firms. Many managers, especially deputy managers, were no longer swayed by socialist or communist ideology. The decreasing importance of Party ideology and the lack of state control over the means of production meant that many pursued actions which enhanced their own material welfare, or at least control over their managerial status. Others, because they believed in alternative development paths, or did not want to cope with the stresses of massive change, chose to opt out in the sense that they retired or continued to fight against the current of change. The transition of Hungarian managers to manager-capitalists was accompanied by a large influx of foreign capital and, with it, the development of the transnational capitalist class.

It is the transnational capitalist class that is a key player in the class struggles over transition. In the competition of alternative development strategies happening during transition, it is their strategy, the liberal-

G. Conclusions

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It is the transnational capitalist class that is a key player in the class struggles over transition. In the competition of alternative development strategies happening during transition, it is their strategy, the liberal-integrationist, which became dominant. The next chapter defines the liberal-integrationist strategy and tells the story of how it became dominant over other strategies.

CHAPTER V

THE EVOLUTION OF A STRATEGY OF ACCUMULATION

A. Introduction

The thesis argued in this chapter is that a *neoliberal-integrationist* strategy of accumulation evolved during the 1990s in Hungary, and more importantly, it tells the story of *how* this came to be the case. By neoliberalism, I mean the economic theory and practice that has been dominant in many Western countries as well as developing countries in recent decades. The basic tenet of neoliberalism is that market forces are superior to any other form of decision-making mechanism in determining what and how much to produce, how to produce it, and for whom to produce. In other words, the market mechanism should freed of state intervention, and the "invisible hand" should be left to determine the production and distribution of material goods in society. The word "integrationist" is also a central component of the accumulation strategy. By this I mean that there is an attempt to divorce Hungary from Eastern Europe and the former Soviet Union, and integrate it with the West.

Neoliberalism has become the dominant ideology informing economic development. With the crisis of the 1970s, Keynesian inteventionism gradually lost its position as the orthodox economic theory and practice. The period of time in which this orthodoxy ruled, and even US Republicans such as former

President Nixon could claim that 'we are all Keynesians now', disintegrated with the rise of neoliberalism, which replaced it as the new orthodoxy. The rise of neoliberalism was initially most visible in the US under the Reagan administration and in the UK under the Thatcher governments. But over the course of the 1980s and 1990s, neoliberal policies had spread their way across most of the world. In developing countries, neoliberal economics informed the IMF structural adjustment policies that were pushed on countries with debt crises. Even in social-democratic Western countries such as Germany, neoliberalism gained ground in the 1990s.

For neoliberals, the role of the state should be confined mainly to the protection of property rights from both internal and external threats. This is normally believed to be fulfilled by providing a legal and judicial system as well as a method of enforcement (e.g. police force), and a national defense. Neoliberals believe that state intervention creates distortions in the market that lead to inefficiency and waste.

In order to achieve a free market utopia, neoliberals usually have a number of common policy recommendations which include privatization, deregulation, creation of the proper incentive structures, and maintaining a stable environment in which business can succeed. Privatization is called for because production and services delivered by state owned enterprises are not as efficient as that by the private sector. It will lead to improved quality and lower prices with fewer inputs. The state should also carry out deregulation in any sector that is suffering from the hindrances that prevent competitive firms from offering better products and services at lower prices.

In order to create a competitive environment, the state must change any existing policies that produce negative incentives. For example, social programs create negative incentives because they encourage laziness and dependence on the state whereas people should support themselves through participation in competitive labor markets which will reward their skills and hard work. High taxes are unsound because they create a disincentive for people to work and reduce profits for business which discourages investment. In the same vein, subsidies to business should be eliminated because they create dependency in firms (likewise for agriculture) and distort market forces leading to over-production.

Maintaining a healthy economic environment that encourages investment requires restrictive monetary policy to keep inflation low. Along with this, the state must prevent interventions in the free market. For example, strong unions reduce flexibility in labor markets and increase the wage rate to above the equilibrium rate, thus causing unemployment. The state has a duty to restrict this type of interference in labor markets.

So-called "market failures" can usually be solved by the market, according to neoliberals. For example, excessive pollution is caused by ill-defined property rights. Again, property rights can be allocated and then the owner, who is interested in the long-run productivity of his property, will ensure that pollution is minimized. Alternatively, pollution vouchers can be allocated to firms by the state. These vouchers can be traded on free markets internalizing part of the costs to heavy polluters.

With respect to economic relations between countries, neoliberals advocate free trade by eliminating protectionism and other trade barriers. However, the state should make investing in the country look as attractive as possible by ensuring low taxes, a deregulated market, low inflation, competitive wages and political stability. Investment might also be attracted to the country by the building of infrastructure. Although this could also be left to the free market, at the bare minimum, if the state does fund infrastructure, it should contract out the construction and then possibly privatize the maintenance and collection of revenues.

In practice, a country embarking on a neoliberal path generally takes the following measures: it devalues its currency to make exports more competitive in the global market; it cuts social programs and price subsidies; it deregulates and privatizes state businesses and services; it eliminates trade barriers, protectionism and subsidies to production; it opens borders to industrial and financial investment (e.g. eliminate capital controls); and it prevents unionism or at least minimizes its interference in labor markets. In short, neoliberal policies for transitional countries can be summed up by the three-prong strategy of privatization (which is sometimes referred to as "institution building"), liberalization and stabilization.

Ironically, a common neoliberal recommendation is for the state to provide tax relief or special duty-free import and export zones to foreign investment. This can even include building infrastructure at state expense. In effect, these types of policies are subsidies to transnational capital and give advantages in the market place to foreign capital over domestic capital. But for the neoliberal, these are simply policies that reduce state disincentives for investment, especially for transnational capital which has the entire world in which it could invest. It has more financial capital and technology than domestic capital and therefore may need extra inducements to be attracted to a particular country. Perhaps more to the point, these types of inducements are necessary if the country in question is to be competitive with other countries engaging in the same strategies.

Neoliberalism provides a basis for integration with the global capitalist economy because of policies around promoting free trade and attracting foreign direct investment. In the case of Hungary, however, integration has gone a step further; it is an attempt to "join the club" meaning the Western hegemonic political, economic, and military structure even if it is at the cost of a dependency relationship.

This chapter tells the story of how the neoliberal-integrationist accumulation strategy evolved and came to be dominant over other possible strategies. In doing so, it explores in greater detail the meaning of neoliberal-integrationism in Hungary. The story is told firstly by mapping out the key actors: the Hungarian state; capital; labor; smallholders; and other players. The transformation process is then examined as it evolved through conflict and compromise amongst the key actors.

One actor in particular, transnational capital, became hegemonic in the processes which unfolded and was able to impose its agenda. Transnational capital is primarily foreign capital taking the form of multinational enterprises and includes the portion of domestic capital that has become co-opted. As discussed in the last two chapters, the reforms of the 1980s unleashed market forces and led to the entry of transnational capital into the economy. Key actors, member of the political and economic elite, pushed for the development of a pro-capitalist transformation. Actors engaged in this struggle because of the pull of capitalist ideologies and the potential for capitalist wealth. In some cases, this took the form of personal gain, wanting to play the role of the owner of capital in the circuit of capital, but in other cases, actors genuinely believed that capitalism offered a better chance at long-term prosperity. Or at the very least, they believed that state socialism was no longer tenable.

Regardless of how the growth of capitalist ideologies affected individual actors, the net result was liberalization and privatization. These processes led to the gradual growth of transnational control over the economy. In particular, the transactions-based approach to privatization favored foreign capital over other ownership possibilities. It was clearly the goal of the state in the form of governments and state agencies that foreign capital was encouraged and favored. Moreover, the expansion and speeding up of the privatization process in 1994-95, demonstrated both the existing power of capital and its increase in power as transnational companies took control of finance, energy and telecommunications.

Transnational capital and the Hungarian elite did not achieve the re-shaping of the economy overnight. The Interest Reconciliation Council, a negotiation body composed of representatives from capital, labor and the government exists in order to achieve consensus over various aspects of economic transformation. It potentially could have derailed the harshest of policies and outcomes. The Compensation Act, which awarded restitution to those who had property confiscated after 1939 also promised to redistribute property to people who would have had no other means to acquire wealth. The voucher program of 1994 and the Employee Share Ownership Program (ESOP) both promised to make the average Hungarian into an owner of capital. But these contributions to development were either derailed as soon as they threatened to pose a challenge to the growing neoliberal agenda, or, had only marginal positive outcomes if at all.

B. Actors in conflict and compromise

There are several key actors important to the transformation process. The section below discusses the state, capital, labor and smallholders in Hungary with a view to describing the ways in which class and non-class interests are represented.

1. The state

The state can be thought of as a network of institutions. It is composed of the government and its ministries, the parliament, political parties, various state agencies, the police, the armed forces, public enterprises, the public educational system and other services amongst others. Although it is not necessary to go into the details of all the various institutions that make up the state, it is at least helpful to understand some basic elements of state governance.

At the most obvious level, interests are represented through parliamentary representation whereby all non-institutionalized adults vote once every four years for a constituency representative (who may be a party member or an independent) and a political party. The unicameral proportional representation system implemented in 1990 allows constituency representatives to take seats in parliament if they have won a simple majority over the course of two rounds of voting. The first round determines the top three candidates that received the most votes; the second round determines the winner by a plurality. Candidates receiving an absolute majority in the first round - over 50% of the votes cast in that constituency - automatically win. The vote for political party lists, which only happens in the first round, ensures that all political parties receiving more than 5% of the popular vote will be represented in parliament.[60] The persons who take the party seats are determined according to national and county lists devised by the respective political parties. Although the system of proportional representation in Hungary is complex compared to other countries' systems, it can be said that the formulae determining the number of seats a party will receive is weighted heavily towards the winning party. In other words, the party winning the most seats will receive more seats than proportional to the vote. For example, in the 1994 elections, the Hungarian Socialist Party obtained a majority of seats in the parliament (54%) although their popular support was significantly less having obtained 31% and 45% in the first and second round of constituency voting respectively, and 33% of the party list votes. In contrast, the Alliance of Free Democrats (AFD) obtained 19% and 28% respectively in the first and second round of constituency voting, and almost 20% of the party list votes, but the party ended up with less than 18% of the seats in parliament.

The formation of a government has been a relatively straightforward process in the first three post-communist elections. The largest party can form a government if either it controls an outright majority of parliament, or, coalitions making up majority control can be formed. A minority government is a possibility, but like any proportional representation system, it would be very difficult for that government to carry out its mandate.

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[60] In the 1990 elections, only a 4% threshhold was required by parties to be represented in parliament. This was later raised under the first government to 5%.

The first post-communist elections resulted in the formation of a conservative nationalist coalition of three political parties, the Hungarian Democratic Forum (HDF) which was the lead party, the Independent Smallholders (ISP), and the Christian Democrats (CDPP). The governing coalition had just under 60% of the seats and so did not have a two-thirds majority. This in contrast to the second government which consisted of the Hungarian Socialist Party as the lead party and the Alliance of Free Democrats as a junior partner. The liberal-socialist coalition ruled from 1994-1998 and controlled 72% of the seats. In 1998, the Alliance of Young Democrats-Hungarian Civic Party[61] (from her onwards, AYD) came to power as the leading party of a new conservative nationalist coalition which also contained the HDF and the ISP (see Table 5.1 for a summary).

[61] Up until 1995, this party was called the Alliance of Young Democrats (Fidesz). In 1995, it lengthened its name.

Table 5.1: Governing and opposition parties, 1990, 1994, and 1998 national elections.[62]

Term	Governing Parties (number of parliamentary seats)	Opposition Parties (number of parliamentary seats)
1990-94	Hungarian Democratic Forum (164); Independent Smallholders (44); Christian Democratic People's Party (21).	Alliance of Free Democrats (92); Hungarian Socialist Party (33); Alliance of Young Democrats (21); Independents (11).
1994-98	Hungarian Socialist Party (209); Alliance of Free Democrats (69).	Hungarian Democratic Forum (38); Independent Smallholders (26); Christian Democratic People's Party (22); Alliance of Young Democrats-Hungarian Civic Party (20); Independents (2).
1998-2002	Alliance of Young Democrats-Hungarian Civic Party (148); Independent Smallholders (48); Hungarian Democratic Forum (17).	Hungarian Socialist Party (134); Alliance of Free Democrats (24); Hungarian Justice and Life Party (14); Independents (1).

Source: Central Statistical Office (1998, p. 549).

The six parties mentioned above, the Democratic Forum, the Socialists, the Free Democrats, the Christian Democrats, the Smallholders and the Young Democrats, are the only parties to have obtained enough votes for representation

[62] While independents are listed under the opposition for the purposes of the table, it is not necessarily the case. For example, Laszlo Bekes who was an independent MP served as Finance Minister for a period of time under the HDF-led coalition (1990-94).

in the first and second parliaments. All except the Christian Democrats obtained enough of the vote for representation in the third parliament. No other parties have been represented other than by receiving a constituency seat such as the Agrarian Alliance and the Liberal Alliance-Party of Entrepreneurs in 1994, but this does not constitute party representation in any case. In 1998, though, the Hungarian Justice and Life Party (HJLP) managed to win 14 constituency seats and although its popular vote fell under the 4% threshold, it could be considered significant especially when compared with the HDF, once a leading Hungarian political party, which only managed to gain 17 mandates in the 1998 elections.

Elections for parliament are perhaps the widest venue for people to express their preferences in Hungary; however, like all bourgeois democracies, there are extreme limitations to how much the political elite can represent the wide array of interests. Also, once a government has a mandate to rule, there is very little check on that power from its supporters over the course of the four years. It might also be pointed out that many citizens have been alienated from a system that much of the West would have claimed they – along with other Eastern Europeans – desperately wanted. In the 1990 elections, only 65.1% of those entitled to vote visited the polling stations in the first round of elections. In 1994, the number increased to 68.9%, but in 1998, it dropped to 56.3% (Central Statistical Office 1997, p. 551). This means that at least 30% of the electorate, and more than 40% in 1998, could not or did not wish to exercise their right to express a preference between parties. It should also be pointed out that, except for the 1998 elections, the voting for the second round was an even lower percentage.[63]

2. Political parties

Political parties often either claim or act consistently to represent the interests of a particular constituency so it is worthwhile to provide a brief description of each of the major political parties, although this does not mean that a change in governing political parties can generate a change in the strategy of accumulation. That a change in government coincides with the development and continuity of a dominant strategy makes it even more important to understand the political disposition of the major parties. It merely reinforces the general argument that it would be difficult to effect change on the national level, and instead it is necessary to view Hungarian economic development as it forms in the context of the global economy.

Any discussion of what each political party stands for is difficult, especially as the political parties are relatively new having only formed in the late 1980s. Even the Socialist Party which is the successor to the Hungarian Socialist Workers' Party has changed in ways that make it difficult to identify its position on the political spectrum. Nevertheless, I will attempt to provide a

[63] In 1990, 45.5%, in 1994, 55.1% and in 1998, 57% of electors eligible voted in the second round (Central Statistical Office 1997, p. 551).

rough guide for the benefit of understanding the participation of governments in the formation of a strategy of accumulation.

The Hungarian Democratic Forum, leader of the first post-communist coalition government and junior partner in the third, is generally considered to be a nationalist-conservative party. During the party's formation in the late 1980s it had close connections to the Hungarian Socialist Workers' Party (HSWP), particularly to Imre Pozsgay, a member of the Central Committee and a key economic reformer. The close connections between the two parties and the fact that it was founded by a number of populist historians would indicate that the HDF's initial orientation was left of center. However, the HDF soon was to distance itself from the leftist populist image and moved to occupy the center-right. It maintained close links with the successor to the communist party, the HSP, until the referendum on early presidential elections which took place in November 1989; it began distancing itself by recommending to its supporters to boycott the referendum while the HSP recommended to its supporters to vote 'yes'. After the referendum, Jozsef Antall took over the leadership of the party and led the rightward movement of the party. Having old aristocratic ties and politically being much to the right of many members of the party, he took the party into the 1990 elections on a strong anticommunist and nationalist stance. The party had clearly changed into a Christian-nationalist party and used Hungarian nationalist rhetoric and mythology to garner support. Prime Minister from 1990 until 1993, Antall died while in office. His death perhaps made more apparent the many splits within the party as discipline eroded and no strong unifying leader filled the void he left, although clearly there were rifts before his death. The party's support also fell during its term in office as its politicians' inexperience with political life became obvious.

Some members of the HDF displayed their extremist political beliefs and were eventually forced out of the party. Istvan Csurka, who became infamous nationally and in the West for his extreme right-wing views and his anti-semitism, formed a new party called the Hungarian Justice and Life Party. The party had some success in the 1998 elections winning 14 seats. In contrast, a few prominent HDF members including Geza Jeszenszky, former Foreign Minister, 1990-94, broke off and formed a new party because of the HDF's rightward movement. The new party, Hungarian Democratic People's Party, did not gain parliamentary seats in the 1998 elections.

The Christian Democratic People's Party is also a conservative-nationalist party and was a junior partner in the first government. Although the party clearly supports a transition away from the state socialist regime which had existed, their support for a transition *to* capitalism is not clear. Unlike other European Christian Democrats, the Hungarian party represents more "third way" thinking. While the party does not occupy the social-democrat position, it also differs from the conservatism of for example, the German Christian Democrat party. Perhaps it was the party's unclear position that led to its downfall.

At any rate, the Christian-nationalist position has been well occupied in Hungarian politics by not only the HDF who claim to represent the general population's conservative-nationalist interests, but also by the Independent Smallholders who more specifically have reached out to the rural population. While always a weakly supported party, by the 1998 elections it did not manage to surpass the 4% threshold to obtain parliamentary seats either by list or constituency.

Both the Smallholders and Christian Democrats have their roots in pre-state socialist politics. In the 1945 elections, the Smallholders managed to garner 57% of the vote. In 1990, the Independent Smallholders stood on a conservative-nationalist platform but focused heavily on representing peasants' and rural interests by strongly advocating compensation and land re-distribution, and arguing against foreign ownership of land. The Smallholders' position and representation of interests has remained relatively constant into the third post-communist government, and the party's popularity has at times reached 30% or more according to various opinion polls.[64] Perhaps the clearer representation of peasant and rural interests explains the Smallholders' ability to have remained steadfastly a major party.

[64] In 1995, polls sometimes had the Smallholders as the most popular party (for example, see Hungarian Gallup, www.gallup.hu).

The Young Democrats initially were a liberal party interested in social issues such as the environment that concerned many young people in the late 1980s. Members could be no older than 35 years of age, a rule that was intended to support the party's image as young and unblemished by the wrongdoings of the previous regime. The party was not only socially liberal and rabidly anti-communist, perceiving the reconstituted Socialist Party as a natural enemy, but it also preached economic neoliberalism.[65] Many of the party's leadership had traveled and studied in the West and were well educated. The Young Democrats were often thought to represent the young, urban intelligentsia. However, after the 1994 elections, the party began a rightward move negotiating pacts with the HDF, Christian Democrats and Smallholders.

The Alliance of Free Democrats, also a liberal party, were commonly portrayed as the older brothers and sisters of the Young Democrats. The AFD was formed by a number of dissident intellectuals and the membership could be described as urban intellectual. While founding members such as Janos Kis and Mihaly Haraszti were dissidents famous in Hungary and in the West, they were also leftists having their roots in Marxism, Lukacs and the like. The party's

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[65] For example, it was not unheard of to hear a Young Democrat member make admiring comments about Margaret Thatcher.

stance was for political and social liberalism and although divided on economics, it generally came down on the side of neoliberalism.[66]

The Socialists had spent the first four-year term in opposition to the conservative-nationalist government, and spent that time very quietly. Socialist Members of Parliament did very little to attract attention or criticism leaving the real opposition down to the AFD and Young Democrats along with opposition internal to the government.[67] It should also be said that it was rumored that the party actually had 87 different platforms ranging from committed socialists to neoliberals. The party claimed to represent the interests of everyday working class people who had seen their living standards drop under the incompetence of the HDF-led coalition government, and that pragmatic politicians who had experience with governing the country (since they had done it already for decades) would save the country from the ravages of transition. The party had a tremendous victory in the 1994 elections and did so with an unequivocal social democratic platform and a pact with the largest trade union federation. Hence the Socialist Party might also be thought of as the party of the unions.

The formation of political parties and the first three post-communist elections demonstrate that parties are still fluid, but certainly public support is more so. What is most apparent is that in the 1990 elections, the HDF won the

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[66] For example, I have heard AFD members advocate the privatization of health care but know other members who strongly object to such proposals.

[67] The Independent Smallholders claimed to be "an opposition party within the government".

restore the social benefits and programs that had been lost by the population. In other words, the public may be fluid as to what party it supports at a given time, but it is unequivocal in its efforts to vote in a party that will ease the burdens of transition and restore some of the security that had existed under state socialism. The fact that voter turnout fell to just over half the population in the 1998 might indicate the public's disbelief after a decade of transition that it has any say in economic strategies.

3. Labor and trade unions

As of 1998, the labor force participation rate dropped to 67.5% of the work force from 81.5% in 1990. The unemployment rate was 11% in 1998 according to numbers of registered unemployed (Central Statistical Office 1997, p. 71). Although the participation rate is higher for men than women, women have a comparatively high participation rate of 61.3%.

The key method of representing workers' interests is through membership and participation in trade unions. Historically, unions have been weak in Hungary due to the country's late industrialization and precarious existence during industrialization where unions were either illegal or suffered from persecution. Trade unions also did not exist in the agriculture sector. This changed under state socialism when trade unionists participated in the provisional government set up in Debrecen at the end of World War II. Trade persecution. Trade unions also did not exist in the agriculture sector. This changed under state socialism when trade unionists participated in the provisional government set up in Debrecen at the end of World War II. Trade unions became part of the monolithic state socialist regime and, although technically "autonomous", they were not independent of the Party.

During state socialism, membership in trade unions was high - approximately 90-97% of workers belonged to a union.[68] By 1996, the rate of unionization dropped to about half of all workers (Country Commercial Guide: Hungary 1996, Chapter VII, section L). Decreasing membership continued and by 1998, trade unions represented approximately 30% of the workforce (ICFTU, 1998).

The structure of unions is similar to what existed under state socialism. Before transformation, unions were organized by regions and by branches of industry. The industry level unions combined at the national level to form the National Council of Trade Unions (NCTU). Trade unions still exist at industry level and join together to form national associations, but the number of national associations has expanded to seven. The National Confederation of Hungarian Trade Unions (NCHTU) is the largest, although membership declined to 300,000

[68] The Country Commercial Guide: Hungary 1996 states the unionization percentage during state socialism as 90%; the 1984 International Labour Office report on Hungary reports that Hungarian officials gave the ILO representatives figures ranging from 94-97%. Regardless of the exact rate of unionization prior to transformation, there is general consensus that it was extremely high. Whether the high rate of unionization represents a popular belief in unions is a matter of debate. It could be argued that the high rate was because workers felt they had to join a union or would face discrimination.

with the Hungarian Socialist Party as evidenced in pre-election pacts and lobbying efforts.

The first independent trade union established by 1989 was the Democratic League of Independent Trade Unions (DLITU) which has "strong ties to the AFL-CIO" (US Department of Labor 1991-92, p. 5), and had approximately 100,000 members in 1998 (ICFTU 1998). The union is most closely associated with the liberal political party, the Alliance of Free Democrats, although it does not have as strong links as exist between the Socialist Party and the NCHTU. Other national associations include the Autonomous Trade Unions' National Associations (ATUNA), the Confederation of Unions of Professionals (CUP), the National Association of Workers' Councils (NAWC), and the Cooperation Forum of Trade Unions (CFTU).

4. Capital

The dominant mode of production in Hungary is capitalism and estimates have the private sector as accounting for 85% of production. Foreign capital is significant: in 1996, *majority* foreign ownership constituted 27% of registered capital, 32% of gross value added, and 18% of employment in non-financial corporations. In 1997 - only one year later, these figures had risen to 35% of registered capital, 45% of gross value added, and 21% of employment.[69] Foreign capital also owned 60% of the banking sector by 1998 (OECD 1999).

Under state socialism, capitalist enterprises did not exist in any significant numbers; nevertheless, with the increasing level of autonomy experienced by state-owned enterprises, representation did exist for firms' interests as opposed to workers' interests even if these interests are theoretically not in conflict under state socialism. The Hungarian Chamber of Commerce and Industry (HCC) existed in other forms before transformation and had voluntary membership. In January, 1995, it was re-created as a "continental European style" chamber[70] and has mandatory membership for both domestic and foreign-owned firms. Given its history of ties with the state, it is a key organization for formally representing capital's interests. Its main functions are to promote exports, issue professional certifications and to help set up Hungarian investment in foreign countries if members desire the assistance.[71] However, it is clear that the Chamber's efforts at securing free-trade zones indicates that its work is more comprehensive than just that of trade promotion.

Other key organizations exist such as the Hungarian Employers Association. Although it is only one of nine organizations representing

[69] Adapted from figures in Central Statistical Office (1997, pp. 303-304, 1998, pp. 297-298).

[70] According to Peter Keszthelyi, Deputy Secretary General of the Hungarian Chamber of Commerce and Industry, interview July 17, 1996.

[71] Interview with Keszthelyi.

employers in tri-partite bargaining, the organization represents approximately 6,000 firms, both private and state-owned. Together these 6,000 firms employ about one million workers which is almost one-fourth of the labor force.[72] Other key organizations exist which represent particular industries and agriculture, consumer, industrial and agricultural cooperatives, artisans, entrepreneurs and small- and medium-sized enterprises. Domestic organizations existing to represent capital (or "employers") appear to reflect patterns in more advanced capitalist countries.

In addition to domestic organizations, there are numerous foreign chambers of commerce. Prominent amongst them are the American, the British, and the Canadian Chambers of Commerce in part because the chambers have worked closely together. Obviously, the significant amount of investment coming from Germany and Austria has made these and other European Chambers important in pressing for their firms' interests.

Foreign capital is also represented through Hungary's membership in numerous organizations. In 1973, Hungary joined the General Agreement on Trade and Tariffs (GATT, now the World Trade Organization, WTO). In 1982, it joined the International Monetary Fund (IMF) and the World Bank. In 1991, the Warsaw Pact and the Council for Mutual Economic Assistance were formally dissolved and Hungary formed an association agreement with the European

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[72] According to figures by Agnes Ungvarszky, Director of the Employer's Association, interview July 31, 1996.

Union (EU) in which the Central European Free-Trade Agreement (CEFTA) was formed with Poland and the then Czechoslovakia. In 1996, Hungary joined the Organization for Economic Co-operation and Development (OECD). Accession negotiations began in 1998 for membership in to the EU, and in March, 1999, Hungary joined the North Atlantic Treaty Organization (NATO). The governments of other countries also represent a source of representation for foreign capital in Hungary.

5. Smallholders

While farming was dominated by the state farms and collectives during the state socialist era, private farmers now have more arable land and more of the land area than co-operatives and corporations combined.[73] Of the arable land farmed by private farmers, more than half belongs to farms of 31 hectares or smaller in size. In other words, agriculture has numerous smallholders, and their interests may be considerably different from the interests of the management of large corporate farms or co-operatives. Smallholders interests are purportedly represented by a political party of the same name. The Hungarian Chamber of Agriculture and various other organizations representing agriculture interests at a general level.

[73] According to Central Statistical Office (1997, p. 396-97), private farmers have over 4.6 million hectares of the total land area while corporations and co-operatives have less than 4.2 million combined (owned, let or leased).

C. The rise of neoliberalism and integrationism as a dominant strategy

The process of a competing strategy of accumulation becoming dominant is a complicated one. The evolution of an economic development model is not a straight-forward case of foreign capital completely imposing its will, nor is it the population participating in civil society or voting into office political parties that will implement policies favorable to them. Certainly economic development strategies have evolved in places which did not bring on growth or may have resulted in the upward redistribution of wealth. On the other hand, strategies have also evolved which brought rapid growth from which most if not all of the population enjoyed the benefits.

The analysis presented below explains the ways in which struggle has taken place among class and non-class groups in Hungary and why the outcome by the late 1990s was an economic development pattern broadly fitting into what I have called the neoliberal-integrationist strategy. In order to tell the story, I will review the processes of transformation, in particular, by examining changing patterns of state intervention and integration with the global capitalist economy. Through the examination the rapid drift towards a neoliberal-integrationist strategy can be identified. I then attempt to more concretely identify why the strategy became dominant by examining intersections among capital, labor and the state.

1. Privatization

The first major area of policy which conditioned transformation was privatization. Much has been already detailed about privatization and its results in chapter four; however, there are a number of salient points that are relevant here.

Firstly, privatization in Hungary took the form of a transactions-based approach. This means that capital was necessary in order to acquire property. This put both foreign capital, which had the capital necessary to purchase the most sought-after firms, in a better position than aspiring domestic capital, but it also put domestic managers who had intangible capital at an advantage. In the case of intangible capital, assets could be acquired through knowledge of the enterprise controlled by the manager or management team. Assets could be transferred with the tools of the legislation created in the late 1980s, without transferring liabilities. This was called spontaneous privatization.

Although privatization was overseen by an agency, the State Property Agency (SPA), which took its directions from the government, the agency had wide discretion. According to Peter Kazar, Portfolio Director of the SPA, managers often lobbied persons in the SPA to approve of certain types of privatization deals.[74]

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[74] Interview with Kazar.

If privatization in Hungary is contrasted with other plans in Central and Eastern Europe, a few features stand out: Voucher-based privatization, practiced in the former Czechoslovakia, at least in theory would spread capital among the population rather than concentrating it in the hands of a small group of foreign and would-be domestic capitalists. Unlike Poland, which due to a number of factors delayed privatization, Hungary intended to rapidly privatize the economy. The HDF government, in 1990, intended to achieve the privatization of 50% of state property by the end of its first term, in 1994, requiring an almost unheard of speed in the process of shedding state ownership.

It should also be added that the plan of privatization itself created a capitalist economy by concentrating capital in the hands of a capitalist class and turning the vast majority of the population into wage-labor by giving them no real opportunity to be anything else. As argued elsewhere, the opportunities of the working class to acquire share ownership in firms was limited. The ESOP program affected relatively few firms and few workers. Most of the first privatized in this fashion were small with few employees and, in almost all cases, ESOP buy-outs were combined with Management Buy-outs where managers retained a larger relative stake and control over the management of the firm. Finally, the voucher program which was created by the HDF government to increase its popularity, amidst widespread dissatisfaction with its management of the privatization process, and with the widespread participation of foreign capital, was only beginning to be implemented by the time the government left office.

However, in 1992 the government did intend to broaden the scope of what industry was to remain in the state sector. It announced a list of 163 firms of which the state would retain full or partial ownership, that would be maintained by the newly created State Holding Company. An additional 60 firms would be maintained by various ministries. Potentially this action, if retained, could have defined a much larger role for the state than would be envisioned by neoliberals.

Any measures taken to re-think the privatization process by the first government were undone by the Socialist coalition government. The 1995 revision of the privatization act combined the SPA and the State Holding Company into one organization, the Hungarian State Privatization and Holding Company. The lengthy list of companies that were to be retained in long-term state ownership (altogether 223) was reduced to 88 firms. These firms covered such areas as the railways, the postal service and the defense industry. The voucher program was immediately scrapped. Instead, the intention of revising the legislation was to accelerate privatization and attract foreign capital. In this light, areas such as energy, banking and telecommunications were developed for privatization (NBH 1996). In other words, the sectors in which foreign investors were interested were finally put up for sale.

According to the foreign chambers of commerce' Task Force report to the government on privatization, the moves made were welcomed: 'The merging of the SPA and the AVRt [sic] is seen as a good thing and it is hoped that the opportunity will be taken to improve the overall efficiency of the organisation and the quality of the staff at the day to day operational level.'[75] Yet, the Task Force was not as approving of fast track privatization of small- and medium-sized enterprises through management buy-outs and employee buy-outs:

> In such cases, if preference is to be given to the management or employees over prospective foreign investors, it is hoped that the APVRt [sic] will ensure that management or the employees (as the case may be) have sufficient resources not only to acquire the enterprise but also to ensure that it is adequately funded for its future operations in the medium term.

Perhaps more importantly, it is the Task Force makes it clear that it would like the government to choose regulation over ownership. Since privatization of parts of the electricity industry had been announced some years before and then cancelled making irrelevant the work prospective foreign investors had put into preparing tenders, the document reinforces the point that this should be privatized. In this vein, the paper suggests:

> If it [the government's interest] is controlling the price of electricity and making sure that there is a safe and adequate supply of electricity this could possibly be dealt with by a regulatory authority rather than by the Government retaining control of the individual companies. This enables the Government to sell a bigger percentage of the companies thus making them more attractive and raising more money for the budget. The foreign investor feels happier...

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[75] Task Force position paper on privatization presented to Prime Minister Gyula Horn on May 26, 1995.

Of course, it was probably already clear to foreign capital that regulation would become less of a worry as substantial price hikes in household fuel and other areas had already been implemented in 1995.

Over 80% of state assets were either liquidated or privatized by 1998. Notably, the Socialist government, by developing key firms for privatization which had previously not been "up for sale", increased the presence of foreign capital. By this point, Hungary had been the recipient of over one-third of all foreign direct investment to all of Eastern Europe and the former Soviet Union and achieved a high per capita FDI at $1,800. As was noted in the last chapter, not only was the participation of foreign capital high and growing during the transformation process, but by 1998 70% of exports consisted of products at least partially produced by foreign-owned companies.[76]

The development of privatization over the years of transformation indicates the increasing power of capital in Hungary. On the one hand, transaction-based privatization facilitated the concentration of capital; on the other hand, as the concentration of capital increased and the role of foreign capital grew, along with the presence of its representatives such as the World Bank and the IMF, the pressures for rapid privatization increased. The years 1994 and 1995 represented a turning point because, as transformation was unfolding in other countries in the region, the early liberalization for foreign

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[76] According to the 1999 Country Comercial Guide: Hungary, available online at www.itaiep.doc.gov.

capital and the ease of foreign investment was no longer as attractive to foreigners. Transnational investors were concluding deals in other countries just to the north of Hungary and the threat of slowing foreign investment, and perhaps, capital flight, made it more important to make the country look attractive again for investment.

Also, privatization played a role in meeting IMF budget targets. The 1995 and 1996 budgets were based on raising significant funds from privatization. This implied that foreign ownership would expand in order to obtain cash revenues.

The other important aspect of privatization is that it represented practically the only effort at industrial policy. What was clear from government documents on privatization is that private owners are in a better position to undertake any firm or industry restructuring. The documents claim that the state has neither the time nor the resources to engage in such efforts. In other words, there was no political will to engage in restructuring.

However, in keeping with the swing towards interventionism in the second half of the HDF government's term, a crisis management plan was initiated for 13 firms. All were large, representing together 7% of industrial employment, and were heavily indebted. However, the firms also were believed to have good long-term prospects and received state support for reorganization.

Yet efforts were also undertaken to improve the financial responsibility of firms. and to reduce state support. The Bankruptcy Act of 1986 had little affect on loss-making firms. From 1987 to 1991, the state gave incentives for creditors to foreclose, but stringency became paramount with the Bankruptcy Act of 1991, implemented in 1992. That act imposed severe requirements: any debtor in default more than 90 days has to initiate bankruptcy proceedings, and the proposed reorganization plan drawn up by a debtor has to be approved by all creditors. According to the 1993 OECD (1993, p. 83) report, "[T]he requirement of unanimous creditor consent is a very stringent provision, in comparison to bankruptcy laws in OECD economies". The law had affected approximately one in every six registered companies (OECD 1993, p. 84) after its implementation. By the end of April, 1996, there were more than 5,500 declared bankruptcies and over 31,000 declared liquidations (Ministry of Finance 1996).

The free market was also let loose on domestic competitiveness. Although there were provisions developed for competition policy, these were ignored to a great extent. For example, the Office of Economic Competition was established January 1, 1991 to review mergers and de-mergers and to veto privatization deals involving mergers that would restrict competition. But by the end of 1993, the Office had not vetoed any deals.

2. Compensation and restitution

Although the working class and in general the Hungarian public were largely excluded from the privatization process, the compensation program was one area where gains were made. In particular, compensation was seen as a significant victory for (would be) smallholders. In Parliament, the forum for policy-making around the issue of compensation, it was argued by the Free Democrats, an opposition party, that everyone should be compensated as everyone had suffered under the Communist regime. The Young Democrats, also an opposition party, argued on supposedly pragmatic grounds that no one should receive compensation because the country already had a heavy debt burden, and compensation was a luxury that the country could just not afford. Nevertheless, the conservative-nationalist philosophy won out, in part because the HDF believed that the old propertied classes were part of its constituency. The matter of compensation was resolved by the Compensation Act in 1991; those persons who lost property after 1939 received compensation coupons.[77] The coupons could be used on the Budapest Stock Market to purchase stocks in certain companies specified by the SPA; used to purchase land up for auction; used to purchase state property being privatized; or, they could be exchanged for

[77] The Constitutional Court in 1990 ruled that restitution would take the form of compensation and not the return of the original confiscated property.

a non-inheritable annuity. Coupons were transferable and would earn interest until 1994 at three-quarters the NBH basic refinancing rate.

Claimants could receive up to 5 million forints in compensation. Out of a possible 60-70 billion forints in estimated claims, only 20 billion had been issued (OECD 1993, p. 75-76). In 1993, the law was extended and in early 1994, 600,000 new claims had been made, much more than the 100,000 that had been expected with the extension of the law. By the end of 1994, 118 billion forints in compensation coupons had been awarded with many more still being investigated (OECD 1995, p. 113).

However, the state became increasingly strict about how coupons could be used. In privatizing state assets, there has been a clear preference for cash in order to make payments on the debt and coupons do not actually bring in cash revenues so were not a preferred option in privatizing. Secondly, there is also a clear preference for strategic investors who can make further investments to modernize the newly privatized enterprises. It is unlikely that coupon holders would have the necessary wealth, as in general, very few Hungarians did. It is to me clear from my research that there was no intention of purposely excluding most Hungarians from the privatization process. Nevertheless, the effect of prioritizing cash and strategic investment meant that compensation coupons were rarely used to purchase state assets.

Instead, it was more common to purchase shares in the specified companies on the stock exchange. This served the purpose of pumping up demand for shares in what was a new stock exchange.

A secondary market for compensation coupons also opened on the Budapest Stock Exchange in December, 1992. Although it would appear that holders of compensation coupons had more options for using their coupons, the effect of this was negative to some extent. Brokers went out to villages and attempted to buy the coupons from the recipients at less than the discount value at which they were trading on the stock market. Since the recipients were mostly elderly rural people who had little knowledge of the stock market, and, with the rapid fall in standard of living, needed cash, brokers could take advantage of them. The prices at which the coupons were trading was published daily in the newspaper *Népszabadság*. Although the newspaper is the most widely read daily in Hungary, the rural elderly did not necessarily understand how they could participate in order to maximize the benefits from the coupons. The elderly were not educated in the workings of new innovations in the Hungarian economy. And, given the lack of understanding and uncertainty about the future, cash in hand was usually the much preferred option.[78]

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[78] That this took place is clear from my conversations with my colleague, Dr. Maria Fekete Farkasne, a professor at the University of Agricultural Sciences in Godollo. It was some of our university's former students who were engaging in such practices.

As for purchasing agricultural land, only the holders of the original coupons were allowed this privilege. According to an OECD (1995, p. 113) report, there were "unofficial attempts to restrict the sale of land only to village residents". The reason for this is clear: While the Smallholder Party was interested in protecting the interests of the rural population, urbanites were acquiring land with the hopes of leasing it and potentially selling it to foreigners in the future, if and when foreigners were allowed to purchase agricultural land. This meant that compensation was being used to disadvantage potential smallholders as they would have to lease land instead of owning it outright. By restricting land purchase to village residents, the interests of the population whom the Smallholder Party primarily represented could be protected.

The effects on agriculture of the compensation process, however, should not be understated. The Smallholder Party, as part of the HDF coalition government, spearheaded the campaign to protect the rural peasantry by using compensation to distribute land. It did so by stripping state farms and agricultural collectives of land, 2.1 million hectares, with 90% of the land coming from the collectives (EIU 1997, p. 32). This was approximately one-third of the entire agricultural area and one-half of arable land.[79] The collectives were liquidated or broken up into smaller co-operative farms. Foreigners were not

[79] In 1991, arable land both sown and unsown was just over 4.7 million hectares; the agricultural area, which includes arable land plus gardens, orchards, vineyards and grassland, was less than 6.2 million hectares (Central Statistical Office 1992, p. 123).

permitted to purchase agricultural land leaving agriculture to a become a domestic sector, and creating a well-defined smallholding class who would be a natural constituency for a political party of the same name. While this apparent hostility to agribusiness is evidence of the presence of economic strategies that are not neoliberal, and might even be anti-capitalist, it was strategically a mistake. Land was broken up into parcels that were too small to be viable. By the end of 1994, almost all of the allocated land was auctioned off to about 500,000 people, meaning the average plot of land was around four hectares. Moreover, smallholders did not have the capital to purchase additional land or to purchase the necessary physical capital. In fact, most former members of collectives elected to maintain their membership in the transformed co-operatives (OECD 1995, p. 120). But, the existing co-operatives did not have access to capital either, and economic transformation caused a massive disruption in their marketing and sales.[80] Overall, the agricultural sector suffered enormously. Production of plant cultivation, animal husbandry and agricultural products had all declined, and by 1997, had fallen back to levels in the late 1960s and early 1970s.[81] The share of agriculture, hunting, forestry and fishing in GDP had fallen from almost 15% in 1990 to just over 5% in 1997.[82]

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[80] These problems were commonly discussed at the agricultural university where I worked. There was a clear sympathy for co-operative forms of agricultural production especially as, under state socialism, co-operative production was integrated with smallholding production.

[81] See long time series data, Central Statistical Office (1997, p. 13).

[82] Based on Central Statistical Office (1992, p. 64 and 1998, p. 288).

Finally, it should be noted that compensation for Jewish-Hungarians was only resolved in 1997. In April of that year, a Jewish Compensation Program was passed by Parliament awarding compensation to Jewish victims of the Holocaust, and that property and monetary compensation was to be awarded to the recently established Jewish Public Heritage Foundation.

3. Macroeconomic and social policy

Macroeconomic and social policy are illustrative in the trend towards neoliberalism. At the beginning of 1991, the HDF government laid out a four-year program, the Program for Conversion and Development. The broad aims of fiscal policy at this time were to reduce the size of the public sector and to shift the burden of taxation away from corporate taxes to personal income and consumption taxes. Many of the changes in fiscal policy - reducing expenditure and changing the tax structure - were initiated under the last state socialist government. However, these changes were continued by the HDF government. For example, the government stopped funding investment in the productive sphere by 1991, and subsidies that were reduced slightly in the late 1980s were significantly decreased in the early 1990s.

As for the tax structure, Hungary was a forerunner amongst state socialist countries by introducing the personal income tax and the value added tax (VAT). However, under the state socialist government, the personal income tax was more progressive and numerous basic goods were excluded from the VAT. By 1993, the number of tax brackets for the personal income tax was reduced from 11 to four with the maximum tax rate being 40% (OECD 1993, p. 41). The VAT was changed in 1993. Only medicine and household fuel were excluded from the VAT, consumer staples were taxed at 6% and the remainder was taxed at 25% (although the government initially proposed that the lower tax band be 8%).

The Corporate Income Tax was introduced in 1992. It replaced the Enterprise Profits Tax and lowered corporate taxes from a maximum of 50% to 40%. Also, the introduction of compulsory dividends on SOEs was intended to encourage state firms to transform themselves into joint-stock companies (OECD 1993, p. 41). The transformation into joint-stock companies was a preparation for privatization and therefore, the policy was an effort combined with others to have the management of SOEs prepare for and pursue privatization.

Ironically, there was a change in the tax preferences for foreign investment granted before 1990. At the end of 1990, the general foreign investment tax preference was abolished and other preferences were limited to ten years with more stringent eligibility requirements. By 1992, it was decided that new foreign investment made after 1993 would not receive tax breaks although existing tax breaks would be continued for ten years. There are a couple possible explanations for this. The government of the day perhaps wanted to maximize foreign investment before it stood for re-election in 1994 and therefore would allow tax preferences to continue through most of its term.

The other explanation is that international organizations like the OECD do not tend to recommend tax breaks for foreign investment:

> In fact, estimated pre-tax profit is generally the most important factor of all. OECD experience also suggests that unduly generous incentives attract investment often designed to exploit the tax advantages and that their net economic contribution tends to be small. Moreover, differential taxation for domestic and foreign firms is an inducement for domestic firms to re-organise themselves through joint ventures in order to avoid taxation.
>
> (OECD 1991, p. 97)

By 1993, the OECD (1993, p. 41) claimed that the tax preferences for foreign investments were encouraging domestic firms to find foreign partners in order to receive the tax breaks. This was another government policy which had the affect of co-opting Hungarian capital (either real or would-be through privatization) to foreign capital. As it was, Hungarian mangers had formed Western (and other) contacts by the liberalization of inter-company trade in the 1980s. While managers viewed foreign partners as a way to retain their management positions and potentially acquire shares in privatized firms, the additional tax advantages from foreign investment making firms more viable made partnerships all the more sensible. These factors helped the encroachment of foreign investment.

In spite of ambitious attempts to decrease state spending, the budget deficits actually increased for 1991 and 1992 (see Table 5.2 and Table 5.3). There are several reasons for this. Firstly, the economic downturn was much more severe than projected. The government's program assumed that GDP would shrink by 3% in 1991 and then grow at 1-3% afterwards (OECD 1991, p. 51). It did not appear at the time that any advisors or forecasters had thought differently. In fact much of the literature written by researchers and international agencies was overly optimistic, usually projecting only a small recession during the transformation process. What actually happened was that GDP shrank by almost 12% in 1991, over 3% in 1992, and continued its decline in 1993. Recovery only began in 1994 (see Table 5.4).

Table 5.2: General government budget in real terms (1990 deflator, in billion HUF).*

	1990	1991	1992	1993	1994
Revenues	1279	1176.81	1140.52	1204.03	1266.76
Expenditures	1279.7	1216.15	1246.78	1277.04	1336.59
Surplus or deficit	-0.7	-39.33	-106.26	-73.01	-69.83

Source: Adapted from figures in Central Statistical Office (1991, 1994, 1997).
*The general government budget includes central government, institutions of the central government, local governments, extrabudgetary funds and social security funds.

Table 5.3: General government budget as a percentage of GDP, 1988-1994.

	1988	1989	1990	1991	1992	1993	1994
Revenues	62.6	62.2	61.5	69.0	64.5	69.2	70.3
Expenditures	63.3	65.0	61.5	71.3	70.6	73.4	74.2
Subsidies to Enterprises	10.0	6.8	4.7	2.8	2.5	2.2	3.0
Subsidies on Final Consumption	3.1	2.6	1.8	1.8	0.7	0.6	0.6
Surplus or Deficit	-0.7	-2.8	0.0	-2.3	-6.0	-4.2	-3.9

Source: Adapted from figures in Central Statistical Office (1991, 1994, 1997).

Table 5.4: Percentage change in GDP from preceding year, 1988-1994.

1988	1989	1990	1991	1992	1993	1994
-0.1	0.7	-3.5	-11.9	-3.1	-0.6	2.9

Source: Adapted from Central Statistical Office (1998, p. 286).

The transformation process also included the break-up of the CMEA in 1991. The break up of the trade block which included Hungary's main trading partners resulted in a loss in export markets. The other CMEA countries were also experiencing economic crises, reducing trade and exasperating the crisis. This drop in trade had more than the usual implications for budget revenues. Revenues were acquired from taxing the difference between CMEA and world market prices. When the CMEA broke up in 1991, these revenues were lost.

The economic crisis had also affected the collection of corporate and personal income taxes. Unemployment increased, eroding the taxable income base. While lowering the percentage of corporate taxes as a share of GDP was a reform goal of the government, the share in taxes decreased more rapidly than projected (OECD 1993, p. 38). And, since corporate taxes were paid based on the previous year's liabilities, firms over-paid in 1991. The taxable income earned by enterprises turned out to be significantly less than the year before due, at least in part, to the economic crisis. These taxes had to be refunded in 1992 causing a larger than expected deficit. In addition, financial reform (the Banking Act of December, 1991) caused no net tax revenue to be collected from the financial sector in 1992 (OECD 1993, p. 37).

Although there may be other reasons for the unexpected budget deficits – besides the overly enthusiastic belief in market economics – the above appear to be the key "unexpected" happenings. Aside from what was unexpected, some projections were just plain bad planning. For example, all new lending from the

National Bank of Hungary starting in 1991 was to be based on market-determined interest rates. The interest rate on past debt would be gradually increased. The increase in interest expenditure, in this case, should have been better predicted. Appropriate policy analysis should have also predicted that stringent bankruptcy laws and other changes in the legal system would have had negative effects. For example, bankruptcy laws would result in numerous bankruptcies and these would have direct and indirect impacts upon budget revenues.

The 1993 and 1994 projected budget deficits were targeted to be off-set by increases in tax revenues. The 1993 budget raised the lower band of VAT to 10% but paid a one-time compensation payment to lower income groups. There were also other efforts to reduce the tax burden on personal income taxes but the central budget deficits were still 5% of GDP for each year although this was down from 5.9% of GDP in 1992. The general government deficit also reached 4.2% and 3.9% of GDP in 1993 and 1994, but these figures were also down from a peak of 6% of GDP in 1992 (see Table 5.2). Although, with the supplementary budgets for each year, revenues ended up being higher than projected, expenditures were also higher (OECD 1995, p. 37).

In spite of claims that the government was only interested in following IMF budget recommendations,[83] and in spite of the growing public

[83] For example, Ungvarszky said this to me.

dissatisfaction with the way the government was managing the economy, the HDF government did not really compare in fiscal austerity with the Socialist government. After all, the HDF government allowed the universal system of benefits to remain largely intact. The two governments also differed significantly with respect to their co-operation with international organizations. The HDF government was very difficult to work with and was resistant to the World Bank's and the IMF's policy recommendations.[84]

With respect to monetary policy, the HDF government had loosened what was a tight policy. At the end of state socialism, tight monetary policy was practiced from late 1989 through the first half of 1990 by raising the reserve requirement from 15% to 18% (OECD 1991, p. 44). The HDF government loosened monetary policy by changing back the reserve requirement to 15% although by October, 1991, it had raised the reserve requirement to 16% and had earlier required forint reserves on foreign currency deposits (OECD 1993, p. 54). However, even if the government wanted the National Bank of Hungary to practice tighter monetary policy, it was difficult in the absence of tighter budgets since the deficits were financed by liquidity created by the NBH (OECD 1993, p. 46). Also, there was a rapid expansion in inter-enterprise credit which which undermined the effectiveness of monetary policy.

[84] Interview with Mihaly Kopanyi, World Bank, June 18, 1997.

After a significant decline in inflation from mid-1991 to mid-1992, monetary policy eased and became expansionist. At this point, although the Central Bank Law of 1991 had made the NBH independent, in practice it was not, and so the government could and did directly affect policy. The foreign currency situation had improved and the current account was in surplus. Hence, improved balances combined with public dissatisfaction over the harshness of reforms led to the easing of policy.

The Socialist government, after having been elected in mid-1994, carried out a complete re-vamping of fiscal and monetary policy. Although unemployment had fallen, investment had accelerated, demand had recovered led by consumption, and economic growth had finally been restored, the budget deficit, current account deficit, and external debt had increased considerably.

The first efforts by the Socialist government to impose more fiscal restraint came shortly after its election to government. In September, 1994, a number of cuts were made to the original 1994 budget in the supplementary budget. However, much of the budget remained the same due to the government's inability to implement the changes it wanted. For example, the government proposed changes in the pension law in order to avoid paying out previously mandated (by the last government) increases, but these changes had been rejected by the Parliament and so the mandated increases went ahead. Nevertheless, the withdrawal of commitment of funds to the World Expo, to take place 1996, had signaled that larger changes were on the cards. The World Expo, which was originally to be hosted by both Vienna and Budapest, was considered a pet of the HDF government. Much planning had already gone into the Expo even though Vienna had pulled out. It was hoped that the event would be a source of national pride. The year coincided with celebrations for the 1,100th anniversary of the conquest of the Carpathian Basin by the Magyar tribes and perhaps could energize people to last through the difficult changes. When state funding for the Expo was dropped, the Socialists were criticized for being indifferent to the economic benefits of the event. Nevertheless, the Socialist coalition viewed the event as costing an enormous amount of infrastructural development and other expenditures that would not be recouped.

The real change in fiscal policy came in 1995 with the introduction of the Bokros package, so named after Finance Minister Lajos Bokros who, with the help of his colleagues in the Finance Ministry, designed the program. The program included on the expenditure side several large cuts and plans to increase revenues. The package was implemented even in the face of public disapproval. Even the OECD, greatly enthusiastic about the Bokros package, refers to its spending cuts as 'draconian' (OECD 1999, p. 46). The World Bank and IMF also enthusiastically supported the austerity measures.[85]

The package included a change in the universal benefits that had begun under the last 'socialist' government. Universal family allowances, maternity

[85] Interview Kopanyi. It is very clear that international organizations were pleased with the austerity program and the subsequent budgets of the Socialist government.

pay and leave provisions were removed although parliament decided that family allowance would continue for families with three or more children. This was a dramatic step towards undoing Hungary's established practice of universal benefits. Instead, benefits were targeted to the most needy. The second major area concerned public sector employment. Laws were amended to make reductions in the public sector work force easier and also limit severance pay. Wage restraints were imposed on the public sector labor force with a 6% nominal wage rise. There was also a freeze on public sector purchases in nominal terms. There were other reductions. For example, the subsidy for medicines was reduced. Transfer payments to local governments were cut and municipal public servants were reduced by 4%.

On the revenue side, a temporary import surcharge of 8% was imposed on all imports with the exception of energy and machinery. Excise taxes were increased. And, in order to reduce deficits incurred in the health and pension funds, the contribution base was widened.

Moreover, the changes implemented indicated structural changes in the public sector, which was seriously attacked for the first time during the transformation process. Employment decreased as well as the public wage bill. The regulation of public finances was restructured in January, 1996 with the introduction of the Treasury. The Treasury began the management of revenues and expenditures; it oversees the financial operations of behalf of the central government, monitoring the central budget, central budgetary institutions and extrabudgetary funds (National Bank of Hungary 1996). Extrabudgetary funds were also reduced from 13 different institutions to only five, and there was a move to funding specific projects rather than institutions (National Bank of Hungary 1996). Fiscal austerity in 1997 continued (see Tables 5.5 and 5.6) and in 1998. By viewing Table 5.2 and 5.5, it can be seen that expenditures in 1997 (1,069.86 billion HUF) was well below the 1990 level of expenditures (1,279.7 billion HUF) and represents a decrease of about 16% in real terms. Meanwhile, revenues dropped after 1994 and by 1997 (1036.14 billion HUF) were significantly below their 1990 level (1,279 billion HUF).

Table 5.5: General government budget in real terms, 1995-1997 (1990 deflator, in billion HUF).[86]

	1995	1996	1997
Revenues	1082.53	1041.12	1036.14
Expenditures	1144.69	1026.83	1069.86
Surplus or deficit	-62.16	14.29	-33.72

Source: Adapted from figures in Central Statistical Office (1997).

[86] The general government budget includes central government, institutions of the central government, local governments, extrabudgetary funds and social security funds.

Table 5.6: General government budget as percentage of GDP, 1994-1997.

	1994	1995	1996	1997
Revenues	70.3	59.7	57.8	54.9
Expenditures	74.2	63.1	57.0	56.7
Subsidies to Enterprises	3.0	2.9	2.2	1.3
Subsidies on Final Consumption	0.6	0.6	0.7	0.6
Surplus or Deficit	-3.9	-3.4	0.8	-1.8

Source: Adapted from figures in Central Statistical Office (1994, 1997).

Fiscal austerity from 1994-98 was complemented by tight monetary policy. When Lajos Bokros was appointed Finance Minister in order to design the austerity program of 1995, his close friend, Gyorgy Suranyi, was appointed President of the National Bank of Hungary.

According to the National Bank of Hungary (1996), the "only ultimate goal is to control inflation, the only intermediate target is to keep the nominal exchange rate on a pre-announced path". Like monetarists have advocated, monetary policy in Hungary took on the only goal of targeting and reducing the inflation rate. No other goals, such as growth or employment, would have an impact on policy.

The key to monetary policy has been the exchange rate. In March, 1995, the forint was devalued by 9% (30% dollar, 70% ECU, later Euro). Along with the significant devaluation, a pre-announced crawling peg took place. The forint was devalued on a daily basis at a rate of 1.9% per month for the first half of

1995, and 1.3% per month for the second half. The total devaluation was 29.86%. In 1996, the pre-announced monthly rate of devaluation was 1.2% (National Bank of Hungary 1996). By October, 1998, the crawling peg was 0.7% (OECD 1999, p. 38).

Although the National Bank of Hungary was made by law independent in 1991, the law was strengthened by a 1997 amendment to improve independence. Nevertheless, the management of the NBH and the government were not at odds in their perspectives on tight fiscal and monetary policy so the move to guarantee independence would act to prevent future governments to intervene in the NBH's policy making.

As already suggested in the discussion of the Bokros austerity package, policies between 1995-98 represented a fundamental shift in social policy. As universal benefits were eliminated, co-payments for medicines and certain types of services were introduced leading to the private share of total expenditure for health care being almost 10% by 1997.[87] Although the HDF government had introduced voluntary private supplementary health insurance (operated by private non-profit institutions), the Socialist government had taken health care much further in the direction of privatization. The 1996 budget included provisions for 10,000 hospital beds to be financed on a "market-like system" (National Bank of Hungary 1996). Planned layoffs in health care amounted to

[87] Based on figures by OECD (1999, p. 106).

5,000-6,000 employees. Free or subsidized health care began to be only available to those in most need, whereas the contribution of households to financing the health service was increased (National Bank of Hungary 1996). Public health care spending was also capped in 1997.

Aside from mass layoffs in the educational sector, and the freezing of budgets, students in the tertiary sector[88] for the first time had to pay tuition. Previously, the system under state socialism was continued whereby students received grants and free tuition to study at universities and colleges if they were admitted by a particular school. Bokros put an end to free tertiary education when he told Budapest university students that they spent more on cigarettes in a month than their monthly tuition would cost. Tuition began in fall, 1996 although provisions were made for students who were deemed low-income.

The pension system was also reformed. A three-tiered pension system was introduced in 1997 which included retaining the previous pay-as-you-go tier (PAYG), a compulsory capital raising pension fund (a compulsory fully-funded tier), and a voluntary mutual pension insurance fund (a voluntary fully-funded tier). Like all aspects of social security, there had been yearly budget deficits in the PAYG system and the central government has been required to transfer funds to the system (National Bank of Hungary 1996). In order to deal with immediate budget deficits, retirement age has been raised from 60 for men and

[88] Meaning higher education.

55 for women in 1995 to 62 for both by 2009. The contribution base has also been broadened by including more people and more forms of labor income. So-called "Swiss" indexing has been introduced which changes the system from a wage-based system to a 50-50 weighted average of increases in consumer prices and in wages. These changes are projected to move the PAYG system into surplus for the next 30 years and this surplus will be used to finance the transition to the three-tiered system. The new plan also reduces employers' contributions to 5% with individual contributions at 15% (OECD 1999, p. 136). The National Bank of Hungary (1996) stated that pension reform will take 30 years, making it the longest transition period of budget reform.

While these types of pension reforms have received wide support from economists, the new three-tiered system may not make as much sense as it appears initially. This is an expensive system to regulate and monitor, it is risky, and it imposes additional costs during the transition between systems. Since 25% of contributions in the compulsory tier are deposited in privately managed pension funds, there is a significant cost to the government to monitor these funds and "enforce" prudent regulations. There is also no guarantee that these funds will be able to produce returns on money invested and the funds have to contribute to a pension guarantee fund, which reduces the amount of return they may be able to provide their clients. The government must, under the plan, "top up" any person's individual savings if they are less than they would be under the PAYG. In fact, it is estimated that it costs 20% of all contributions just to *administer* the Chilean system which is very similar (Weller 1998, p. 32). Finally, these types of plans can lead potentially to the marginalization of the very poorest in society who need a state-guaranteed pension the most. Since most of the population – and the most politically active portion of the population – will have individual savings account, there will be very little political motivation to ensure that the worst off receive at least a livable pension.

It should also be pointed out that that the pension fund and the health insurance fund were supposed to receive income-generating assets which would be owned and controlled by the respective funds and the income used to fund payments. However, the HDF and Socialist governments did not follow through on the initial plans of transferring the income generating assets and fewer assets were transferred than had been originally envisioned. Hence, these funds were not sustainable without a large injection from some income source. By setting up the funds for failure by not transferring the assets gave the appearance that spending was out of control and nothing could be done other than to further shift the burden onto the public, and to privatize old age and health care.

Moreover, there is tendency in the reforms to reduce universal benefits and increase participation in private insurance. While the elimination of universal benefits had already been made with cuts in child benefit and other cuts in the Bokros package, the capping of health insurance, introduction of certain types of co-payments and the restrictions on seeing specialists will give incentives for those who can afford it to acquire private health insurance. This will decrease the support for universal coverage and support of the single-payer system. In the case of pension provision, voluntary pension funds will decrease the reliance on the compulsory pension by those who have enough money to make voluntary contributions. Again, this can lead to the slower increases in the compulsory pension as those with money and more political power will have less need for it. Something like this has already happened with respect to pensions. Increases for those receiving larger pensions has disproportionately increased compared to those persons receiving relatively smaller pensions.

4. Integration

Aside from macroeconomic and social policy, it is important to understand how the transformation process opened up Hungary to the international capitalist economy.

Like most processes, integrating westward, and away from the Soviet bloc, was begun under state socialism. Hungary joined the GATT (now the World Trade Organization) in 1973. It concluded an agreement in 1988 with the EEC to remove quantitative restrictions not in line with Article XIII of GATT according to a time-table. This was achieved by the beginning of 1990 along with increasing certain quotas for EU imports from Hungary.

Integration, however, was speeded up with the elections of the HDF government in 1990 and the break up of the CMEA in 1991. By June of 1990, Hungary began discussions with the European Free Trade Area. By the end of that year, Hungary and the EEC began discussions for drawing up an association agreement.

Much of the trade liberalization was already accomplished by the end of the 1980s. In 1987, firms were allowed to freely negotiate export and import deals, with the exception of a list of goods that required special authorization from the Ministry of International and Economic Relations. The coverage of exceptions was lowered in 1990 to 20% and 35% of convertible currency imports and exports respectively, and this was lowered again in 1991 (OECD 1991, p. 182). No licenses were required for approximately 90% of 1991 imports (OECD 1991, p. 98). However, there was still a global quota for consumer goods. The global quota was increased from $100 million in 1984 to $200 million in 1990 and to $630 million in 1991, and the range of products covered was reduced between 1989 and 1990 (OECD 1991, p.98). Although approximately $150 million of the 1991 quota was due to the inclusion of CMEA imports (OECD 1991, p. 98), it still demonstrates that in the face of a worsening debt burden and the need to improve the foreign currency balances, the policy was towards liberalizing trade. Less restrictions were placed on fewer goods leading to a rapid expansion of imports.

The trend towards trade liberalization has continued throughout the 1990s, and a number of treaties assure that liberalization will continue. Hungary has been affected in similar ways as other member countries by international negotiations of the WTO. Hungary also has agreements with EU where it must eliminate various tariffs and quotas most of which already had taken affect by 1999 with other reductions taking place until 2001. Hungary as part of the Visegrad group is attempting to become a member of the EU. A major consequence of rapid trade liberalization has been ballooning trade deficits (see Table 5.7).

Table 5.7: Balance of payments figures, 1990-1997 (in million USD).

	1989	1990	1991	1992	1993	1994	1995	1996	1997
Trade balance	537	348	189	-48	-3247	-3635	-2442	-2645	-1734
Current Account Balance	-1437	127	267	342	-3455	-3911	-2480	-1678	-981

Source: Adapted from figures in Central Statistical Office (1992, 1995, 1998).

Moreover, there was a shift away from producing for domestic demand to producing for exports as can be seen by Table 5.8 which shows the growing importance of exports as a percentage of GDP. By 1997, exports accounted for over 45% of GDP.

Table 5.8: Exports as a percentage of GDP (at purchasers' prices) for selected years.

Year	1992	1993	1994	1995	1996	1997
Exports as a % of GDP	31.5	26.5	29.0	36.9	38.9	45.5

Source: Adapted from figures in Central Statistical Office (1995, 1999).

Foreign investment was also liberalized. Although modestly encouraged in the 1980s, the real push to attract foreign capital begins in the 1990s. By 1991, the OECD (1991, p.96) already reported, "The Hungarian foreign investment regime is by international standards liberal". By 1995 capital flows were fully liberalized. Duty-free foreign trade zones (FTZ) also exist where foreign investors may set up operations or acquire interest in companies. FTZs are considered foreign territory for customs, foreign exchange and foreign trade regulation.

Integrationism goes further than trade and investment liberalization. Aside from membership in the IMF, World Bank, OECD, and applied membership to the EU, Hungary joined NATO in March, 1999. Economic integration has been complemented by political and military integration.

D. Explaining neoliberalism in Hungary: the dominance of foreign capital and the marginalization of labor

By 1998, neoliberal policies had permeated all aspects of state intervention. Fiscal and monetary austerity had dominated the most recent four years of policy. Substantial real cuts and reorganization had taken place in the public sector, including the health and pension sectors. The state had done away with the universal benefit system and along with it, had undermined the existing welfare state.

Hungary had been fully integrated into the global economy. Trade and investment liberalization were bound by international treaties and transnational capital had come to be dominant in industry and the financial sector.

The neoliberal-integrationist strategy of accumulation gradually came to be dominant over the course of transformation. But, how did this happen? It did not happen with the consent of the population, and, as will be discussed in Chapter Six, the majority of the population became worse off over the course of transformation. By 1997, the real wage per wage earner was less than it was in 1968, per capita real income was less than the 1981 level, and per capita consumption was equivalent to the 1979 level.[89] The rate of unemployment had risen from 0.4% in 1990 to a height of 14% by 1994, and by 1998, unemployment remained high at 11%. This dramatic rise in unemployment happened at the same time the labor force participation rate decreased from 81.5% in 1990 to 67.5% by 1998 (Central Statistical Office 1999, p. 71) indicating that perhaps the unemployment rate was artificially low due to discouraged persons leaving the labor force as the length of job search increased. The real terms of monthly provision per provisioner[90] by 1997 dropped to 70.9% of what it was in 1990 (Central Statistical Office 1998, p. 149). By some estimates, the rate of poverty was as high as half the population.

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[89] Measured in long time series indices where real wage index per wage-earner was 181 in 1997 and 182 in 1968; index of per capita real income stood at 339 in 1997 and 343 in 1981; and index of per capita consumption was 313 in 1997 and in 1979, where 1950 equals 100 for all measures (Central Statistical Office 1998, p. 4).

[90] This amount refers to on average how much a provisioner receives. A provisioner can be a person receiving an old-age pension, disability pension, widow's pension, orphan's allowance or other similar type of provision.

1. Capital, labor and the state

In order to explain how neoliberalism became dominant in Hungary, the following section explores labor relations and the increasing role of representatives of capital, especially transnational capital. It argues that the methods of consultation and consensus building only allowed the participation of labor as long as labor would agree to the neoliberal agenda. Although conflict between the state, capital and labor is far from over, by 1998 labor had been marginalized.

The relationships between labor, capital and the state can be observed through different sites of conflict and compromise: Firstly, there were macro-level tripartite negotiations that were already established at the end of state socialism. Secondly, at the firm level, labor-capital relations -- and the role the state played -- changed significantly. Thirdly, capital, especially transnational capital, had special abilities to influence the state.

To begin with, the state weakened the main representative of labor, the trade unions through legislation. In 1991, parliament passed two important pieces of legislation affecting unions. One piece changed the manner in which union dues were collected. Instead of having an automatic check-off system which benefited NCHTU, workers had to specifically request their employer to deduct dues for a particular union. The legislation was to make union membership "voluntary", and obviously decentralize the union movement. Although under the provision of the law, it would be relatively easy to form a union -- only ten workers were necessary -- the employer has the right to negotiate with whatever union it desires.

The second piece of union legislation lead to the re-distribution of union assets. As NCHTU was the legal successor and heir to NCTU, it acquired all of its assets. However, new emerging unions contended that it was unfair for NCHTU to inherit all assets. The legislation provided for the freezing of all assets for one year while the unions would provide a detailed account of all assets worth more than HUF 200,000 to the State Auditing Office. Assets would then be redistributed according to membership.

As both pieces of legislation would harm NCHTU both in terms of its membership and control over assets, the union, with the support of the Socialist Party, appealed the new laws to the Constitutional Court. Most NCHTU affiliates were also not co-operating with the second piece by refusing to report their assets. The Court upheld the first piece, but the second one it ruled unconstitutional because representation on the board which would decide the distribution excluded some unions. At the end of 1992, the government, the unions represented on the IRC and some other smaller unions came to a compromise agreement which awarded assets according to membership. NCHTU, still by far the largest union, retained 40% of the assets but other unions were also able to obtain a share of the defunct NCTU's assets.

In effect, the government had used what powers it could to decentralize the union movement and to weaken the strongest and richest of the existing unions. The division of assets, while in principle a fair solution, indicated that the NCHTU would have far fewer resources to support a strike or other labor action; and, given the small size and newness of the other unions, they would probably find supporting strikes financially difficult.

The other key effect of the legislation had been to pit unions against each other thereby breaking up the union movement not only into separate organizations, but separate entities which did not trust each other. Other unions continued to contend that NCHTU had hidden assets from the redistribution process and therefore had really acquired more than its fair share. While the agreement concerned assets valued at over $50 million, some estimates of the true value ran as high as three times that amount (US Department of Labor 1992-93, p. 3). Unions were mistrustful of one another and co-operation became difficult. Even the trade union roundtable established in 1990 was broken up in 1991 as unions were unwilling to co-operate with one another. Thus, the labor movement was successfully divided which diminished its ability to offer real opposition or put forward a unified platform during the transformation period.

Although the legislation favored newly forming capital and the entrance of foreign capital, it might also be explained by the predisposition of the government against trade unions (which certainly is compatible with the preference of capital). The HDF government favored Workers' Councils which are a firm-specific type of a labor organization. In this sense, the government favored "business-friendly" unions.

In spite of hostile legislation towards the union movement, or at least a faction of it, the HDF coalition did revive the tripartite bargaining which had started at the end of the state socialist era.

Macro-level tripartite negotiation was first established in Hungary in December, 1988, under the name of the National Interest Reconciliation Council (NIRC). The reforms of the late 1980s had eliminated the central wage-regulation system and introduced free collective bargaining. The implementation of the NIRC provided for marcro-level wage bargaining over wage increases and maximum and minimum wages. The NIRC during its short one-and-a-half year history also began negotiating over other issues such as exemptions for firms from income policies and the allocation of funds to depressed regions (Lado 1996, p. 160). In this way, the NIRC provided for a bridge between the centrally-administered system that was quickly being dismantled and the de-regulated, de-centralized system that was evolving.

The NIRC had severe constraints on the representation of actors. Labor was only represented by NCTU; other emerging unions were not allowed at the bargaining table. The Hungarian Chamber of Commerce (HCC) had the sole right of veto power for the employers, although other employer organizations were invited to participate.[91] In other words, the initial formation of tripartite

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[91] Interestingly enough, Lado (1996, p. 160) cites the National Association of Entrepreneurs as the only organization invited to participate which refused the offer. It was also the most recently formed employers' organization.

bargaining in Hungary had labor only represented by one organization, whereas pluralism within employers organizations was recognized. Even if the HCC had sole right of veto for the employers side, other employers' organizations were invited and could have input into the discussions.

The existence of bargaining over wages and economic policy amongst representatives of labor, employers and government was an admission that these three economic actors had different interests, interests that would no longer be reconciled by the Party. Instead, these interests would - and could - somehow be reconciled by a move towards a pluralist structure of transparent negotiation.

One might interpret the move towards tripartite bargaining during state socialism as a move towards a new form of corporatism. The move might be one towards the evolution of pluralism and social dialogue, perhaps even a move towards social democracy in Hungary, but not necessarily towards social democratic capitalism. In other words, the NIRC might have represented the expansion of participation in the socialist economy and therefore indicated the evolution of a new form of actually existing socialism.

However, it might be argued that social dialogue in the form of tripartite bargaining arose as an institution necessary for *maintaining order* during what would be an increasingly difficult economic transition towards capitalism. In order to continue the transition, social peace had to be maintained or there would likely be a reactionary move back to state socialism.

The 1980s witnessed significant changes in the regulation of the economy in Hungary. De-centralization granted increasing autonomy to firms. Firms gradually were becoming profit-maximizing enterprises; what and how to produce became firm-level decisions instead of centrally administered decisions and more and more firms were instructed to produce at a surplus. The elimination of central wage regulation was just one step further away from the centralized system of state socialism and one step closer towards the individual decision-making which takes place in capitalist economies. Tripartite bargaining was a cross-over institution. It could facilitate the movement from central decision-making to enterprise decision-making and thus represented a bridging mechanism.

Another way of thinking about the role of tripartite bargaining is how it contributes to the legitimacy of the system. As a forum in which actors may have input into decision-making, actors believe themselves to have participated and informed decisions. Even if actors were not able to achieve the exact outcome they wanted, participation in decision-making may make the actors believe the they have achieved a better position than would have otherwise been imposed. Hence, participation is superior to non-participation, and it is also more pragmatic than attempting to achieve the position of sole decision-maker. As the transition towards capitalism was legitimated by the expansion of pluralism and democratic participation, the NIRC was an institution signifying pluralism and participation in economic decision-making at least until the acceptance of firm-level decision-making and capitalist forms of power relations by society was achieved.

Although tripartite negotiations were initiated by the Nemeth-Grosz governments under state socialism, the forums continued and expanded under the first post-communist government of Antall-Boross. After the elections of 1990, the NIRC went on a brief hiatus but was revived by the HDF-led coalition under the name of the Interest Reconciliation Council (IRC).

Tripartite bargaining expanded after the re-institution of the IRC. Regional County Labor Councils were set up in mid-1991 which expanded tripartite bargaining from the national level to the regional level. The Interest Reconciliation Council for Budgetary Institutions (IRCBI) was established in mid-1992. The new council effectively took the place of the Interest Reconciliation Council for the Labor Affairs of Budgetary Institutions which had been established in November, 1989 in order to address labor relations of public employees. In mid-1993, another sectoral bargaining institution emerged, the Interest Reconciliation Forum for Civil Servants (IRFCS) (Lado 1996, p. 161).

Although government representation on the tripartite structures depends on the issues under negotiation, the workers' and employers' side have fixed representation. For the IRC, the workers' side became represented by six union federations instead of one. The employers side was represented by nine organizations.

In the case of the IRCBI, the workers' side includes 15 organizations and the employers are represented by representatives from eight municipalities and four professional chambers. Important issues for the board are wage policy and issues regarding the central budget. Wages are also a key agenda item for the IRFCS. On this board, the workers' side is represented by nine organizations and the employers' side is represented by seven municipalities and one professional chamber.

Although there is no genuine legal basis for the IRC, IRCBI, or the IRFCS, there are government decrees and parliamentary acts which provide for the recognition of the IRC's and IRCBI's existence and some of their functions (Lado 1996, p. 168). Hence, there is not necessarily any state commitment to the continuation of tripartite bargaining, only government-by-government recognition of its existence and a commitment to efforts at the process.

In addition to the above tripartite structures, legislation was passed in February, 1993 establishing the Health Insurance Board and the Pension Insurance Board which would have representatives from employers and unions. Although the organizations representing the employers on the health and pension boards are selected by the employers' organizations, the unions were subject to nationwide popular elections in 1993. In other words, the employers are only representing themselves, but the unions are representing the entire population and therefore, each person is allowed to vote for which union s/he believes best represents her interests. In a pluralistic and class-based society, this legislation is absurd. The law implies that unions should represent (domestic) capitalists, state-owned enterprise managers, smallholders, the political elite – basically, anyone eligible to vote. While the vast majority of the population is working class and other classes represent a much smaller proportion, it still appears an odd way of determining union representation on the board.

I would argue that, like the two pieces of legislation passed in 1991 discussed above, the elections for unions represent another ploy to diminish the power of the NCHTU. Remaining the largest union in 1993 with a larger membership than the other seven union confederations combined (ICFTU 1998, p. 131)[92], representation according to union membership would imply a very strong presence of the NCHTU. Also, given the belief that workers were alienated from the union movement and the public had generally became disgusted or disinterested in union activities during the struggles over assets, elections could also elicit the lack of public support for unions in general.

However, the elections actually reinforced the position of the NCHTU and unionism in general. Voter turnout was around 40% which was considered high (only 65% of the population turned up for the first post-communist national elections in 1990). NCHTU received approximately half the votes and thus demonstrated strong support. Moreover, the voter turnout indicated a strong

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[92] The figure given is from 1996-97, but it appears from all documents that NCHTU represented at least half of all union members.

interest and support for union representation on the health and pension boards and potentially an active role in policy-making more generally.

The main areas of negotiation were economic consultation, social policy, and wage determination. Lado (1996, p. 164) points out that that over half of the agenda items between 1990-94 were general economic and social issues whereas wages, income and employment relationships comprised only one-fifth of the agenda and general employment and training accounted for only one-tenth of the agenda items. These figures do not indicate the time spent discussing the issues, but they do give some credibility to the argument that the IRC is much more than a wage negotiation body. This is why some commentators believe that Hungary is displaying a type of corporatist form of economic development. Nevertheless, the key areas the IRC made decisions upon between 1990-94 concerned wages, establishing the minimum wage and nominal wage increases. The IRC could only make recommendations for policy, its decisions only became binding when they reached agreement by all parties. Any representative can veto a decision. But in the key areas, the IRC was setting policy. It did set the minimum wage and other policies regarding wages. For other issues, the body was more of a discussion committee or sounding board.

One example of an IRC compromise concerns the value-added tax debate of 1993. The government proposed to have a lower band of VAT at 8% on basic consumer goods; all other goods would be subject to a 25% VAT. The IRC agreed to a compromise of 6% for the lower VAT and to carry exemptions of medicine and household energy. This example still demonstrates that while the consensus practice worked - all members agreed to a policy decision - the compromise also embedded a move towards more regressive types of tax structures. It also meant that labor supported a regressive tax structure that would disproportionately affect the lower income groups and advantage better paid groups - all the other people sitting around the table.

Also, agreements by the IRC did not necessarily lead to implementation. The IRC agreed with the proposal by the NCHTU that 15% of privatization revenues be used for the creation of new workplaces. However, this was not actually fulfilled (ILO 1997, p. 13).

Moreover, the HDF government was not particularly prone to compromise. According to a representative from the Hungarian Employers Association, working with representatives from the HDF government was difficult both for labor and for the employers.[93] She argued that for many issues, the employers and labor's interests were in agreement: In short, policy should be geared towards promoting growth; instead the government was restricted by the IMF budget targets.[94]

The first few years of the IRC mainly demonstrated labor's willingness to concede that fiscal restraint on the part of the government was necessary and

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[93] Interview with Ungvarszky.

[94] What is also interesting is that this viewpoint contradicts the viewpoint of the World Bank representative mentioned earlier.

therefore, wage increases would be difficult given the fact that government was still the largest employer and tightening the budget required containing wage growth. Moreover, given the strict bankruptcy proceedings and the government disinterest in preserving failing firms, demands for wage hikes, particularly in certain endangered industries, would lead to layoffs instead of wage increases. Unemployment had seriously impacted labor's ability to accomplish much. From total job security to 14% unemployment in four or five short years had left labor with the priority of protecting jobs. In the presence of shrinking employment, capital and the state had almost complete power over labor.

It should also be noted that much of the population - including many workers - were optimistic in the first couple years of transformation. If the government's and international bodies' projections were to be believed, the economic downturn would be short lived especially as foreign investment poured in creating jobs. Even though the public's optimism had waned by 1992-93, labor was in no position to affect change.

The existence of the IRC and its agenda did, however, indicate that there were numerous possibilities for the direction of future negotiation. Since the NCHTU had concluded an agreement with the Hungarian Socialist Party prior to the 1994 elections, and the Socialist Party had campaigned on a social democratic platform, the room for labor to have a voice should have improved after the Socialists won a tremendous victory.

Supposedly in order to live up to campaign promises and in keeping with its social democratic platform, the Socialist coalition, shortly after its election, began to negotiate within the parameters of the IRC a "Social Pact". The Pact would cover economic, social and industrial relations policy for the next three years. In short, it would comprehensively define the framework for the economic development strategy that would be pursued. This might indicate that the path of economic development could have shifted to some sort of social democratic path. But this was not to be the case.

By March, 1995, the efforts at negotiating the Social Pact were finished. For six months, the employers' representatives, the government, and labor had searched for agreement on the Social Pact. The social partners did agree on the basics of the 1995 budget and a small increase in the minimum wage; labor also agreed to wage restraint. However, negotiation of the supplementary budget in 1995, the Bokros package, could not conclude in agreement. The original 1995 budget already specified no increases in social spending, it would not increase the scope for a redistribution of income, and the unions had already agreed to wage restraint. But the Bokros package called for further sacrifices and the unions could not and would not accept it.[95]

But the final straw for the trade unions was over amendments to the labor code. They walked out of negotiations in February, 1995 because of this. The

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[95] The negotiations were widely covered in the Hungarian media. Also, the ILO, as a supporting body of tripartism, reported on events in Newsletter 1, 1995.

employers had been pushing for greater flexibility with respect to overtime and standard working hours and had drafted changes in the labor code designed to meet these desires. The unions had suggested maintaining the labor code but adding a provision which would allow branch level collective agreements to allow greater flexibility with respect to overtime and working hours (ILO 1995). This dispute is a good example of the false claims of the Socialist Party as being social democratic and it is clearly a comment on its commitment to labor.

The employers, however, did not find the Socialists any easier to deal with than the trade unions. Agnes Ungvarszky of the Employers Association stated, 'We were looking forward to the HSP being in power, but it hasn't worked any better. The HSP doesn't seem to respect the consultation process any more than the HDF coalition did'.[96] She also said that Finance Minister Lajos Bokros did not listen very well and was difficult to work with and that they did not expect Peter Megyessy who was the new Finance Minister at the time of the interview would co-operate any better than Bokros.

After the breakdown of negotiations over the Bokros package, the IRC had met a few more times but the meetings also ended in dispute. Why did tripartism fail so miserably when the government of the day was supposedly pro-union? Probably the most important reason is that the government had prioritized fiscal austerity above any other goals. According to the Employers'

[96] Interview with Ungvarszky.

Association, the IMF seems to control the agenda.[97] The ILO cites, "intensive pressure from the Bretton Woods Organisations," as the reason (ILO 1995).

The above point of view might be confirmed by the IMF's and World Bank's opinion of the Socialist coalition government. According to one representative from the World Bank, the Bank and the IMF found the Socialist government easy to work with and much easier than the HDF government. He said of the Socialists: 'I am a liberal, they [the Socialists] are liberals.'[98] In the context of the conversation, it was clear that he was referring to the Socialist government as what I have described in this work as neoliberal.

One year after the introduction of the "draconian" Bokros package, the IMF concluded a stand-by agreement to grant Hungary a 23 month Special Drawing Rights of 264.18 billion stand-by credit facility. In concluding the agreement, the IMF approved of the government's stabilization strategy. The Hungarian government committed itself to reduce the current account deficit by specified amounts in its application to the IMF, to less than $2 billion in 1996 and $1.5 billion in 1997. In 1995, it was $2.48 billion (National Bank of Hungary 1996, p. 20).

The agreement, according to a National Bank of Hungary document (1996, p. 20)[99] also included: 'the structural reform of the public sector, strengthening of

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[97] Interview with Ungvarszky.

[98] Interview with Kopanyi.

[99] This was also confirmed in my interview with Kopanyi.

the financial basis of the social security system, reorganization and privatization of state owned enterprises and banks, continuing liberalization of international payments'. The agreement had three other major areas: enterprise reform concerning privatization and bankruptcy; the use of privatization receipts specifying the types of government policy; and the banking sector. The Bank disapproved of the banking consolidation program started in 1992 by the HDF government due to its high cost. Nevertheless, the recapitalization of banks made them more attractive to investors and, when the Socialist government put the banks up for sale, the privatization resulted in 60% foreign ownership.

The Hungarian government announced that it would not draw credit from the stand-by agreement as the country's financial position did not require it. The agreement was necessary, however, for admission to the OECD, for World Bank loans, and would assist in external borrowing. In effect, the point of imposing austerity on the population is to get a clean bill of health from the IMF, important for foreign investors and lenders.

After the Socialist coalition's term in office, the IMF was still congratulatory in its efforts: "Executive Directors commended the authorities for their steadfast implementation of fiscal and monetary policies, which had led to a significant decline in inflation in 1998 and facilitated strong growth, in the context of a manageable current account position" (IMF 1999).

But the push of international organization has not been the only way in which capital has been able to solicit the co-operation of the state to the disadvantage of labor. While the Labor Code of 1992 guarantees the right of workers to organize and to have collective bargaining, the state has not upheld these rights. According to a report by the International Confederation of Free Trade Unions:

> In the growing private sector, including the large foreign-owned sector, many employers actively discour00age trade union organising by victimising and discriminating against union officials and members. The harassment goes unpunished because of ambiguities in the law and disputed interpretations. Enforcement proves difficult because the labour courts are overburdened and proceedings can take serveral years.
>
> (IFCTU 1998)

The IFCTU report also gives examples of the above claims. In the US-owned United Technologies Automotive Hungary, the company responded to organizing efforts of workers by forming a works council. A works council has members that are appointed by management of the company and so is not necessarily representative of workers. The leaders of the union and some of its founding members were fired on the claim that the workforce was being reduced, but in normal circumstances of layoffs, workers are not escorted home by security guards as they were in the case of United Technologies. Although a labor court found that the workers were fired because of union activities, the company had appealed the process and in the meantime had offered the workers a monetary settlement which they accepted fearing further victimization if they were to return to the workplace. By 1998, there was still no union at United Technologies.

The foreign-owned Piszke Paper offers another example of capital failing to respect legally guaranteed rights and the failure of the state to uphold them. In 1993, a dispute began when the company was privatized. The privatization contract specified that a collective agreement be concluded and set a deadline for its conclusion. In violation of the agreement, the firm cut social benefits and would not grant wage increases. Bargaining came to a stop when a strike was organized and when the chairman of the local branch of the Paper Workers' Union was fired and was banned from entering the factor. Other workers were intimidated by the threats from the management to close down the company. A labor court found his dismissal illegal, but he was not reinstated. After an appeal by the Union, the Supreme Court ruled that he should be reinstated but Piszke Paper had sent him on compulsory leave. Eventually, his employment was terminated by mutual consent (IFCTU 1998). Given the hostile treatment by labor and the lengthy process to achieve a satisfactory legal resolution, it is not difficult to see how workers are easily intimidated by capital.

The IFCTU (1998) also reports that "many workers are employed without employment contracts and there are reports that some foreign companies require women to undergo a gynaecological examination to ensure they are not pregnant when being employed". Additionally, there are many reports of safety violations due to the decrease in labor inspections.

Moreover, according to one representative of foreign capital, the "corporate" view on unions was that "they had too much power".[100]

2. Domestic capital - foreign capital relations

Although the interests of capital are often portrayed as unified, conflict does exist. For example, the interests of capital are not always supportive of liberalization as it increases competition. Westel 900 objected to liberalization as it wanted to control competition.[101] The representative from the Employers' Association also commented that the organization was not in favor of the speed of liberalization because the government had not implemented necessary legislation. For example, the Hungarian cement industry was "destroyed" when Slovakian cement producers, who are heavily subsidized, exported cement to Hungary. With anti-dumping legislation, this would not have happened, according to Ungvarszky.[102]

Another area of conflict appears to be between Hungarian small and medium-sized enterprises and other forms of capital. These firms are mainly suppliers to other firms and were disproportionately affected by the break-up of the CMEA. As foreign investment has mainly obtained its supplies from outside

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[100] Interview with Dorrotya Hovanyi, Executive Director of the Canadian Chamber of Commerce in Hungary, July 5, 1996.

[101] Interview with Hovanyi. Westel 900 is one the Canadian Chamber's members.

[102] Interview with Ungvarszky.

of Hungary, small and medium-sized enterprises have not been able to recover much of a market.

But it also appears that there are some conflicts between Hungarian capital and foreign capital. For example, there have been tensions between representatives of foreign and domestic capital. According to the Hungarian Chamber of Commerce, the American Chamber of Commerce (AmCham) has maintained bad relations despite the HCC's efforts towards co-operation. This changed, however, when the HCC was able to receive money and participate in the government's program for free trade zones.[103] The foreign chambers of commerce appear to resent the mandatory membership requirement of the HCC.[104] According to the Hungarian Chamber of Commerce, the foreign chambers resent the special place of the HCC as it is a public body with different rights under law than the foreign chambers. It is therefore able to receive money from the government and participate in government programs which the foreign chambers can not do. However, the foreign chambers' view is different: It contends that the HCC tried to have the foreign chambers banned.[105]

More importantly, the foreign chambers admit there is conflict between foreign capital and Hungarian capital. This is because domestic capital views

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[103] Interview with Keszthelyi.

[104] This was expressed to me in a few different interviews with persons from foreign chambers. It should be pointed out that membership fees are insignificant.

[105] Interview with Hovanyi.

foreign capital as being able to tell the government what to do.[106] The experiences with the IRC might be one indication of this. The Hungarian Employers' Association contends that the government is only interested in following IMF instructions pertaining to decreasing the budget deficit and therefore runs counter to capital and workers' mutual goal of economic growth, and it is not particularly in the employers interests to have a decline in wages.[107] The effects of deficit reduction has reduced real wages thereby reducing domestic demand. Domestic capital is more reliant on domestic demand whereas foreign capital is driving export growth so decreasing domestic demand will impact capital differently. With the pattern of foreign investment that evolved in the 1990s, statistics clearly indicate the dominance of foreign capital in export markets. In 1993, already 50% of exports were produced by foreign-owned firms. Foreign-owned firms accounted for all of the increase in exports between 1992 and 1993. By 1998, foreign-owned firms at least partially produced 70% of exports in 1998. Also, as indicated earlier (see Table 5.8), exports as a percentage of GDP grew over the 1990s such that by 1997, exports accounted for over 40% of GDP.

While generally capitalists want to decrease the wage burden, it is important to understand that Hungarian capital views the problem with labor

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[106] Interview with Hovanyi.

[107] Interview with Ungvarszky.

costs in conjunction with the tax structure and not with the wage rate itself. For every 100 HUF earned by the worker in terms of wages, only 52 HUF is take-home pay due to the heavy burden of personal income taxes and social security taxes. The burden on the firm for the same 100 HUF in wages is really over 150 HUF due to the taxes the firm must pay associated with wages.[108]

However, it should be pointed out that foreign capital has a slightly different view of wages as the following quote from the Task Force on labor and immigration indicates[109]:

> All serious investors must come to the conclusions during the due diligence process that Hungarian labor is the most expensive among the ex-communist countries. In fact, studies show that Hungary is a world recorder with the [sic] 61% total wage burdens...The question is what level of higher costs are justified by all these good features of Hungarian labor [educational background, creativity, etc.] especially when in other countries similar characteristics are coming more and more to the surface as the transition toward market economy progresses. It seems to be the policy of the government to put more burdens on employers in cases where the high costs are caused by the ineffective or wrong systems in place. E.g.: the high costs of sick-money payments are caused by the intricate problems in the system...The government wants that the sick days paid by the company be raised by 100-150%.

The paper goes on to propose that:

> If Hungary wants to stay an attractive country for investors and wants to keep competitiveness large-scale comparative studies should be started with the involvement of international experts in order to find out what level of total wage costs the country can afford in order to keep its positions on the international export and capital markets.

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[108] Numbers given by Keszthelyi. His comments about wage decreases were in the same vein as Ungvarszky's mentioned above.

[109] Quote taken from the paper by Task Force on Labor and Immigration entitled, 'Proposals to the Hungarian government in the area of labor and immigration in order to facilitate foreign investment,' presented to Prime Minister Gyula Horn on May 26, 1995. As the Task Forces are secret with the exception the Environmental, the papers are not publicly available.

Interestingly, the paper only mentions once taxes and wage burdens: 'The results of studies [described above] must be seriously considered by the legislators when establishing tax and other burdens in connection with wages'. The paper by the Task Force on Tax Law and Customs does not mention taxes associated with the labor costs either.

The existence of the foreign chambers' Task Forces might be one reason why domestic capital views the foreign chambers as being able to tell the government what to do. Originally, British Chamber of Commerce had a governmental relations committee which dealt with issues of lobbying government but then it decided that doing so would be more effective if they combined forces with other foreign chambers. This is because according to the Executive Director of the British Chamber of Commerce, foreign firms have generally the same interests and the types of discrimination by the state are against all foreign firms.[110] At first the Task Forces were a joint effort between the Canadian, British and American Chambers of Commerce but later others joined.

The Task Forces initially set up were: Privatization; Bank and Finance; Labor, Transport and Telecommunications; Tax and Customs; the Consumer Sector; and Environment. In 1996, the Privatization Task Force was winding down and a new one, the Task Force on Energy was established. The Task

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[110] Interview with Eva Markus, Executive Director of the British Chamber of Commerce, July 18, 1996.

Forces focus on three areas: legislative process, administrative and bureaucratic process and the policy process. By May, 1995, the Task Forces had presented the first reports to Prime Minister Gyula Horn. It should be added the Prime Minister, after initial discussions with representatives, invited the reports.

The existence of the Task Forces and their reports remained a secret with the exception of the Task Force on the Environment. In July of 1996, I was only able to obtain copies of the reports by making numerous promises that they would not end up published or reported on in the media in *any* country. The Chambers expressed a keen desire to keep the matter of the Task Forces and the special relationship with the Prime Minister and the Government of the day completely confidential. According to the Chambers, the reason they are not public except for environmental task force is because they promised the government they would not go to press on various matters and instead would work with the government.[111] But since popular dissatisfaction with foreign capital has been increasing throughout the 1990s, it is clear that the Socialist government did not want to make the public aware of the special relationship. In other words, the existence of the Task Forces does cause the appearance of what foreign capital has been attacked for -- too much influence with the government.

[111] Interview with Andre Mecs of Mecs and Associates, President of the Canadian Chamber of Commerce, July 17, 1996.

Although some of the Task Forces were trying to become lobby groups, that is not their purpose. Instead they are offering "expertise" in how to do things and how to make Hungary operate like a "Western country".[112]

In general, the main thrust of the Task Force reports is that there is over-regulation, the judiciary needs to be educated in "commercial matters", and that labor needs better discipline. Implicit and sometime explicit throughout the reports are threats of capital flight or that the Hungarian state is preventing more foreign capital from being invested. The Task Forces have continued to build relationships with ministries and other state agencies.

But all of the above leaves the question as to whether the foreign-owned sector has been advantaged over domestic capital. Data on profits are unreliable due to transfer pricing. As Major (1995) shows, firms with double-entry bookkeeping had significant losses in 1993 although they had shown profits in 1988. In discussing the profits with Major[113], he indicated that foreign firms are experiencing losses due to transfer pricing. In other words, as is common in many countries, firms use the pricing of components to transfer profits to a lower tax country thus hiding profits. The research of the OECD (1995, p. 84-85) indicates that in 1993, exporting companies continue to make losses but that the losses had declined from 1992 levels, whereas for non-exporters, losses only

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[112] Interview with Mecs.

[113] Discussion with Ivan Major, researcher at the Hungarian Academy of Sciences, July 20, 1996.

decreased marginally. Since most of the export sector is dominated by foreign-owned firms, their profitability may be returning more quickly than firms producing for the domestic market which include the domestic-owned sector. But again, due to transfer pricing and the lack of data, it is difficult to conclude anything about profitability.

What can be said is that the growth of value-added in foreign-owned sector much higher than the growth in the domestic-owned sector. As can be seen in Table 5.9, the foreign sector's growth in value added from 1993 to 1995 was 160%, for 1995 to 1996, it was 45%, and for 1996 to 1997, it was 89%. The corresponding figures for the private domestic sector are 67%, 26% and 8%. In other words, while the foreign-sector is rapidly growing in terms of value added, the private domestic sector is growing more slowly and growth has slowed.

Table 5.9: Growth in value added by sub-sector of ownership for selected years (in percent change).

Sub-sector of ownership	1993-1995	1995-1996	1996-1997
Public	10%	-8%	22%
Domestic (private)	67%	26%	8%
Foreign	160%	45%	89%

Source: Adapted from figures in Central Statistical Office (1995, 1999).

E. Conclusions

While the emergence of a neoliberal-integrationist strategy of accumulation is not surprising to many who have studied developing countries, the cause of its emergence is also not surprising. The role of foreign capital has become dominant and has been able to generally impose its agenda over the interests of labor and other classes in Hungary. It might seem that Hungary has joined the "race to the bottom" in an effort to attract capital and prevent capital flight.

It does leave the question as to why the state has co-operated so whole-heartedly with transnational capital. As argued above, the Socialist government, in spite of its pact with the largest labor union and its social democratic platform, had quickly adopted a neoliberal strategy. And the strategy of the Socialists was even more concretely neoliberal than that of the the HDF government even though the HDF had been voted out because of the harshness of the reform process. Instead of cooperating with social partners and adopting a more social democratic strategy, the Socialists did just the opposite. As their term in office proceeded, it was clear that they were quickly losing their support - labor unions and other groups struck and protested, and the Bokros Package of 1995 was received with outright hostility by the electorate.

It might be argued that the reason for the adoption of the neoliberal strategy was that radical reformers were rewarded for their efforts: Miklos Nemeth, the Prime Minister at the end of the 1980s and a leading radical reformer at the end of state socialism, was given the position of managing director at the European Bank for Reconstruction and Development. Lajos Bokros, the mind behind the infamous Bokros package, is now a managing director at the World Bank. Gyula Horn, the Foreign Minister at the end of state socialism who dramatically cut the fence at the Hungarian border allowing East Germans into Austria, and the Socialist Prime Minister from 1994-98, is rumored to be worth millions. For many, being a reformer has paid off.

But it would seem that there must be more to the story than individual gain. Perhaps what is most important is how global events in the 1970s and the 1980s shaped the dominant ideology around the world. Many Hungarians in power in the 1990s, receiving training and advice from the West, reading Western textbooks and making trips to the West, were quick converts to neoliberalism. But this needs to be combined with the reality of the Hungarian economy as perceived by policy-makers. Policy-makers believed their policies to be born of pragmatism and necessary for future growth and development even if living standards had to fall in the shorter run. As one of the main authors of the Bokros Package said to me, "[M]y generation is the lost generation. We are doing this for our children". [114] For policy-makers, Hungary is a small country with limited resources and had a high per capita debt by 1990. It would appear that to the very Westernized leaders of Hungary, that what became the

[114] Interview with Istvan Fabian, Ministry of Finance, September 4, 1996.

mainstream belief in the West - that there is no alternative to neoliberalism - was the truth. Policy-makers (and those giving support to policy-makers such as academic economists) generally accepted that a harsh reform process was necessary for overall development. It is not that they believed that this a permanent path, but that attracting foreign capital is necessary for investment and modernization. Tight fiscal and monetary policy is necessary for lowering inflation and to reduce the debt. In general, they believed that there was no way around the policies adopted. Growth and development was not sustainable if they could not get the numbers right. And in order to get the number right, they needed to implement one particular set of policies. No other choices were made available.

Additionally, the attractiveness of the EU in the early and mid 1990s should not be understated. While critics of neoliberalism can point to Southeast Asia as representing another model of development, the geographical position of Hungary would indicate another direction. Ireland, Portugal and other poorer EU nations represent, at least to politicians, better examples of the possibilities for a country like Hungary. But in order for Hungary to benefit the same way as Ireland, it must become a member, and to become a member, it must co-operate with foreign capital on their terms. EU countries represent the largest investors in Hungary and the biggest trading partners. It must cooperate with these investors and adopt EU policies in order to curry favor. Clearly appearing Western-friendly and open to foreigners was key in many policy decisions such as joining NATO. In fact, the Hungarian government, during NATO's intervention in Yugoslavia (in Kosovo), allowed the use of its territory and gave its full support to NATO while the governments of the Czech Republic and Poland did not hide their lack of support. A day after the Hungarian Parliament voted to allow NATO troops to use Hungarian air bases, the EU came out in praise of Hungary' reform process and progress while in the same breath, it criticized that of Poland and the Czech Republic.

Although policy-makers may believe that the neoliberalism is the correct strategy, at least for the short run, the effects of the strategy are debatable. In the next chapter, the effects of the emergence of the neoliberal-integrationist strategy, and the potential to change course are explored.

CHAPTER VI

CONCLUSIONS

A. Introduction

In June, 1999, Peter Tufo, US Ambassador to Hungary declared that, "[S]eeing the country's rapid development, Secretary of State Madeleine Albright decided that the Hungarian assistance programme of the United States would end in June," [Magyar Taviroti Iroda (MTI, Hungary) 29 June 1999]. It appeared that by 1998 or 1999 the US and other Western governments considered Hungary a success; the country no longer needed "assistance", it was rapidly "developing". But was it? Or, at least, what does "development" mean in this context?

Certainly it would appear that "transformation" or "transition" has come to an end in Hungary. The changes that occurred in the 1980s and the 1990s have undoubtedly brought about the transformation in Hungary from the state socialist mode of production to the capitalist mode of production. But how successful was transformation in Hungary? Obviously, there were winners and losers, but it will be argued here that most of the population, as wage-laborers, has lost out because it will take years for them to regain the losses in their standard of living incurred over the decade of transition. Additionally, key aspects of the welfare state that have benefited the working class have been reduced, eliminated or threatened and the tax base, due to tax cuts, has declined to the point where it will be difficult to justify the continuation of social programs in the light of the consequential budget deficits.

In the last chapter, I argued that the strategy of accumulation which emerged during transformation was neoliberal-integrationist. This chapter also attempts to answer the question of whether Hungary will continue along the same path it has done over the course of transition. In 1998, for a third time, the population has elected a new government with the hopes of easing transition. The new government, a coalition led by Fidesz-HCP, has been elected on promises made to increase security and raise the standard of living. But, like its predecessors, the new government will find that election pledges can only be fulfilled to a limited extent in the absence of changes in the global economy. In the first year of the Fidesz-HCP government's term, it was already clear that the election promises would mean little to the actual practice of government.

However, the trajectory of Hungarian economic development is what Western governments describe as "rapid development". Not only is capitalism firmly embedded as the mode of production, but its institutional structure is one in which neoliberalism is the overarching guiding force. The economy is wide open to foreign trade and foreign investment and the will of capital is more important than the will of ordinary citizens in determining state intervention and capital-labor relations.

Finally, this chapter also examines the extent to which regulation theory was helpful in underpinning the explanation of the processes of transformation from state socialism to capitalism, but before reviewing the theory of transformation, the chapter evaluates the reality of transformation.

B. Living standars and economic performance during the transition period

In Chapter Four, the emergence of a capitalist class was examined. In a sense, the new owners and managers of capital can be described as the "winners" in the transformation process. For the most part, the winners were individuals who already formed part of a broadly defined elite under state socialism, managers, deputy managers, others with political and economic power. It is also clear from the discussion that foreign capital was a beneficiary of the distribution of property. Yet, the vast majority of Hungarian nationals constituted a wage-labor class under state socialism and was transformed into a wage-labor class under capitalism. This process was not complicated: those without access to property were forced to continue as wage-laborers.

One way to understand the impact of the transformation to capitalism is to view how it affected the vast majority of people as wage earners. To this end, indices of average wages, income and the like give some indication how on average a person has been affected. Table 6.1 shows indices of real wages per wage-earner. Although real wages per wage-earner declined from 1980 to 1989 by 6.5%, the decline accelerated from 1989 to 1996 when they fell by 24.2%. The decline was so severe that the 1996 real wage per wage-earner level stood at approximately what it was 30 years earlier somewhere between the years 1966 and 1967.[115] The index of per capita real income shows a slightly different picture (also see Table 6.1). Although real wages declined in the 1980s, per capita real income steadily increased.[116] However, per capita real income started declining in 1990 and continued falling through 1993, and then after increasing in 1994, declined again in 1995, stagnated in 1996, and increased slightly in 1997. This put real per capita income in 1997 just over the 1980 level.

Table 6.1: Indexes of real wages and salaries per earner and per capita real income for selected years (1980=100).

Year	Index of real wages and salaries per earner	Index of per capita real income
1980	100	100
1988	92.7	111.6
1989	93.5	115.4
1990	90.0	113.3
1991	83.7	111.4
1992	82.5	107.5
1993	79.3	102.4
1994	85.0	105.2
1995	74.6	99.6
1996	70.9	99.6
1997	74.4	101.0

Source: Central Statistical Office (1998, p. 101).

[115] According to long time series data where the index is 1950=100, the 1966 level was 172, the 1967 level was 178 and the 1996 level was 173 (Central Statistical Office 1998, p. 4).

[116] With the exception of 1988. According to long time series data where the index is 1950=100, the 1987 level was 376 and the 1988 level was 372 (Central Statistical Office 1998, p. 4).

It would be helpful to understand more how income is distributed because if wages and incomes began growing, it may be the case that this is a reflection of growth at the high-end and therefore, the average worker may not be benefiting from statistical growth in wages and salaries or growth in real income. The 1999 OECD report (p. 62) indicates that the gross earnings dispersion as measured by the D9/D1 ratio (the ratio of gross earning of individuals between the tenth and ninth decile to those in the first decile) widened from 4.1 in 1996 to 4.3 in 1997. While this figure only gives a picture of what happened during one year, it is commonly acknowledged that widening income inequality has been a feature of the 1990s. This would explain why real income fell less that real wages during the period 1980-1996.[117]

Widening income inequality is unsurprising given the redistribution of property, but there have been significant increases in salaries at the high end as well. Even just between 1996 and 1997, the annual salaries of directors increased tremendously with the largest increase, from 8 million to 12 million HUF per year, achieved on average by managing directors.[118] This means that the average managing director made more than 17 times the average monthly earnings of an employee in 1997.[119] Again, this example of change in one year - a 50% increase -

[117] Demographic changes do not clearly explain the difference in the two trends because the labor force participation rate declined in the 1990s and the population has aged.

[118] Price Waterhouse figures on directors' salaries can be found at www.multijob.hu/m_stat.htm.

[119] The average monthly earnings for employees in 197 was 57,720 HUF.

is representative of the trend in wages and salaries at the high end over the course of the 1990s. These salary increases for managing directors and other large increases at the high end have occurred with decreases at the lower end and freezes in the middle. In the absence of changes in state redistribution functions or any other shift in the social structure, income inequality will continue increasing. Although income inequality is less than in some of the advanced capitalist countries, it is most likely the case that over time, it will more closely resemble countries with more unequal distributions of income such as the US and the UK, or many developing countries.

Table 6.2 shows other indicators of well-being. While per capita consumption steadily increased from 1950 to 1989, it began declining in 1990. Although there was a slight increase in the index in 1993 (and no change in 1994), 1995 and 1996 again witnessed decreases. A slight increase in 1997 left per capita consumption below the 1980 level.

The consumption of nutritive materials also declined by 1997 to lower than the 1962 level.[120] Although consumption of meats, cereals and other food products has declined, consumption of potatoes has increased. This is typical consequence of declining household income. As income declines, the consumption of inferior goods, such as potatoes, increases.

[120] 1962=12,326 kJ per day.

Table 6.2: Index of per capita consumption and kJ per day of nutritive materials for selected years.

Year	Index of per capita consumption	Nutritive materials, kJ per day
1950	100	11,317
1960	152	12,301
1970	228	12,971
1980	316	13,486
1988	362	14,047
1989	382	14,637
1990	362	14,164
1991	329	13,460
1992	329	13,796
1993	335	13,080
1994	335	12,770
1995	314	12,473
1996	306	12,405
1997	313	12,323

Source: Central Statistical Office (1998, p. 5).

Another indicator of the state of society is the tremendous growth in poverty since 1990. Two measurements give an idea of the extent to which poverty has increased during the period from 1989-1993. Measuring incomes below the minimum pension, the incidence of poverty in 1989 was only 1.6% but grew to 8.6% by 1993. Measuring poverty according to the number of households with income at half of mean household income, poverty increased from 4.3% in 1989 to 34.6% in 1993 (World Bank 1996). According to other reports, poverty continued to grow throughout the 1990s.[121] By 1998, one estimate rated the incidence of poverty as high as 5.2 million people, over half the population.[122] Regardless of the exact figure or method of measurement, there is no dispute that poverty has increased tremendously and represents a serious problem in the 1990s and for the future. These measurements of changes in the rate of poverty also given an indication as to how much income inequality has widened.

What remains unclear is whether any serious effort has been made to reduce poverty. In order to reduce poverty, either the state would have take on more redistributive functions, which goes against the prescriptions of international agencies, or implement a serious program to increase employment. Unless the government significantly changes policies, neither of these is likely to happen. If the trajectory over the course of the 1990s continues, the government will only continue to reduce wealth redistribution.[123]

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[121] For example, the Ministry of Foreign Affairs, Press and International Information Department cites an ILO survey. According to that survey the incidence of poverty was seven times higher in 1994 than in 1989 as measured by half of the average income threshold (www.undp.org/missions/hungary/970317kp.htr).

[122] This statistic is from Maria Hegedus, founder of the World Organization for the Elderly and was cited in the *Budapest Sun*, 6 May 1999.

[123] It is clear that the government has chosen to decrease the state's redistributive function. For example, in a 1996 government document, it states that, 'the Hungarian government plans to reduce wealth distribution by the public sector by bringing public expenditure down from 55% of GDP in 1995 to 51% in 1996 and below 45% in the next three or four years (National Bank of Hungary 1996, p. 28). While the share of state spending might be high compared with many advanced capitalist countries, the commitment to continue the radical reduction in expenditure is clear. Primary expenditures (net of debt interest payments) fell between 1994 and 1998 from 52% to 39% of the GDP.

The reason that wages decreased and poverty increased is the shortage of jobs. While unemployment has fallen from its peak in 1993 of 11.3% to 7.8% in 1998, all of this decrease can be accounted for by the decline in the labor force participation rate (see Table 6.3). The participation rate, which was 61.8% in 1992, was only 51.7% by 1998. In the absence of available jobs, many workers became discouraged and left the labor force. Table 6.4 indicates that job creation had not even begun until 1998, the first year to show an increase in employment.

Table 6.3: Unemployment and labor force participation rates, 1990-1998.

Year	Unemployment rate	Participation rate
1992	9.3	61.8
1993	11.3	59.2
1994	10.7	54.0
1995	10.2	52.4
1996	9.9	51.8
1997	8.7	51.2
1998	7.8	51.7

Source: For 1992-93, Central Statistical Office (1996, p. 66) and for 1994-98, Central Statistical Office (1999, p. 81).

Table 6.4: Change in percent of employment, 1992-1998.

Year	1992	1993	1994	1995	1996	1997	1998
% change	-9.8	-6.3	-2.0	-1.9	-0.8	0.0	1.4

Source: IMF (1999).

In spite of what might appear to some to be a dramatic decrease in the standard of living, mainstream economists would argue that the economic benefits of growth will trickle down. Without question growth returned in 1994 after a serious downturn in the early 1990s. Although growth was moderate for a few years, 1997 and 1998 produced growth rates of 5% each year (see Table 6.5 for per capita GDP). Fixed investment and exports also made significant recoveries in 1994 and inflation steadily declined over the 1990s. In 1997, real earnings (net of taxes) finally increased by 4.9% and again in 1998 by 3.5% (OECD 1999, p. 27). The first four months of 1999 indicated that real average earnings (net of taxes) grew at an annual rate 3.1% according to the Central Statistical Office (MTI 15 June, 1999).

Table 6.5: Per capita gross domestic product.

Year	Index (1980=100)	Index (Previous Year=100)
1980	100	100.1
1990	115.8	96.8
1991	102.4	88.4
1992	99.4	97.1
1993	99.1	99.7
1994	102.4	103.3
1995	104.1	101.8
1996	105.9	101.7
1997	110.8	104.9
1998	116.4	105.1

*By the official exchange rate of the National Bank of Hungary.
Sources: For 1990-1994, Central Statistical Office (1996, p. 223) and for 1995-98 Central Statistical Office (1999, p. 286).

Growth has clearly been led by strong increases in investment in 1994 and continuing in 1996 onwards. However, as Table 6.6 indicates, investment declined so much that only by 1998 did the level of investment surpass the 1989 level.

Table 6.6: Volume index of investment (1960=100).

Year	Investment
1960	100
1970	227
1980	359
1988	312
1989	325
1990	293
1991	257
1992	253
1993	259
1994	291
1995	276
1996	290
1997	315
1998	355

Source: Central Statistical Office (1999, p. 12).

Growth has returned to the economy but it will still take a number of years before real wages and consumption reach 1980s levels. And, growth may very well continue slowing. The signs from the end of 1998 and beginning of 1999 indicate that growth may slow to low levels and thereby make a full recovery take longer. No matter what happens, the 1990s are a lost decade in Hungarian economic development. By the end of 1998, the GDP was only just above the 1986 level. Growth of 3.1% in 1999 would still mean that GDP would still be well below the 1989 GDP.[124]

[124] According to long time series data in Central Statistical Office (1999, p.12) where the index is 1960=100, the level for 1998 was 303, and for 1989 it was 317. With 3.1% growth, the index for 1999 would be 312.

There is no doubt that aspects of the economy have improved over the course of the 1990s. The gross debt as a percentage of GDP (including intercompany loans) from 64.3% in 1990 to 56.2% by 1998. However, as can be seen in Table 6.7, this decline in gross debt relative to GDP has been uneven, often rising significantly as opposed to falling steadily. The same trend exists for net debt as a percentage of GDP but this decline was more significant falling from 48.2% in 1990 to 25.9% in 1998.[125] Notably, the share of net debt has shifted considerably from the government (and National Bank) to the private sector. This trend can be seen in Table 6.8.

Table 6.7: Net foreign debt and gross foreign debt as a percentage of GDP.*

Year	Gross debt as a % of GDP	Net debt as a % of GDP
1990	64.3	48.2
1991	67.9	43.6
1992	57.5	35.6
1993	63.7	38.7
1994	68.4	45.4
1995	72.3	38.4
1996	61.0	31.4
1997	51.9	24.4
1998	56.2	25.9

*See footnote 11 for definitions of gross debt and net debt.
Sources: Adapted from figures in Central Statistical Office (1996, 1999).

[125] Gross debt is the net debt plus international reserves and foreign claims. In other words, gross debt is what is owed in its entirety whereas net debt excludes reserves (which are assets for Hungary and liabilities for other countries) and foreign claims which are claims Hungary has on foreign countries and thus, are also an asset for Hungary.

Table 6.8: Share of net foreign debt - government and National Bank of Hungary (NBH), and private sector* expressed as a percentage.**

Year	Net debt (million USD)	Share of net debt: government and NBH	Share of net debt: private sector
1990	15,938	103.9	-3.9
1991	14,555	103.5	-3.5
1992	13,276	98.8	1.2
1993	14,927	89.7	10.3
1994	18,936	80.4	19.6
1995	16,817	65.6	34.4
1996	14,229	54.4	45.6
1997	11,157	42.5	57.5
1998	12,344	36.8	63.2

*For data on 1996-1998, share of net debt is "private sector" where as earlier, it is defined as "commercial banks and enterprises".
**Negative percentages in 1990 and 1991 represent negative debt held by the commercial banks and enterprises for those years.
Sources: Adapted from figures in Central Statistical Office (1996, 1999).

But the reason that debt has been reduced is, at least in part, a commitment by the government to reduce the debt. This commitment can be seen in Table 6.9 which indicates that the share of central government expenditures devoted to making debt payments was generally rising. In particular, during the time of extreme fiscal austerity, from 1995-1997, the share devoted to making debt payments was over one-fourth total expenditures. But, making debt payments means that there is less left over for other types of government spending. In the absence of new sources of government revenues and a growing budget, there are fewer resources to devote to social programs and other types of government spending that may enhance living standards and productive capacity.

Table 6.9: Foreign debt service and interest payments as a percentage of total central government expenditure, 1993-1998.

Year	1993	1994	1995	1996	1997	1998
Percentage	14.9	23.8	29.1	27.4	30.9	24.2

Source: Adapted from figures in Central Statistical Office (1998, 1999).

Another issue related to debt repayment is that the government revenues during the 1990s were enhanced by privatization. In other words, privatization revenues can mainly account for debt repayment, but this is unsustainable. Since privatization ended at the end of the 1990s, and very little money can be expected to be raised from privatization in the next decade, this process of selling off assets to repay debt became no longer feasible by the end of the 1990s. It is easy to argue that this was a sensible way of dealing with the debt burden - sell assets and use the revenues to repay debt. This will, in effect, also lower interest payments and therefore decrease the state's future commitments. However, this use of revenues does not necessarily enhance the productive capacity of the country and it may be possible that other uses of revenues would have. It is not necessarily in the long term interests of a country to reduce spending on, for example, education. More importantly, if we take the perspective of capital accounting, nothing was gained. For example, if mining rights are sold for \$100,000 and that money is used to repay the debt, there may be \$100,000 less debt but there is also \$100,000 less assets. This issue is further complicated by the speed at which privatization was carried out in Hungary. It is conceivable to believe that at least a large proportion of assets were not sold at their full value, thus the decrease in assets is actually larger than the respective decrease in debt.

Nevertheless, gross foreign debt as a percentage of GDP still remains at a comparatively high level.

C. Alternatives to neoliberal integrationism

Given the rather dismal effects on transformation on the average Hungarian, that leaves the question of whether there was another strategy that could have been pursued which would have resulted in a stronger economy and that, at least, would have lessened the effects on the ordinary person. There could have been an alternative.

During the 1990s, there was widespread support for a social democratic alternative - the support for the Socialist Party which ran on a social democratic platform is evidence of this support. Even before 1994 (when the Socialists were elected), there was popular support for encouraging Hungarian ownership and Hungarian control. The HDF government elected in 1990 did not immediately preach neoliberalism. The government was elected on a nationalist platform, and although the HDF ran a strong anti-communist platform, it was not a party of neoliberals. Although the union movement quickly became splintered, there was still a great deal of support for unions in the early 1990s.

An alternative to neoliberalism could have involved much more gradual privatization and an active industrial policy. Financially troubled firms could have been restructured to become internationally or domestically competitive, or at least wound down more slowly giving workers a chance to take advantage of new opportunities elsewhere. State socialist economies had a strong state with experience in directing economic policy. It may have made more sense to study the policies of East Asian economies and adopt more state directed economic development.

Part of the answer to the question as to why other alternatives were not pursued was because strategies used in certain East Asian countries were home grown - designed and put into practice by nationals without significant foreign advice. This is in stark contrast to Eastern European countries which relied heavily on Western advice.

Another part of the answer lies in the timing of transition. Neoliberalism became not only the orthodox ideology and economic strategy, but it became the only strategy. Even the successful East Asian economies (except for China) adopted neoliberal policies which led to crises. Nevertheless, alternative ideas and strategies were scarcely discussed, if at all. When Hungary began transforming its economy in the early 1990s, the only advice the government received from foreigners such as the World Bank and Western advisors, was to make as quick a transition as possible. But the same forces at work in the international arena also explain why internally there was limited generation of alternatives.

In order to generate new ideas and to adopt a different strategy, widening democratic participation would have been necessary. In so many ways, the transition process marginalized the average Hungarian. Attempts at tripartism proved half-hearted at best. Moreover, the transition process was so difficult, that workers, pensioners and others were left scrambling just to get by with what they had. The excitement of change quickly died after a couple of years of the effects of transition, but instead of this meaning greater worker solidarity and a fight for an alternative, the population was disorganized and divided. The representation of interests became segmented by disputes between different unions and the rural versus the urban population.

The elite benefited from the transition by gaining economic and political power. Nevertheless, it is still important to remember that many of the members of the advantaged classes greatly believed in what they were doing. They believed that they could achieve a Western-style economy (capitalism) and although they did not believe they would immediately achieve the Western standard of living, at least they would be on the path to achieving a better standard of living. And, the elite, on an individual level, did to some extent achieve the Western standard of living. As the segment of the population with money, they were able to buy imported goods, some of which were difficult to obtain before transition, they could travel more to the West, and more generally, they could have contact and interaction with the transnational elite.

But transition in the Hungary of the 1990s took the path that it did. This leaves other questions such as whether the neoliberal integrationist strategy will continue.

D. Indications of future paths

Despite the enormous problems caused by the neoliberal-integrationist strategy, so far Hungary has stuck with it. Although a new government was elected in 1998, a shift in policy was not apparent, nor were the practices of seeking and appeasing foreign capital and the attempts to integrate with Western institutions. The new Fidesz-HCP government promised public sector workers higher wages, a return to universal benefits, free tuition for university students and early retirement for women. What can be seen is that in the first year of the government's term, a divergence from the neoliberal-integrationist path did not happen. This will be discussed below in terms of state intervention and the continued advantage of foreign capital over domestic capital and wage-laborers. Furthermore, it is not clear that integration with Western institutions will bring as much economic or other benefits as promised.

One of the first actions of the new Fidesz-HCP government was to cut the planned increase of pensions that had been passed under the previous government. Also, instead of granting wage increases, public sector wages were frozen and an across-the-board staff cut of 3% was implemented. While the original policy program of the government did imply increased spending, the policy program was refined, regaining business and investor confidence (MTI 5 June 1998). The 1999 budget submitted to parliament in October, 1998, called for a budget deficit of 4%. This would be a further decrease in budget deficits as the 1998 budget deficit was 4.7% (OECD 1999, p. 12). The budget all eliminated all but three marginal tax rates. While the budget did meet the promise of returning universal tax deduction to households with children, reduced social security contributions, there is no question that the refined program of the new government, at least as pertains to fiscal policy, was continuing the neoliberal path.

State intervention also continued along the neoliberal path with respect to privatization. Although by 1998 there was little left to privatize, government ownership was set to be further reduced. The State Privatization and Holding Company (APV Rt.) was slated to sell OTP shares (the National Savings Bank), which were the assets of the social security funds in the autumn of 1999. The state's minority shares in the electricity distributors was set to be sold by the end of summer, 1999. And the government also planned to sell the national airline, Malev, which was already partly owned by Al Italia. Istvan Stumpf, the minister heading the Prime Minister's Office, said that, "We are seeking a strategic partner who is as dedicated to making Hungary a regional transport hub as the government is," in June, 1999 (MTI 30 June 1999). As with all searches for "strategic partners", it is obvious that a foreign partner is indicated. Perhaps the Economics Minister, Attila Csikan, best summed up the Hungarian government's position when he said that the priority of economic policy is to create a favorable climate for foreign investors (MTI 12 May 1999).

Foreign capital will continue its hegemony over national capital. This is clear both from the advantages it had and will have in privatization and the government's desire for hard currency revenues, and from the advantage it has in access to capital. Although capital has become more readily available over the course of transition, foreign firms which have greater access to capital markets abroad have an advantage in obtaining credit at lower rates than domestic firms obtain. The situation is particularly difficult for small- and medium-sized enterprises with lending rates as high as 14% over the prevailing rate (1999 Country Commercial Guide: Hungary).

Capital, whether foreign or national, has an established presence in the policies of the new government. When the National Federation of Entrepreneurs proposed lowering the tax on new ventures from 18% to 10% for a so-called trial period of seven years, Prime Minister Viktor Orban agreed (MTI 29 April 1999). Hungary, with the 18% corporate tax, already had the lowest tax in Europe. The further reduction of corporate taxes is just another indication of the power of capital. Meanwhile, the government has declared in the tax concept for 2000 that *all* incomes should bear at least a minimum tax burden (MTI 10 May 1999). In other words, while corporate taxes are being lowered, the working poor will face a heavier burden, more than they already face from high value added taxes, which are regressive.

Furthermore, labor's chance to have input into government decisions will not improve in the near future. In the first half of the 1990s, Hungary was considered the jewel of Central and Eastern Europe with respect to tripartite bargaining where labor, capital and government negotiated over regulations, wages and other policies. The year 1995 proved to be the death-knell for tripartism but potentially this form of state-capital-labor relations could make a come-back. After the Fidesz government's 1998 election, a new tripartite institution, the European Integration Council, was set up. This institution would hold four sessions a year and would contain representation from employers, unions and the government in order to discuss issues relating to Hungary's accession to the EU (MTI 30 June 1999).

However, there are two possible interpretations of this move to form the Council. For one, it may be another body which is meant to solicit labor's agreement to the program of capital and the state. Like its predecessors, it may only function as long as labor does not disagree and is willing to accept at best, minor concessions. A slightly different interpretation would point to the fact that government has no intention of meeting with the Council more than four times a year. It is not a body which will continually meet discussing possibilities and forming policy based on the compromise of all parties. Either way it is viewed, the new Council is not re-emerging tripartism. In fact, it appears more to be a ploy by the government to deflect criticism of its lack of consultation with opposition parties, unions and other forms of interest representation.

Aside from the bare fundamentals of neoliberalism, Hungary is pursuing integration at full steam. In March, 1999, Hungary became of full member of NATO after being a member in "Partnership in Peace" for some years. Perhaps not so coincidentally the membership in NATO was before the scheduled date of accession and was just prior to the beginning of the NATO war on Yugoslavia. Considerable debate exists regarding the validity of the NATO intervention in the Yugoslav civil war. Nevertheless, the war illustrates Hungary's integration into the global capitalist economy.

Before the war, Hungary's potential membership in NATO was almost ironic. While poverty has steadily increased, pensions have decreased, and general living standards have decreased, Hungary committed to spending enormous sums of money on upgrading and purchasing new military equipment. The absurdity hit new heights when under the Socialist government, a White Paper declared that the only way to make a decision as to whether Boeing or Saab would receive a contract for new fighter jets was to flip a coin. During the war, the Hungarian government gave fuel to arguments that Western powers, in defiance of the United Nations, began the war to divide Southeastern Europe into weak, powerless states. Joszef Torgyan, Minister of Agriculture, declared that Voivodina, a region of Yugoslavia dominated by ethnic Hungarians should become independent. Other politicians offered similar sentiments. While the official Hungarian government's stance on Voivodina was that it should not become independent, but have increased autonomy, it still is difficult to ignore that members of the government were advocating further disintegration of the Yugoslav Republic. Even Prime Minister Viktor Orban, in an address to a session of the Council of Europe in 1999, said that, "[O]ur goal is for the representatives of the Council of Europe to increasingly consider the issue of ethnic Hungarians in Voivodina, Yugoslavia, as their own cause" (MTI 6 May 1999).

Moreover, the government committed Hungary to a war which, if polls are any indication, most of the Hungarian population did not support.

Hungary also worsened its relationship with Russia during the war. Russia strongly opposed the admission of Hungary and other Eastern European countries into NATO, however, the disapproval of the Russian government did not result in a weakening of diplomatic relations with Hungary. This only came later. During the war, the Hungarian authorities prevented a Russian humanitarian convoy from passing through the Hungarian-Yugoslav border. This resulted in the cancellation of Hungarian politicians visits to Russia, most notably the July, 1999 visit of the Hungarian Prime Minister to Moscow was postponed in April. Probably the most significant sign of a break in diplomatic relations was when Russia sent the Hungarian Ambassador to Russia back to Hungary.

Overall, NATO membership presents a drain on already tight resources for the Hungarian economy but a market for the goods and services offered by the Western military-industrial complex. After all, the cost of the military equipment needed to modernize to NATO standards is not one that the Hungarian state would have undertaken without membership, but the benefits to Western suppliers of Western military goods and services is obvious as Hungary has to conform to NATO standards in a short period of time. As Hungary acquired its military hardware and tactical training from the former Soviet Union and other Eastern European countries, harmonizing with NATO hardware and practices will require significant re-tooling.

The benefits of NATO membership are not so clear. No threat to Hungary exists. The country's relationships with its neighbors have been strained at times over the 1990s, but there is no indication that any military threat exists. Moreover, the countries with which Hungary has strained relations, such as Slovakia and Romania, are making bids to join NATO. While a civil war has taken place on and off over most of the 1990s in Yugoslavia, it is a *civil war;* Yugoslavia has never threatened to invade other countries. Russia could pose a threat, but that possibility is only through Western antagonism and could never be the result of a neutral Hungary.

The costs and benefits of the war in Yugoslavia also pose an interesting question for Hungarian integration with Western institutions. The decline in trade with Yugoslavia as an outcome of its civil war may have resulted in costs for Hungarian exporters, but anyone who has traveled along the southern border of Hungary has seen the sprouting up of a thriving retail trade catering for Yugoslavs (or former Yugoslavs) wanting to purchase goods not available in their own country. The real costs of instability in the region has cost Hungary through its membership in NATO. Due to the country's membership, as of 1999, it was committed to troops in Kosovo that would cost the fiscally restrained budget at least 4 billion HUF a year and possibly as much as 8 billion a year (MTI 11 June 1999), whereas the loss from the war itself was estimated at 10 billion HUF (MTI 6 May 1999). Without NATO membership, the Hungarian state would have limited its commitment to humanitarian aid, economic losses from trade would have been reduced (as it may not have participated in the embargo) and it would not have had the public expenditures associated with the war.

Nevertheless, Hungary might have benefited from the war. As of July, 1999, the Hungarian government continues to claim that the country should be a major participant in the rebuilding efforts in Yugoslavia. The implicit and sometimes explicit statements by politicians are hopes that Hungarian construction and other industries will receive Western assistance to rebuild Yugoslavia. Whether the benefits to Hungarian industry will come to fruition, undoubtedly Hungarian participation in NATO and the war on Yugoslavia will have lasting costs to public sector finances and possibly to the stability of the region.

At least in the eyes of the West, Hungary has become a friend. During the Yugoslav war, Hungary was praised by the European Union whereas the Czech Republic and Poland, nation-states which were very reluctant in committing to the war effort, were criticized (MTI 27 April 1999). This announcement came only a day after the Hungarian parliament voted to allow NATO to use any airbases on Hungarian soil. As EU membership is also a goal of the Hungarian state, this may have been a benefit.

The benefits of agreements with the EU have been questionable. Ensuring free trade and foreign investment from the EU hurt national industries in a period of crisis. However, full membership in the EU could mean that Hungary would benefit from redistribution from richer regions in the EU and improved access to markets. However, Prime Minister Viktor Orban in June, 1999, said that based on negotiations with the European Union for membership, it was likely that the EU would ask for derogations with respect to the free flow of Hungarian labor to EU member states (MTI 30 June 1999). This in itself is a fascinating indication of what EU integration means for the Eastern European countries. While the free flow of trade and capital is ensured, it is likely that Hungarian labor, as well as labor from other new members, will be prevented from entering EU labor markets. Moreover, membership in the EU is not guaranteed. While Hungary has done substantive work as far as harmonizing legislation and other economic and social aspects, the EU would only project a possible entry date for Hungary into the EU after June, 2000 (MTI 30 June 1999). While by mid-1999, it appeared that the dynamic of integration would continue, the potential for membership was not promised. And, when the summer of 2000 came, officials from Germany suggested that it was more likely that Hungary would be admitted in 2005, instead of 2003 which had been the previously suggested year. Moreover, tensions within the EU itself might mean that if and when Hungary joins, the actual membership could be confined to a more or less free trade pact. With dissension from member states such as the UK, the EU very well could be in the future an expanded free trade and investment zone rather than a redistributive superstate.

Regardless of whether Hungary joins the EU, the existing agreements in the 1990s have caused some concern with the United States. The US has taken a tough stance on the customs duties on US imports. Imports from the European Union have lower customs duties than US imports. Patrick A. Mulloy, the US Undersecretary of Commerce, in a speech to the American Chamber of Commerce in Hungary said, "[F]or this reason, it is feared that the United States will not prolong its Generalised System of Preferences with respect to Hungarian deliveries" (MTI 16 June 1999). Although the application of differing customs duties does not break the regulations of the World Trade Organization, Peter Balas, the deputy State Secretary of the Hungarian Ministry for Economic Affairs said that Hungary would prepare a proposal of American products which could be subject to lower customs duties (MTI 16 June 1999). In other words, the US has used Hungary's agreements with the EU to yet further guarantee access to Hungarian markets for US goods.

E. Potential for change

It is impossible to determine the future path of Hungarian development. What can be said is that growth, at least temporarily, appears to slowing. Although GDP grew at 5% in 1997 and 1998, the first quarter report from the Central Statistical Office indicates that GDP, compared with the first quarter of 1998, is only increasing at 3.3%. Moreover, agriculture, forestry and fishery in the first quarter declined by 5.4% (MTI 30 June 1999). The budget deficit for the first five months of 1999 was already over 86% of the annual target (MTI 14 June 1999).

Popular dissatisfaction with foreign capital is indisputable. This is well known to foreign capital and to the government. Surveys have shown that only around 10% of the population actually support the presence of foreign capital in Hungary. Although the survey cited is from 1997, there are only indications that hostility to foreign capital and foreigners in general is becoming worse.

Strikes over the 1990s only amounted to a handful and although demonstrations have continued to be the preferred action to dispute falling wages and to express other dissatisfactions, it may be the case that the number of people participating in demonstrations is increasing and that strikes may become more commonplace. In March, 1999, police, border guards and other Interior Ministry employees demonstrated throughout a whole weekend protesting staffing cuts and demanding wage increases. Ministry workers stated that they would strike if their demands were not met. This demonstration was complemented by another one by workers and children protesting the closure of nursery schools and kindergartens used exclusively by the Interior Ministry. Also in March, 1999, almost 20,000 public sector workers demonstrated to demand a 16% wage increase. The petition handed to the government demanded a wage increase, an increase in pensions and the cancellation of staffing cuts. Furthermore, the union organizing the demonstration claimed that a strike would be organized if the demands were not met.

There is no telling whether popular dissatisfaction will generate any change in Hungary. Of the parliamentary parties, the Socialist Party is the only one connected to a serious leftist movement. The Board of the party discussed a blueprint for a new party platform, the Social Democratic Charta, which is expected to be approved in 2000. Chairman of the Board, Gyorgy Foldes, called for a "New Left", and Board member, Imre Szekeres, defined the Hungarian Socialist Party as a left-wing people's party united by the notion of social justice (MTI 16 May 1999). The party also concluded a cooperation agreement with the MSZOSZ, the largest trade union (MTI 12 June 1999). However, this is reminiscent of past agreements and statements before the party's tenure in government during 1994-98. There is no good justification to expect radical change in the way the party would carry out governing the country if returned to power. The neoliberal faction of the party is still in power. This is reinforced by the fact that the party is considering naming Miklos Nemeth, currently deputy president of the EBRD as the party's Prime Ministerial candidate for the

2002 elections (MTI 20 July 1999). The other left-wing party, the Worker's Party, does offer significant alternatives in its platform. However, it is not a parliamentary party, and at support of less than 4% of the electorate, does not stand to gain power in the near future.

With popular dissatisfaction, the growth of xenophobia and anti-Semitism, a swing to the far right is also possible. After all, the far right-wing did gain a number of parliamentary seats in the 1998 elections. However, it is also unlikely that representative democracy in Hungary will give way to any extremist faction coming to power.

In short, I suspect that any possible change for the future will only come from an anti-capitalist movement wider than just the nation-state. With the spread of capitalism across the world, it is difficult to see any major changes happening in a small country like Hungary. It is possible that a major crisis in capitalism will make necessary an accommodation to capitalism that ousts neoliberalism as the dominant ideology. Historically, this has happened, such as in the advanced capitalist countries after World War II, but perhaps it will take a tragedy of such great proportions to happen before there will be a fundamental change.

Specifically, in the case of Hungary, a change in strategies would require the dissolution of the monopoly on power held by the elite. Workers and their allies will need to become more organized and find better leadership that will accurately represent their interests in the face of international criticism. Instead of occasional demonstrations, dissenters of reform have to effectively take control of a political party and elect leaders which will implement new policies without compromise with international capital.

F. Conclusions

The period of transformation has resulted in the lost decade of the 1990s for Hungary. Although reducing the country's gross debt, ensuring payment to Western creditors, the country has undergone a decrease in living standards and has been left with an economic structure more vulnerable to changes in the global economy than during the period of state socialism. By the end of the 1990s, GDP was less than what it was during 1989. Wages and salaries substantially decreased. Poverty had increased tremendously. Homelessness, which previously did not exist, became commonplace.

In the fifteenth and sixteenth centuries, Hungary along with Eastern Europe made up the beginnings of the Third World by becoming the agricultural reserve of Western Europe. By the mid-nineteenth century, feudalism finally ended, even if more in law than in practice. The beginnings of capitalism and industrialization were limited mainly to Budapest. The transformation of the 1990s somehow resembles turn-of-the-century Hungary. Capitalism began in Hungary by being dependent on foreign capital, depressed conditions for the wage-labor class, struggles by peasants over land redistribution, and a ruling elite which was not compelled to serve the interests of the population. As the title of Ivan Berend's book (1995) suggests, Hungary has gone from the periphery to the periphery.

APPENDIX

SELECTED HUNGARIAN GOVERNMENT DOCUMENTS

Act on Employees' Stock Ownership Programme (1992).

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