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Economic Management System in Hungary at the End of the Second Reform Decade*

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The grave functional disturbances of the Hungarian economy, recurring from time to time, indicated already in the sixties that the socialist transformation — nationalizations and the collectivizations of agriculture — as well as the planned economy based on the former had led to such obsolete and bureaucratic management which put a brake on Hungarian economic development and hindered its relations with the more advanced countries. The reform of Hungarian economic control and management, proclaimed in 1966, wanted to help in solving this problem.¹ The two decades passed since then have supplied important evidence about the opportunities the socialist ownership of the means of production provides for *substituting a planned regulated market* for the exclusive role in economic control of governmental administration, and about the difficulties arising in this process.

1. Structural Interdependence of Organizations in the Economy after the Introduction of the New Economic Mechanism (NEM)

The economic policy program of a regulated market, approved in 1966, set the aim not only of abandoning the practice of directive planning and the central allocation of materials, but also of making cooperative ownership equal to the state property, and of opening the way for private initiatives. It wished to transcend the system of central state administration and of the centralized control and direct checking by party organizations, the subordination of monetary processes to the national economic plan, as well as the strong limitation of the economic freedom of citizens.

Comparing the results of a great number of case studies and of analyses relying on other sources with the results of other investigations, the following may be established.

1. In the course of its development between 1968-1984 — not free from fluctuations — the Hungarian economy was capable of raising the efficiency of management by resolving the internal inconsistencies of the mandatory planning system, and of securing its citizens, as producers, a growing freedom in choosing jobs, and creative opportunities, and to get closer to the consumer sovereignty.

2. It also became clear that the hierarchically organized state and cooperative enterprises necessary for market conditions *cannot get their autonomy by simple declaration.*

The actual evolution of enterprise autonomy was hindered by:

—the almost confused dependence of the firms on the territorial, functional and branch administration, on the institutions of the Party—*appearing in formal and informal systems of relations*;²

—*the large number of financial prescriptions* which provides an opportunity for the control agencies to prevent firms from freely using their money stocks, and to restrict the use of enterprise incomes to paying wages (earnings) and to financing investments; here belongs also the price regulation which prescribes the price formation rules of the

so-called free-priced products;³

—finally, the lack of capital and labor market; that one firm can not have access to resources for even the fast paying-off investments, while another one can use its own resources and even credit for loss-making investment projects.⁴

It may be thus stated that the changes implemented between 1966-1968 started a process towards a planned regulated market in the course of which no adequate requirements were raised towards efficiency owing to inconsistencies in the implementation of the programme, conservative political forces and some problems which had not been thoroughly considered and thus remained unsolved. Within the framework of centrally determined financial regulators the firms could decide themselves on questions of production, procurement, sales and even investment, but if their financial results deviated from the planned targets, and if their profits did not increase monotonically, the extent of their autonomy became restricted by state interventions. As a matter of fact, owing to unforeseen developments in domestic or external markets, or to deviations in their own performances from the planned ones, the results of firms frequently fall beyond the narrow path deemed acceptable by the authorities and securing a profit under the given regulations. In such cases, when income of the firm are more favorable as expected the central agencies collect their gains, while when income conditions are unfavorable, the firms concerned are at the mercy of the central agencies—whether they reduce taxes or even grant subsidies. And the authorities because of the large number of firms in distress come to the rescue rectifying their own earlier issued rules.

3. The structural interdependence of organizations *was determined*, even under the conditions of the NEM, *by the simple functional system, developed after the nationalization* which gave an easy opportunity for control of enterprise activities.⁵

The reorganizations had namely the aim to reduce the number of economic units, to abolish competing activities, to concentrate production—in the interest of reducing specific costs.

The enterprise organization thus functioning is characterized not only by a significant reduction of the number of firms, and the lack of competing firms, but also by the fact that firms suited for satisfying similar demands, having similar production lines, develop such division of labor which reduces competition to minimum. Further, adjustment to demand can only take place by modifying the production pattern of existing firms—which are generally large and not sufficiently sensitive to costs and revenues—because of the *lack of bankruptcies and automatisms for founding new firms*. All that results in a slow change in the product-mix.

It causes perhaps even more harm that firms cannot get rid of their loss-making products, because the authorities expect them to satisfy for these products at practically unchanged prices.

4. The firms could *regard the profit as a measure of success only to a limited extent*. This was so on the one hand because prices could be used to influence demand and supply in a restricted scope and they are also forced to produce and sell loss-making products. On the other hand, a great part of their profit was taxed away and if the remaining profit proved to be small to secure the necessary wage rise for survival or to repay the credits, they could regularly bridge over difficulties with central support (tax reduction or subsidy).⁶

5. The slowing down of the reform process after 1972 was mostly a consequence of the fact that, under the impact of disturbances in management accompanying the changes and because of the not sufficiently carefully elaborated elements of the 1968

reform, the autonomy of the economic entities was further restricted. The economic policy braking the reform—while avoiding the restoration of directive planning—emphasized the delivery commitment of firms towards the state and restricted their autonomy with financial and political measures. Measures were also taken against the spontaneously developing small entrepreneurial activities (complementary activities of farming cooperatives, household plot and private small-scale farming); inefficient big firms were financially rehabilitated by amalgamations and other methods and, instead of a uniform regulation by the state based on economic efficiency criteria, individual “bargaining” took place, about the regulations. The central economic leadership occupied with the restriction of enterprise autonomy and strengthening its position substantially lost its ability to perceive problems by the mid-seventies. As a consequence, it was late to recognize the external shocks the country suffered between 1973 and 1979 and hardly reacted on them. Instead of working out an adequate defensive strategy, economic policy prompted enterprises to such development projects, without properly analysing the return of capital, which later pushed these firms into insolvency.⁷

6. Experiences of the period between 1968-1978 borne out that to bring about a successful mix of plan and market was a more complex task, and demanded more comprehensive and deeper changes in control and management than had been thought two decades earlier. *The heritage of the directive planning mechanism continued to survive* in the supervisory role of the state and party organizations, in the overcentralized structure of firms, in the monopolistic commercial relations. Major decisions concerning the economy continued to be taken in the control apparatuses—outside the economy. The approval of ambitious development programmes exceeding the country’s potential remained characteristic. But there is a great price to be paid for such seemingly useful programmes which can always be well justified: they prevent firms from giving an answer to genuine market demands. No substantial change could be achieved in the dependency relations. There is particular contradiction observable in the fact that the modernization of the control system could only take place by decision of the highest power. Thus, only the leading body of the party could have settled the unclarified problems; that is, restrict the rights of the economic control organizations and expand the scope of money in such a manner that the firms observing their own interests should be forced to effectively adjust to domestic and external demand.

The government and party apparatus controlling the economy got used to organizing and checking economic processes directly and in detail. Thus they were inclined to treat arising disorders in the old way (wage differentials, the “labor-sucking” effect of complementary cooperative workshops or of consumer cooperatives). This put a brake on the changes that could force a more flexible and efficient operation of the economy. Owing to these factors the economic policy reacted on the unsolved problems of the reform and on the external market shocks of 1973 by trying to circumvent the troubles. Between 1973 and 1978 since the economic leadership put off the solution of the emerging problems, it hardly changed the earlier consumption and investment tendencies of the country which objectively involved that Hungary spent at the expense of foreign indebtedness.⁸

2. Renewed Recognition of the Necessity of Reform

The accumulated stock of debts and the expectable changes in the conditions of the international credit market as well as the diminishing deliveries of raw materials

from CMEA countries suddenly changed Hungary's economic development at the end of 1978. The declarations showed that the period of hidden recentralizations, that is, the economically lost period had come to an end, when the formal endorsement of the concrete reform measures, within it of the abolition of directive planning and of the central allocation of materials was accompanied by strengthening central control and by the firm by firm regulations.⁹

The changes after 1978 were no doubt characterized by efforts at improving the balance of payments. Beside successfully improving the balance of trade until 1984, also three directions of changes emerged which deeply affects the organizational system of the economic mechanism and which, although in harmony with the market-oriented declarations uttered since 1978, have been implemented with some contradictions:

1. Transformation of the big enterprise organizations. Expansion of entrepreneurial activities and small ventures.
2. Harmonization of the branch control, within it mainly of that of the industry, with the requirements of the regulated market.
3. Suppression of the individual elements of economic control, and development of a uniform—in common parlance “normative”—regulation of price, wage and investment aimed at bringing about competition among firms. Appearance of market methods of regrouping incomes among firms (issuing of bonds, foundation of joint enterprises etc.).¹⁰

Problems of the Enterprise Structure

One of the questions of major portent, but unsolved to our days, is the enterprise structure, more closely the dominance of big firms and the lack of small and medium ones. Several debates were conducted about the desirable enterprise structure. The periods of success for those who advocated the dominance of big firms fall between 1962-63 and 1975-77 when the number of economic entities clearly diminished. Opposed tendencies could be observed between 1968-1970 and after 1979.

Those participating in the discussions knew well that the concentration of production entails savings in unit costs and that efficient management demands definite sizes of establishments and firms. They also knew that adjustment to the changing, ever diversifying economic needs would be helped in general, and in the branches not characterized by capital concentration in particular, by competition among firms, within it by the appearance of firms with new supply.

From the background of the debate, not lacking ideological arguments either, the following actual problems should be underlined.

The strong enterprise concentration developed since 1950 has in most cases not brought about such big firms—to be counted as big also by international standards—the activities of which would have produced significant savings in unit costs. In those branches where international practice is characterized by strong concentration the Hungarian firms are, in general, not big. Still, in Hungary there are relatively many such enterprises which are regarded as big, but are squeezed out from the international competition. They are not sufficiently specialized and thus only concentrate the disadvantages deriving from being big: the slow change of the product-mix, clumsiness and the concomitant high per unit production costs. The unchanged survival of unsuccessful firms is in the interest of many people who spare no pains to argue about the efficiency of scale with general statements, without analysing the concrete

cases. For this they also exploit the natural political reluctance developing because of the social problems brought to the surface by the losses of the major firms. The lack of small and medium firms is most characteristic in the Hungarian economy in those branches where technical progress demands division of labor on the market and cooperation among diversified smaller productive units as well as a fast modification of production patterns (light industry, services, agriculture, fine chemical industry, certain branches of engineering etc.). The creation of firms big in their own area by international comparison—though insignificant relative to the biggest mass-producing concerns—can be deduced from the internal logic of mandatory planning, from the efforts of direct control aiming at transparency. This logic was further supported, even after the proclamation of the economic reform, by two major factors. Firstly, the relatively markedly delimited production lines, the specialization of enterprises allowed to call firms to account not only and not primarily for profit, but also for the quantitatively measurable domestic and foreign deliveries, that is, for commodity supply. Secondly, the post-reform Hungarian economy accepted and strengthened the big firms even where their economic advantages were not unambiguous, because—as has been mentioned—Hungarian firms can operate without government support only if their actual results do not show too large dispersion from the one taken into account when the regulators were “calibrated.” In reality, the bigger and the more diversified a firm, the more likely it is that the deviations from the expected conditions will level out and thus the planned and actual results will not show any significant differences, either. The trend observable all over the world that the raising of the volume of output through diversification reduces uncertainties in the results of enterprise management holds true *a fortiori* under Hungarian conditions. It follows that if, with the regulation of demand and investment valid since 1968 to our days, there had been smaller, specialized firms operating, the individual subsidies and tax reductions could have even less be avoided. All that makes it understandable, although not offering an explanation, why the supreme authorities and firms did not abandon their earlier efforts at concentration, and why the organizational efforts, reappearing after 1979 and stimulating competition, have not led to a smashing success.

Nevertheless, from 1979 to our days significant changes took place. The decline in the number of state and cooperative firms has stopped and even some increase can be registered. The biggest changes occurred in the food processing industry and in some services. Although progress in the breaking up of large organizations has not reached the planned extent, the results are worth attention. Even more significant is the formation of subsidiaries and so-called enterprise and cooperative small ventures. Parallel to them new forms of enterprise also appeared (economic workteams, civil law associations, specialized cooperative groups etc.), and economic workteams began to spread also with in the enterprises. As regards the latter, actually the most widespread, form, it may be stated these teams have not become new forms of enterprise in reality; we cannot regard them to be anything else than work brigades operating under the dependency relations of the enterprise while enjoying autonomy in the selection of members and income distribution.

This development, not free from contradictions, resulted in a significant number of economic organizations with more or less autonomy not only in the agriculture—considering household plots and complementary farming of employees with main jobs in other branches as well—but also in the industry, construction, trade and services.

But the strict division of labor between big firms and their subsidiaries, the avoidance and lack of competition remained essentially the same as had been earlier

the case. Several case studies indicate that state and cooperative big and small organizations—first of all in industry, construction and catering—reacted on declining demand and sharpening competition by reducing supply, instead of increasing their efforts. Similar phenomena could be observed in the activities of the already existing smaller ventures, as well as among the small servicing firms of the state and cooperative sectors. We shall later revert to the question—in the context of the general regulation of earnings—how the defensive behavior of new and old small enterprise organizations became possible, why they were not forced to compete for the solvent demand.

The behavior of state and cooperative firms, and within it that of the new small enterprises and cooperatives is determined by the activity expected by the center, that may be called with some simplification the supply task. If the profitability of this activity was not satisfactory, the meeting of the task was supported by individual subsidies and tax reductions. But the situation did not essentially change even after the reduction of subsidies and moderation of tax facilities in those firms with deteriorating results which reacted—while their staff was diminishing—with price rises and used the depreciation allowance for covering current costs. A part of the workers withheld performance within the firm during the legal worktime, but was capable of getting extra income (through overtime tips, enterprise workteams, small ventures outside the firm and illegal work).

From the private activities the most successful ones have been the family household-plot farming of cooperative members and the complementary farming of employees of state firms. The value of output from these small farms steadily exceeds one third of the gross output of agriculture, in animal husbandry this is 40 percent and as regards the net output of agriculture more than a half. Small-scale production secures for people living in the countryside a considerable additional income—true, at the price of much extra work. As regards, however, the future, without adequate mechanization and modernization small-scale agricultural production can hardly grow and keep pace with the requirements towards efficiency—thus food supply and exports may become uncertain. In addition, lacking domestic and import supply, there is no opportunity for adequate mechanization in small-scale production and thus capital must be substituted by so much labor that its economic rationality is already questionable. The country is not prepared technically for mechanizing small-scale production.

The security of agricultural producers continues to require substantial state procurement actions. At the same time, it is a task of procurements to better stimulate farmers to produce products that can be efficiently sold on the world market.

The problems of private activities are different in the other sectors of the economy, and the picture is highly differentiated. In the traditional artisan trades low mechanization and the administrative restriction of the number of employees is coupled with difficult living conditions and the extinction of many trades.

In some fields, however, the situation is different. While in the state and cooperative sectors firms are generally forced to restrict earnings, and are sometimes even incapable of paying the wages absolutely necessary for solving their tasks, private activities sometimes result in very high personal incomes. A considerable part of those performing private activities in the new small organizations are *not* full-time employees. They consider the entrepreneurial activity not as a means of livelihood—for their whole lifetime—but as a transitory state lasting for some longer or shorter time which they only maintain as long as they can earn significantly more than their

labor income, even if complemented perhaps by tips or through other (illegal) activities. This is remarkable not because some people may earn through small-scale entrepreneurial activity essentially more than the employees of big organizations, but because—as against capitalist market conditions—small entrepreneurs across a wide scale of industrial, construction, commercial catering and transporting activities consider such high income as normal, and if they cannot get it, they abandon the small entrepreneurial activity.

All that shows that the rather radical transformation of the concentrated enterprise structure in the eighties entailed contradictory consequences. On the one hand the organizational structure that has emerged continues to be polarized, although it brought many changes in the size of organizations: the medium-sized firms are invariably missing beside the large and small ones. On the other hand, this change in production structure, even if it has improved the range of supply, has approximated equilibrium relying on competition only on some partial markets (e.g. bread or taxicabs), but it has not resulted in a general breakthrough towards a buyers' market. Small entrepreneurs need not take, in general, any particular risk when they shift from their employee status to the entrepreneurial one. Apart from a few exceptions, they are forced to make either only small or easily mobilizable investments, and thus can abandon the activity in question without any risk, and can return to their employee status without losses or, and this is even more characteristic, they can look after new business.¹¹

Reorganization of branch control

In the course of the economic change after 1978, economic policy unambiguously wanted to alter the much criticized situation in which, against the spirit of the reform, the autonomy of the profit-motivated firms is restricted through the branch ministries exercising the supervisory rights of the owner.

In harmony with this criticism a delayed element of the reform ideas of the sixties again came to the fore, i.e. amalgamation of the branch ministries and the formulation of a qualitatively new control function. As also earlier in the history of the reform, the starting point was the transformation of the control of industry. With January 1st, 1971, the Ministry of Industry was formed.

In principle, the new ministry could not determine the tasks of firms belonging to the industry and, as distinct from its forerunners, it had no scope of authority in respect of the trade in the means of production nor was it to be a price authority. Thus, according to the approved resolutions, its function was restricted to elaborating the development concepts of the industry, within that the central development programmes, and organizing their implementation as well as providing help in the acceleration of technological development. In a complementary capacity, its task was to actively participate in the organization of technical and economic cooperation with CMEA countries, of product and production cooperation and specialization. Finally, its scope of authority included the supervision of enterprises, extending to the foundation, liquidation and separation of firms, appointment of the higher enterprise executives, their relieving, awarding and checking.

Also the internal organization of the new ministry was built up in view of these goals and, by reducing the staff of the control apparatus, it was intended to forestall interference with the life of enterprises. This was reinforced by the measure that the functional control activity was separated within the ministry from the supervisory func-

tion lest the free decisions of firms should be restricted by abusing the latter.

Practice got into a sharp contradiction with the accepted principles and ideas about control. The ministry had to choose daily whether to answer the system of general requirements accepted for the government administration and relating to the new Ministry of Industry, or the continually repeated expectations of the economic control bodies (Council of Ministers, State Planning Commission, Economic Commission) demanding operative measures and cede to the pressure demanding individual regulations for firms. It was pushed towards the latter option also by its own apparatus formed from the three legal predecessor ministries, the members of which knew from their earlier practice that for strengthening the government apparatus positions of the Ministry the crisis-averting interferences are more advantageous than the principles approved when the Ministry was founded.

Thus, from 1982 on the main activity of the Ministry was to stimulate exports with the aid of wage preferences and performance premia, granted individually to firms, as well as to regulate imports so that in the meantime the supply of the domestic market should not much deteriorate, either. But the new organization of the ministry did not provide an adequate framework for managing the crisis. Therefore, when in 1984 important personal changes were made in the leadership of the Ministry (although certainly for reasons beyond the viewpoints of ministerial control), work also started to newly define the tasks of the Ministry of Industry—although the principles have not been clarified to our days. Together with these changes the programme for the reorganization of branch control pointing beyond the industry was struck from the agenda or was essentially modified.¹²

Changes in the financial system

It was the financial regulations which had to struggle with the largest number of internal contradictions. After 1978, both the documents determining monetary policy and those of fiscal policy, and even those establishing the frameworks of price and earnings regulations proclaimed the idea of competitive economy. It was then that the idea of a competitive price system—adjusting to world market prices—appeared and the idea of a uniform, normative regulation, not differentiated by firms was more underlined than ever. Later, in order to mitigate the negative consequences of the rigid regulation of earnings and prices, an experimental regulation of earnings was introduced which extended to the scope of efficient firms, and a wage and price club was brought into being for the same. For the efficient firms the rigid prescriptions were relaxed under the particular forms of government administrative control. The principle of price calculations which prescribed the depreciation allowance should be obligatorily accounted among costs was abolished with general validity. Thus a chance was created for the utilization of unexploited capacities if this helped reduce losses. To facilitate rational reallocation of capital the market instruments of capital regroupment among firms got a role, such as associations, the issuing of bonds, and also small financial institutions were founded.

The promulgation of market-oriented measures came into complete conflict with the established practices. Referring to economic difficulties, the central agencies continued to directly control the firms with formal and informal instruments. Thus the new market methods, introduced with great emphasis, mostly remained empty forms. The changes of free prices were linked to previous announcement obligation; the firms were ranked into the regularly changing forms of competitive price system and wage

regulation by official measures, thus restricting their freedom of decision. These measures caused difficulties mainly for the large firms. Many of them could continue to operate only by getting financial facilities—usually tax remission—and by becoming indebted to other firms. The financial difficulties of the medium and small firms were usually not solved with the aid of discrimination financial measures. The cause of the difference is not that they are more efficient than the big ones, but the fact that their management is less surveyable for the central agencies because of the many details and thus their position is more advantageous in the “regulation bargaining” with them. In the final analysis, the fiscal and credit institutions as well as the price control agencies continued to take discriminatory measures to keep alive essentially all firms, or to prevent that their incomes exceed the planned outlays. In the interest of the survival of the indebted—mostly large—firms taxes were remitted, and credit repayments were rescheduled. The overwhelming majority of small and medium firms could acquire the conditions necessary for survival through the price bargaining conducted with the authorities.

The large number of changes facilitating the capital movements did not affect the major proportions of capital allocation, and did not amount to a substantial change towards the market. Their function was rather to solve the investment problems just on the order of the day and in harmony with the central ideas, as well as to support the market slogans.

The revenues of the budget and the possibilities of money creation proved to be unsatisfactory for covering the budget subsidies and other budget expenditures as well as the burdens of the international debt service. Thus a general tapping of incomes originating in the enterprise sphere also became necessary. The use of enterprise reserve funds was prohibited, and part of them was taxed away, the credit amortization payments of firms with liquid monetary reserves were accelerated, increased burdens were put on investments by ulteriorly cancelling valid agreements.

The fiscal and credit policy measures, combined with export-import regulations and steps taken in the field of economic diplomacy proved to be sufficient—while some world economic circumstances also were advantageous—for avoiding international insolvency, but, as against the earlier targets, they did not lead to improving economic efficiency, and even prevented realization of the economic policy slogan of a new growth path.¹³

Weaknesses of the economic restrictions between 1979 and 1984

Between 1979 and 1984 the danger of insolvency could be averted with the strong reduction of investment and real wages, and at the price of some deterioration in domestic commodity supply, but without any substantial improvement in the efficiency of state and cooperative enterprises.

The restrictive economic policy could not lead a major success, that would have not only allowed to avoid the payment crisis, but would also have provided foundations for further progress because, under the pressure of having to reduce debts, the central economic leadership preferred administrative measures to the curbing of aggregate demand and to strongly moderating the administrative interferences going into detail and permeating every field of management. Under such condition the halt of economic growth did not entail either a change in management behavior or the beginning of a substantial transformation of the production structure. The performance of the economy did not improve, economic entities continued to remain rather

indifferent to consumers' needs, to changes in demand and supply. It was only the activity of the small economic entities, falling beyond the main scope of economic regulation, that became livelier.

The state and cooperative enterprises were not pressed and thus were not capable, either, of raising increased requirements towards their employees or members. The population tolerated the fall of real wages and of the real value of social benefits without major troubles. Quite a few people could make up financially for the losses suffered in the second economy.

In order to avoid all this, a general regulation of aggregate demand would have been needed instead of the administrative measures chosen in 1979. The general regulation of demand—instead of administrative regulation—means that the state, in harmony with the production potential of the country, determines solvent demand and controls it through the budget and credit emission. The survival and growth of firms operating under strict financial limits depends exclusively on whether their income earned with their products and services covers—apart from shorter transitory problems—their costs and allows growth. Enterprising also has institutional conditions. It suffices to refer to the transformation of the property rights of enterprises asserting the viewpoints of wealth (increase of capital), to the opening possibility of bankruptcy, to the substantial relaxation of the rigidities of price regulation and control of incomes as well as to the development of the protection of interests of various strata.

The general regulation of aggregate demand also entails a greater differentiation of enterprise incomes than the present practice. The regulated money supply forces the business units to efficient production, to adjust to the demand and supply, conditions, to cost reduction. Only the economic coercion can entail efficient enterprise management, entrepreneurial spirit, and pressure towards an efficient production structure. Under such pressure state and cooperative firms will more strongly counter the workers withholding their performances, to the lack of discipline, to the private work done during legal worktime, and to the use of enterprise assets for private purposes. All that may also help repress illegal elements in the whole economy and illegal incomes.

In order that firms should be forced to pay attention to the demand and that they be at the same time able to adjust to these, their operation must be freed from the special price, wage and investment restrictions.

The shift would no doubt entail several unfavorable side effects lasting for some shorter or longer time. The curbing of aggregate demand—without the compensation of enterprise incomes—might even force the closing down of workshops, establishments and even enterprises unable to manage financially. Such a structural change of the economy would put an end to job safety. Dismissals for the sake of the necessary transformation of the production structure, and the handling of the ensuing, even if transitory, unemployment demand serious government measures—among them support to be given to self-employment. Owing to the growing role of actually free prices the rate of inflation is not likely to decrease even with a successful monetary policy. And it is more difficult to prepare the population for price rises, since they would not be preceded by central administrative measures.

The change entailing unfavorable impacts needs political will. But without a political determination the economy is incapable of emerging from the gradually deteriorating situation.¹⁴

3. Impact of the 1984 Resolution of the CC of the HSWP, and of its Measures Taken in 1985

After long preparatory work, the Central Committee of the Hungarian Socialist Workers' Party took a resolution in April 1984 regarding the question of streamlining economic control. The resolution and the measures following it brought major changes in the next three questions: institutional foundation of the autonomy of firms, development of the financial regulations and the methods of market surveillance.

Steps towards enterprise autonomy

The property rights of a major part of state owned firms was taken from the hands of government administration. It was only the firms producing public utilities and some in exceptional position in which the property rights remained unchanged—in their case the supervision of the owner continue to be exercised by the branch ministries and the local councils. A great part of the property rights of the market-oriented firms was transferred into the authority of the enterprise council, or the meeting of delegates or the general assembly of employees. It is the enterprise council, the meeting of delegates, general assembly that elects—in agreement with the local and branch agencies—the manager and that decides on essential questions of enterprise development.

The bases for the new forms of enterprise control were provided by three concepts: the one relating to *self-management* which wanted to give the whole control over enterprise management into the hands of the employees; —the *corporative solution* in which the enterprise council consists of three parts, representatives of the state, the representatives of the employees, and the management. The council is in charge of the strategic control of firms; —and finally, the one in which *the property* rights were given to several competing, profit oriented state holdings controlling firms from the viewpoint of the return of capital.

The present solution, chosen instead of experimenting with the three different concepts, equally of closed logic, approximates in its principles rather the system of self-management. It transforms the enterprise supervision rights of the branch ministries and the local councils into an inspection of the legality. This restricts, in principle, the right to check whether the laws have been observed. There have, however, remained several loopholes through which the central bodies can formally or informally interfere with enterprise decisions. A further weakness of the new practice is that it has not provided means to handle the conflicts between enterprise collectives and the government regulations. It is a source of even greater problems that the contents of the property rights of the working collectives formally disposing of a great part of property rights has not been adequately clarified. This also comes to expression in that the settlement of enterprise interests in the maintaining and increasing the value of firm's assets failed to materialize. It was intended to put this question on the agenda only in 1986. Thus, it was not clarified how an enterprise collective, using the property rights, becomes interested in taking decisions exceeding the demand for a short-term increase of its income, how it will meet decisions increasing the long-term profitability of the firm and the long-term safety of the working collective. Is the enterprise council or general assembly capable and willing to counter exaggerated claims to wage rise, and if so, on what considerations? The difficulty of the problem is indicated by the fact that the viewpoint of the return of enterprise wealth not always coincides

even with the long-term interests of the enterprise collective. The utilization of enterprise assets demands weighing from time to time also from the viewpoint of the given collective, e.g. what should happen with the assets that cannot be efficiently exploited etc. In addition, not only the collective but also the society outside the enterprise has short and long-term interests attached to the wealth of the enterprise. It has not been adequately clarified whether a representation of these interests is not necessary and feasible and who will exercise that task.

For the perception of the problem it is necessary to refer to the problem which appeared recently that the new regulations permit wage increases at the expense of depreciation allowance. In such cases a conflict appears between the short-term incomes of the enterprise collective and the interest in the increase of the value of the enterprises assets. Thus it may be advantageous from the aspect of the short-term interests of the whole enterprise collective, or even more from that of the older workers to turn gradually the depreciation allowance into personal income. At the same time, from the aspect of the long-term interests of the younger members of the collective it may be more advantageous to provide for the safety of current production, to reconstruct assets and, for citizens outside the enterprise, it may be more advantageous to close down the firm and sell its assets. In such cases the interests of the enterprise collective exercising the rights of the owner may be divided and/or may get into conflict with efficient utilization of enterprise assets. The latter may entail a reduction of the income of those producing the obsolete products, perhaps a reduction of staff and/or a change in the structure of labor.

The above also indicate that the new order of exercising the state property rights has not solved the basic problems: the concerns of the regulation of personal incomes and investments. After the changes, the enterprise management and the body checking it do not comprise forces in whose interest it is to raise their voice against the further operation of non-efficient firms misusing the means of the state budget. Nor do the bodies controlling the enterprise comprise such forces which, on the basis of their interests, would advocate the breaking up of large organizations if this were demanded by the viewpoints of efficiency.

The multitude of unsolved problems might easily lead to the new system of enterprise control becoming formal. Already the danger is felt that following the transitory shock accompanying the formation of new leading bodies and the election of managers a situation develops with which everybody is dissatisfied.

The enterprise management is not satisfied because amidst the essentially invariable regulations and expectations restricting its scope of movement it also has to try to come to terms with the enterprise council or general assembly. Therefore, many managers feel that, instead of facilitating their work, the introduction of the new forms of management rather makes it more difficult. At the same time, the expansion of their rights was unexpected for employees. Earlier they did not demand the introduction of self-management, and their demands included, at most, participation in decisions affecting income relations and working conditions. Now, under the new conditions, perhaps an increasing number of them will learn the tasks to be done and will like it. But the fear is not unjustified that in practice—under the impact of the expectable manipulations—the chance offered by the self-management will not fully evolve and employees will grow sceptical towards the new forms.

Financial policy

In 1985 the system of regulators was transformed and the system of taxation, of the income centralization channels established in the course of time, was rationalized. The profit tax was reduced. In the interest of enforcing the efficiency requirements the role of taxes on resources increased; thus a tax on enterprise property was introduced and the wage tax increased. But the changes promising progress are of doubtful value; e.g., with reference to the difficulties of the economy, a tax on accumulation (investment) was introduced which hinders development and is economically unjustified. But the changes as a whole rather increased than diminished the extent of income centralization, nor did the system of enterprise subsidies and tax reductions disappear.

A great promise in the price mechanism was the gradual abolition of administrative price formation rules in manufacturing, more flexible price formation in agriculture and trade, accompanied by the abolition of the notions of unfair profit and unfair price. According to the new rules only a price higher than those of the competitors counts as unfair. In price control, the price limitation linked to the rate of profit was eliminated. Thus, in principle, the contradiction causing troubles in earlier periods was overcome that, although the raising of profit was considered to be the goal of firms, yet when prices were officially checked it was considered as a harmful or at least a suspicious phenomenon if the price calculation of some products (or that of a whole company) comprised a higher than usual rate of profit. Also the prescriptions about the obligatory adjustment to changes in world market prices were to be abolished gradually and in a widening scope.

The changes pointing towards a regulated market did not exert their effect in reality. Fearing an unexpected and strong rise in prices becoming free, the evolution of the substantial impacts of the price mechanism was braked by imposing an early warning system.

The rigid regulations affecting the raising of incomes of enterprise executives and employees were mitigated by the introduction of various forms of less rigid ones and, within it, by relating the level of earnings to the profits. The latter—particularly if working without the simultaneously introduced brakes—abolishes the distinction between wage increment and wage cost—harmful from the economic efficiency point of view. But a more rational regulation of earnings leads to increasing efficiency only if firms are unambiguously interested in profit, and in increasing the value of assets. If there is no change in the latter respect, —and the firm continues to operate as an economic entity fulfilling supply and export tasks—it will subordinate its strategy and tactics to this goal in other fields of management as well—thus, in the interest of higher profit it will not risk its relations with the employees and will not spare costs, including wage costs.

It may be thus established that the firms behavior was logical from their own point of view when they exploit the diversity of the wage regulation mainly for finding the form for paying high wages. The new form of the regulation of earnings came to the fore in 1985 favors those firms which attain a high rate of profit and can bear in the long run that the high wage—tax following the new regulation puts a great burden on their costs.

Thus, it cannot be considered a mere chance that the development of enterprise revenues and of wages was not synchronous in either 1985 or 1986.

Also the new forms of capital allocation were consolidated: associations, the issu-

ing of bonds and shares, the formation of financial institutions etc. But the determining forms of capital allocations are and will remain in the foreseeable future the old ones. Therefore, the earlier reviewed most important contradiction, related to investment financing, will continue to assert itself. The firm investing a considerable sum relative to its own capital will be forced to resort to credit, not being capable of relying only on its own resources, and thus its success will not depend on the success of the development but on the conditions negotiated in the credit agreement and differing firm by firm. And the firm implementing small investment relative to its own capital can remain profitable even if the profitability of the development does not attain the desirable level.

The most ambiguous case of changes is the bankruptcy of loss-making firms and activities and the accompanying dismissals. The long delayed bankruptcy law has been put into force in such a way that the creditor finding its interests endangered can initiate the liquidation procedure forcing the debtor through accelerated court procedure to sell its assets and indemnify him only in agreement with the state administration. It has also to be feared that the simultaneously introduced changes will not force the liquidation of low-efficiency workshops and factories either. A direct consequence of both actions would have been, according to earlier plans, the discontinuing of jobs. The original ideas gradually lost ground in the practice. This came to expression not only in that, owing to the continued strong centralization of free incomes, the purchase under market forms of failing establishments and factories (i.e. the free exchange of properties without central decision) remains impossible, but also in that "the reorganization of the wealth of not adequately managed economic entities to be liquidated" is expected from the decisions and organizational activity of state organs. The weakening of efforts at closing down the non-efficient workshops is also indicated by the fact that, in spite of the strong excess demand on the labor market, the institutional preparations for the dismissals (unemployment) is progressing slowly (system of aid for retraining etc.).

The contradictions of the financial changes implemented in 1985 is mainly rooted in the fact *that the order of the money emission has hardly been affected*. Although the program of *bank reform* has been approved with great delay; and no resistance has been developed against forced interfirm credits, and a strict regulation of the money supply is still missing. Instead of a program for regulating aggregate demand the banking system continues to make difficult for efficient firms to raise credit and does not—cannot—stop granting credit to low-efficiency firms, nor does it strongly interfere in order to stop the heavy indebtedness of firms to each other.

The way how money supply was developed has not restricted the aggregate demand, but has essentially secured the survival of every firm. This practice brings about a particular situation. The unexploited capacities are coupled with shortage on the market of goods and services and with overheatedness on the labor market.

The smooth supply with money of the state and cooperative firms, not strictly depending on their results, has brought about an internal chain of complicated interrelations. On the one hand, not even the almost insolvent state and cooperative firms are forced withstand the price-raising efforts of their partners, to dismiss superfluous staff, to save wages. They solve the difficult production tasks, instead of organized internal work, with overtime, enterprise economic workteams, orders given to expensive suppliers etc. Nor do they stop supplying their buyers in default of payment. On the other hand, as a natural concomitant of all the above, the just reviewed changes in market—oriented price and wage regulations have not entailed a growing

role of money, but have loosened the financial conditions of management. In this case the economic leadership of the country can protect itself from runaway inflation only with methods discarded in its declarations. Finally, the unfavorable phenomena observed in the scope of state and cooperative enterprises also loosen the management conditions of small ventures.¹⁵

The development of trade

The development towards a market system raised strict requirements to trade as well. The economic reform demanded a multi-channel, diversified trade system which could not be brought about to this very day. The declared free choice of partners cannot assert itself in most of the cases, as there are not several partners from whom to choose. More firms competing with each other would be needed. But the ambitions and chances of founding firms are restricted even more in trade than in production.

In the eighties, and particularly after 1985, efforts were made to change the situation. The firms, first of all the productive ones, obtained new possibilities also in the trade with raw materials, capital goods and consumer goods more over even in foreign trade. Also organizations were transformed, which increased the number of commercial firms. That of firms with rights to trade abroad suddenly increased. Still, except for the appearance of private retail shops, the changes do not unambiguously point towards the desirable objective. Competition among commercial firms is still in an embryonic stage, which among others is a consequence of the price margin not sufficient for covering trading risks, and of the big commitments entailed by trading rights.

The government entrusted the *market surveillance* organization to bring about diversified commercial relations, organize and control markets. This institution is one of most controversial elements of today's economic control. Namely, a multi-channel market can only come about by changes in the general conditions, which the market surveillance can help but cannot bring about with its organizing activity. Therefore, it is still the "trouble averting" activity that is preponderant against the tasks of market organization. It is still far from reality that the free market areas should be unambiguously delimited from the trading areas belonging to the scope of market surveillance and that even the latter should be interfered with—apart from separate authorization only by exploiting the incentive role of the funds made available for this special purpose. Instead, the situations have persisted, and their number even increased in 1966, when the market forces have not solved the market shortages and the measures of government agencies moving between unambiguous legal limits have been weak too. It is with growing frequency that branch organizations, councils and territorial party organs try to settle social conflicts (commodity shortage, spontaneous price rise, dismissals etc.) with the means available to them. In this way, however, only the relieving of short term tensions can be helped, while the local interferences do not point in the direction to be followed in the long run: they even weaken the desirable behavior of economic entities that should be based on enterprise interest and autonomy.¹⁶

Notes

*In 1981 a major research project was launched in the Institute of Economics, Hungarian Academy of Sciences, directed at the organizational system of the economy. In this paper the two leaders of the project report on the results, relying on several hundreds of analyses and case studies as well as on a debate conducted in the Institute. [Editor's note: This article has not been edited by the editor.]

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