# ECONOMIC TROUBLES IN THE NEW ERA OF FREEDOM : THE HUNGARIAN EXPERIENCE

by Eva Ozsvald

(Institute of Economics, Hungarian Academy of Sciences)

Eastern Europe, 1989 and 1990–two subsequent years, yet what a sharp contrast! The year of 1989, specifically, the last three months of it, by any standard must be considered as the most remarkable turn in the history of post–war Europe. The Soviettype, totalitarian systems were overthrown in one country after another. These were revolutions at their best–shockingly quick and, in most cases, non–violent. The euphoria of those hot weeks was shared with the rest of the world. Thanks to the media, Eastern Europe in those days was in the center of worldwide attention. However, all wonders last but nine days. The tense interest from outside has relaxed and the news coverage of Eastern Europe's great transformation has diminished. Casual observers may conclude that since basic political actions were successfully carried out, freely elected governments put in power, the parliaments are functioning and the residua of the institutions of post–stalinist states are being cleaned up, the lion's share of the historical task has been accomplished. Unfortunately, this is not the case. To reach the desired goal to be like "them", the democratic welfare states of Western Europe–there is still long way to go on the Eastern half of the continent. (The exception is, of course, the postunification East Germany which has its own special problems.) After laying down the political foundation of pluralistic, democratic societies, substantial changes in the economic sphere must occur. Democracy and command economies are logically incompatible. The hope to solve Eastern Europe's deep economic crisis can start only after its old irrational system is completely purged. New insights reveal that this is much more difficult task than anyone could have predicted.

In this article I concentrate on Hungary's experiences, narrowing the subject and thus being more concrete. However, most of the topics I touch upon comprise aspects of the general character of the problems shared by all countries of the region in transforming from a centralized, state-managed economies to open market economies.

Having said this, there is one issue in which the uniqueness of Hungary should be stressed : she has the longest history of experimenting with the reforming of a Soviettype economy. In fact, by 1989, she had an at first glance, made unrecognizable modification to the "classical" socialist economy : no mandatory planning, a plethora of market elements and relative openness. For two decades the Hungarian case helped to sustain the belief that there was a third way : a viable political-economic system which was neither capitalist nor typically socialist. As the years passed, the unsurmountable barriers - both political and that of stemming from the logic of the original system - became visible and illusions about the viability of this blended system faded away. There has been a vast literature written on "reform-economics". While this may now seem obsolete, the knowledge it has generated about the functioning of different economic systems will still be valuable.

The Hungarian economy has been in a daunted crisis for quite some time and the inability of the former leadership to stop the economic situation from further deterioration was no doubt one of the reasons for their downfall. Symptoms describing Hungary's economic malaise are huge external debt, double-digit inflation, decreasing living standards, outdated industrial production structure, scarce resources for technological development, and poor general infrastructure. This is the legacy of the past forty years of the economic mismanagement. The changing of the political system did not relieve the burden of this legacy from the shoulders of either the freely elected government or the Hungarian people. The latter are disturbed that the daily life of the majority of the population has been deteriorating for years and that the new system offers no quick solution. During the election campaign they were promised improvement; they received the opposite. Thus, economic troubles are accompanied with increasing social dissatisfaction and tension.

It is probable that the present three party coalition government at the time of the election was not aware of the magnitude and difficulty of simultaneously creating a market economy with limited government intervention, renouncing the former practice of intertwined politics and economics, yet being strong enough to manage the crisis; to restrict internal demand in order to ease the external disequilibria, to impose financial discipline, to put central budget into order and to fight inflation effectively.

A half year has passed since the new government began its work. Thus far it has been unable to solve any of the acute conflicts of the economy. The government has been hesitant and reluctant to take the radical, necessarily painful measures which are indispensable to stabilize the economy. The longer these measures are avoided, the higher the price that will eventually have to be paid.

Students of the Hungarian transition agree that it will take years before it is completed and that the road the country must follow is uncertain and dangerous. There is also a general agreement that measures should come in packages rather than in piecemeal steps so that the individual elements could reinforce each other ; on the other hand, there are absolute and immediate priorities in establishing a free market system.

Fundamental changes in property rights are a typical example of this latter category. Only in countries, where private property is predominant producers strive for efficiency, consumer satisfaction, innovation and respond to the challenges of competition. In Hungary, although the private sector has been developing dynamically in recent years, its role is still small with the state owing most of the assets. However, there is no capitalism (i. e. efficient market economy) without capitalists (i. e. profit-seeking private owners.) This obvious point, however, was ignored in Hungary at the heights of reform optimism. It was believed that simulating the market, decentralizing decision making and liberalizing prices, wages and trade would automatically lead to the desired improvement in efficiency. We can list among the achievements of the Hungarian reform economics that by mid-1980's illusions about the marketization of the socialist system without substantially extending the scope of private capital were irrevocably given up. The reality now has to be faced : there is no substitute for the private owner as an entrepreneur and as a rational decision maker in the microsphere of the economy. Great number of private owners and free competition are necessary for genuine, efficient markets. Hungary is still misses these.

## PRIVATIZATION

Reducing the hegemony of the state in business and in resource allocation has, unlike in other Eastern European countries, been on Hungary's agenda since well before the political events of 1989. The last communist government (very reform minded, though) also learned the lesson that even the boldest steps in deregulation and liberalization are at best half-successes if the confused state of ownership relations remains intact. Understandably, it was not easy to overcome such a major ideological barrier (i. e. to turn back to the "socialist principle" of ownership relations). Nevertheless in the field of legislation substantial progress was made.

With new acts coming into force corporatization of the formally self-managing enterprises has begun. New types of enterprises, (e. g. joint stock and limited liability companies, joint ventures etc.) were formed within a relatively short time. The question emerges whether these transformations were preludes to true privatization or were just "changes of the labels" to serve the interest of the old management. In fact, the answer to this question is probably little of both. Unfortunately, the majority of transactions did not meet the requirement of transparency. There were cases when corruption was apparent in some pseudotransformations which led to the exaggeration of negative aspects of the whole process of transformation. The air remained full of suspicion even after the new, freely elected government took over the task of privatization. The first months of the new leadership were characterized by a loss of momentum, consequently, the results were very modest. The new government did not have the communist ideological barrier preventing the transfer of ownership but did have another one connected with their mistrust of radical liberalism: the fear of "squandering" the national wealth. In such a complex matter careful planning and gradualism is one thing, hesitation is another.

A variety of methods are applicable when increasing the domain of the private sector. Promoting entrepreneurship – I mean small usiness here–has been underway in Hungary for a couple of years. This segment of the private sector is small and operates businesses with low capital requirements and where competition, especially with state enterprises, is rather weak. Nevertheless, once restrictions were eliminated, this was the most dynamic sector of the Hungarian economy. They need support, easier access to credit and further fiscal incentives.

The positive aspect of entrepreneurship in the small businesses is, that ownership is clearly defined. This cannot be said yet of the hitherto state enterprises. Only a few of them have already gone private. The fate of this largely prevailing sector is still uncertain, although the government has declared in its program that around 50% of the economy will be in private hands three years from now. These enterprises, as a rule, are oversized and many of them are loss making. (Until now, bankruptcy has been almost an unknown phenomenon in the Hungarian economy. Non–viable enterprises were heavily subsidized from the state budget.) Who will be the new owners? Obviously, those who are financially strong enough to buy what is offered. Given the present rate of domestic savings, by relying solely on Hungarian capital it would be impossible to turn the economy private even in the longer run. Thus, the resources should come also from abroad, foreign direct investment is essential if the ambitious program of privatization is to be fulfilled. Additional benefits from foreign direct investment are the transfer of new technology and modern management know–how, both of which Hungary lacks. Tax advantages and other regulations have been established to attract foreign investors. As a result, spectacular growth in the number of joint ventures is already observable though it would be too early to call this a success. While the number might be impressive the capital involved is not. These joint ventures in most involve cases small enterprises, in limited sectors with services, retail trade being the favorites. To improve this situation, stabile general economic conditions, revised incentives, information, upgraded infrastructure and less bureaucracy is needed.

The whole process of transformation and privatization is supervised and managed by the State Property Agency, which was established a half year ago. Its first task was to establish the conceptual and legal framework for different privatization methods. The Agency is expected to fill the role both of the "coach" and the "referee" in promoting, assisting and regulating the privatization process. The procedure can be initiated by the enterprises themselves. They are encouraged to draw the plan of their own privatization.

We are in the initial phase of ownership transformation. Privatization and the subsequent birth of efficient markets are regarded as a panacea for all the economic diseases Hungary suffers from. This faith, (the fruits of which are slow to ripen) however, does not release the government from the obligation to pursue sound macro-economic policies with clearly stated priorities. Long-lasting imbalances, depression might impede the transformation of the system as well.

The single strongest factor which has restrained the options of the central governments for already more than a decade is the huge external debt. This sum is around US$20 billion requiring almost 40% of export earnings to service. Hungary always met its international debt obligations for both principal and interest. The price paid for this, however, has increased over the time. The money borrowed in the past was not used for investments that could generate enough foreign exchange earnings to ease the debt constraint. As a result, income continues to flow out of the country. The living standard has been deteriorating, investment, so much needed for the modernization of the economy, has fallen behind. The statistics show a decrease in GDP for this year. With the help of the International Monetary Fund new credits are available but the instructions of the Fund have to be followed. These usually include a tight monetary policy, a reduction in the current account deficit, trade liberalization, depreciation of the real exchange rate, lowering the fiscal deficit and controlling inflation.

## INFLATION

Neither the former nor the present government took seriously enough the threat of inflation. They even contributed to it : the central budget spent the money it did not have and price increases were always the easiest way to improve the imbalances. This year the general price level has increased by more than 30 percent and inflationary expectations are increasing. The pessimism of expectations is justified because, with the exception of privatization, all the necessary measures taken in the transition to a market economy, together with servicing the large foreign and domestic debt, will contribute to inflation. More concretely, the factors which exert an upward pressure on prices include the liberalization of wages and prices, reduction of subsidies, eliminating the barriers to free trade, the devaluation of the Hungarian currency, etc. Unfortunately, the economic laws and trade-offs that are more or less effective in the developed market economies do not apply in the only semi-marketized Hungarian economy. (To mention but one example : the increase of interest rates is one of the classical weapons against inflation, yet in Hungary, it turned to form a part of cost inflation.) The anti-inflationary policies (which existed at least on paper) of either the former or the present government have not been successful, partly because the measures implemented by them were inconsistent. The present government, for example, has been reducing subsidies considerably. This, in itself positive step, however, because of the undeclared aim of avoiding harsher conflicts resulting from this policy, was accompanied by increasing the supply of money, both in open and hidden forms.

A next reason why the tight monetary policy, strongly advised by the International Monetary Fund, has not yielded satisfactory results is that many enterprises which did not get direct financing could circumvent the regulations by selling to another enterprise on credit, which, in turn could do the same with its own customers. This pattern soon became popular. So called "queuing" was formed with obvious adverse effect on stabilization. Because the Hungarian financial system is still weak and undeveloped, the banks were unable to fight this phenomenon. On the other hand, there are powerful monopolies and oligopolies on the producers side with a long history of successful lobbying. It has been always difficult to prevent them to pursue their own interest at the expense of the less organized groups of the economy and society. There is hope that if privatization completely changes the nature of the Hungarian market, walls between politics and the economic sphere are erected, imports are fully liberalized and the government guards fair competition, then the strength of the monopolies will be drastically reduced.

## EXTERNAL ECONOMIC RELATIONS

Given the size of the Hungarian market, its poor endowment with natural resources and the need of economic modernization almost as a matter of survival – it is imperative that Hungary be an open economy, following a trade policy which makes her globally competitive. The heavy external debt burden and the poor Hungarian export performance demonstrate the weakness of the country's trade strategy over the past decades. The basis of the problem was of course, the economic system itself. There is a strong anti-foreign trade bias built in central planning, which is only suitable for the mobilization of resources in an early phase of industrialization. But choosing trading partners (or letting partners be chosen) plays an equally important role in the formation of foreign economic policy. Hungary, politically aligned, was a member of Council of Mutual Economic Assistance (CMEA or Comecon), the regional trading bloc of the centrally planned economies, from its very beginning. Within this, vis-a-vis the non-members' highly protectionist grouping, the cohesive force was primarily political. Factors which had to do with the market were excluded when deciding on mutual deliveries of goods. It is enough to say here that no real money was used in transactions.

The pillar of the CMEA was the supply of the Soviet raw materials to the East European countries, which in turn, were paid for by manufactured goods and agricultural products. Manufactured products, mainly machinery, were tailored to the needs of undemanding Soviet users. These goods, in quantities they were produced, could not have been marketed in East European countries themselves, let alone in developed market economies. While the deficiencies of the CMEA trade were recognized as early as the mid-sixties, but all efforts to reform it were doomed to failure. Security on both the supply and the demand side, which helped to maintain full employment and did not necessitate painful structural adjustments even after the world economic shocks of the 1970s, seemed to be a sufficient pro-CMEA argument for top decision makers. Even when the large scale borrowing from the West had made already headway, the share of intra-bloc trade was around 2/3 of Hungary's total foreign trade turnover.

The 1980s then saw a new chapter in the history of the CMEA, which, as we know now, was the last one. Mutual trade and other cooperation (e. g. joint investments) did not alleviate the growing economic depression all over the region ; in fact, they contributed to it. The institutions and mechanisms employed by the CMEA again proved to be unreformable, however. Disillusionment was finally expressed by the Soviet Union itself. From last year on it has joined those member-states which have been pushing for radical changes to be implemented. At the top of the list was abolishing the "rouble-zone", switching to world market prices and use dollars as a means of payment. It was agreed to introduce this new regime in January 1991. The new system will serves the long-term interest of each participating country. In the short term, however, only the Soviet Union will gain through considerable improvement in terms of trade at the expense of its ex-socialist partners. It is estimated that trading with the Soviet Union in convertible currencies will contribute to the deterioration of Hungary's balance of payment by more than one billion US$ in the first year.

With the collapse of the former political system in Hungary the last reason for not quitting the sinking ship of the CMEA also disappeared. In the trade with the Soviet Union, considerable surpluses have been accumulated on the Hungarian side which were frozen assets and had their contribution to the surplus country's inflation. Determined policy was needed to restrict exports to the Soviet Union. A big sector of the Hungarian economy was challenged to switch their export capacities to markets outside of the CMEA. Structural adjustment has, in fact, started. After their initial resistance and maneuvers, many big enterprises have lessened the pressure on the central authorities. Trade with the Soviet Union, the former number one trading partner has been shrinking noticeably. Moreover, the switch to the dollar-based trade in itself will have trade-diverting effects. Trade with the Soviet Union, the former number one trading partner has been shrinking noticeably.

As the Eastern European cooperation is disintegrating, the countries in question are not able to support each other in the hardships. Each looks for its own way in the demanding task of transformation. While turning to the developed world to be "taken in", they even compete with each other. These tendencies of disintegration may conceal the fact that the countries of the region are natural trading partners. Once they overcome the acute phase of their crises and solve the apparent ethnic and political problems, there is hope that they would recognize the advantages that lay in intraregional cooperation in the "new" Eastern Europe.

In the coming years, however, the centers of gravity of external relations, political and economic alike, are going to be shifted westward. By next year, around 30 percent of Hungary's foreign trade will be conducted with the unified Germany-the same share as used to be with the Soviet Union. Given its size, strength, geographical closeness and traditions, the "pull-effect" of the German economy on Hungary is very strong. A closer examination of export and import structures and of cooperation which goes beyond the limits of conventional exchange of goods, furthermore, the role of German capital in the Hungarian economy reveals a progressed state of dependency and raises the question of one-sidedness of the Hungarian economic orientation. Future external economic policies should be carefully weighed in order to find the orientation which helps Hungary to be a full member of the globalized economy rather than being pushed to the periphery of it. The European Economic Community membership would be a blessing in this respect. It is Hungary's declared goal to reach that status. The idea of a united Europe is very appealing indeed, yet at present it is more of a vision than tomorrow's reality. Notwithstanding, Hungary's efforts in the field of economic reforms and political renewal have been generously supported by the European Community. Aid is guaranteed in the future as well. Yet, the EC will be very conservative in expanding and considering new members so as not to disrupt the 1992 plans for integration. Hungary's precarious economy and versatile political climate does not allow her to be on the top of the waiting list to join. Nonetheless, compared with the past, the doors of the Community will become more open. Hungary will be given an Associate member status, unilaterally easing the trade barriers for Hungarian exports.

## CONCIUSION

Since the Hungarian political and economic situation is changing very quickly, it is important to note that this article was written in October, 1990. Rapid, often unpredictable changes are a natural accompaniment to the yet untried trânsformation. At the same time, however, they reflect the dangerous instability of the system. Just this month, for the first time in the new era of freedom, the government had to face the fact that the citizens might not always obey – a sign of the limits of the people's tolerance in connection with the austere economic strategy. The government will have to adopt greater sensitivity to social problems including poverty and growing income differentials. This will further reduce its already limited space for maneuvering. Moreover, the impact of unfavorable events in the international arena (notably, the Gulf crisis and the chaos in the Soviet Union) will have to be confronted. The energy sector must be restructured urgently in the light of foreseeable events. Since the re-scheduling of debts is still regarded as the worst choice, it is advisable to meet the rigorous conditions of the International Monetary Fund in order to ensure the continuous flow of credits.

Next year's program reveals a shift to a more radical approach in solving the acute problems. Imports, prices and wages are expected to be liberalized further. Admittedly, this will aggravate inflation (which is believed to reach its peak in 1991), an alleged prerequisite for future stabilization. Soaring inflation, on the other hand, will certainly interfere with the other goals of the plan, namely the strengthening of the Hungarian currency and a time-specific commitment to convertibility.

The state is also expected not to bail out loss-making monopolies. Bankruptcies will occur which will create unemployment, an additional concern for social policy. Unlike in the past, people are now aware that hardships await them. Noone can be sure, however, that they will give their consent to the outlined policies. Compromises certainly will be unavoidable. It is certain that if Hungary fails to accomplish its economic transformation and is not able to establish market economy and meet the basic demands of the population for social security, its fragile democracy will also be in serious danger. If Hungary is not extended substantial help from the luckier and richer parts of the world, this scenario will, however, be quite probable.

Tokyo, November 1990

〔解題〕

堀林　　巧

1989年「東欧革命」の先陣を切ったのがポーランド、ハンガリーの「改革先進国」であったことはよく知られるところである。即ち、同年6月の総選挙結果を受けて夏にポーランドで「連帯」主導の非共産党政権が誕生、他方88年5月のカーダール書記長退陣以後「経済改革から政治改革へ」の移行を試みていたハンガリーでは、89年初頭に複数政党制移行が議会並びに共産党（正式名称は社会主義労働者党）中央委員会総会を通過、6月には「56年人民蜂起」当時首相のナジ・イムレの名誉復活の改葬式が実施され、10月には共産党の社会民主主義政党（社会党）への改組が実施されるなど旧体制からの離脱が急速に進行した。この両国での変化の圧力を受けて89年秋以降、旧東独、チェコスロバキア、ルーマニアの激変が生じたのである。

「東欧革命」翌年の1990年にはポーランドを除く東欧各国で自由選挙が実施されたが、旧共産党の影響力が残ったルーマニア、ブルガリアを別として、この選挙を通じて誕生した新政権はいずれの国でも「非共産党政権」であった（チェコスロバキア「市民フォーラム」、ハンガリー「民主フォーラム」、旧東独「キリスト教民主党」主導の連合政権）。そして、この新政権の下でプライヴァタイゼーション、資本主義国重視の方向での対外関係再編など、一言で言えば「再資本主義化」が試みられている。こうして、89年に起きたものが「政治革命」であったとすれば、90年以降進行している事態は「経済体制転換」と特徴づけられよう。

しかし、現在までに明らかになっていることは、この「体制転換」、「再資本主義化」の予想された以上の困難さである。西独に吸収合併された旧東独の特殊例はひとまずおくとして、いずれの国においても民間資本の不足などからプライヴァタイゼーションは緩慢であり、外資導入に関しても内側からは「民族主義的」抵抗、外側からは西側投資家のためらいなどの障害があり、期待どおりのスピードでは進行してはいない。こうして、経済危機を克服すべく「体制転換」が遅れる中で、危機そのものは長期化する傾向にある。ポーランド、ハンガリーの膨大な対外債務が減少する気配はみられないし、逆に「湾岸危機・戦争」による原油価格上昇がソ連からの原油供給削減（生

産停滞による）とあいまって「債務危機」を激化させようとしている。また、新体制への移行が緩慢である一方、旧体制も経済へのコントロールの力を失う中で、統制されないインフレーション、失業などが国民生活を圧迫している。

以下のオジュワルド・イーヴァ氏の論稿「新しい自由の時代における経済諸困難ーハンガリーの経験」は、こうした1990年に見られる東欧の事態を彼女の祖国であるハンガリーに即して分析したものである。1989年の「希望」と90年の「幻滅」のコントラストを全体的に描写した後、上記の「プライヴァタイゼーション」、「インフレーション」、「対外関係再編」など個別論点を具体的に検討しており、現在の東欧の経済問題の所在を知るうえで有益であるが、同時に東欧（特にハンガリー）エコノミスト固有の分析方法も散見され、日本の読者にとって興味深いところであろう。

オジュワルド・イーヴァ氏は、ブダペスト経済大学卒業後、アムステルダム大学で修士号を取得、現在ハンガリー科学アカデミー経済学研究所の上級研究員の職にある30代のエコノミストである。88年夏より日本に滞在しており、一橋大学経済研究所、金沢大学大学院経済研究科で非常勤講師を務めたこともある。以下の論稿も、90年２月の大学院講義（金沢大学）ノートをもとにして書き上げたものである。