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A Short Review of the History of the Hungarian Privatization

Abstract. This article is intended to give a short synopsis on the history of the Hungarian privatization, which has not been fully finished yet, but the most important aims however have been accomplished. As this issue is rather a complex one, having also legal and economic nature, one cannot avoid providing a short historical introduction from legal and economic aspects. Therefore the author also outlines the most significant elements of the changes in the system of the Hungarian ownership at the beginning of the 1990s, which can be featured as the transaction from planned economy into market-economy.

After the introduction the author describes the most important steps of the Hungarian privatization, which can be summed up as follows: (i) stage of spontaneous privatization (1985–1989); (ii) stage of state-controlled privatization (1990); (iii) stage of state-“directed” privatization (1990–1991); (iv) stage of privatization under the SPA/-programmes (1991–1992); (v) stage of self-privatization (1992–1995); (vi) the “third” regulation of privatization, strategic privatization (1995–).

The author also pays attention to the analysis of the relevant legal rules, which are or used to be in effect regulating privatization. The author also highlights that the law of Hungarian privatization cannot be thoroughly studied without taking into consideration the economic goals and economic characteristics of Hungary, as well.

Keywords: law and economy, Hungarian law, company law, law of privatization, history of privatization.

I.

The present study is intended to provide a brief summary of the history of privatization in Hungary, without pretending to be exhaustive in several respects. One of the primary reasons lies in space limitations, for a historically rather prolonged process of over 15 years, abound in complicated economic, legal and political interrelationships, cannot be described on a few pages except in no more than scanty outlines.¹ Privatization in Hungary has not yet been

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¹ For a rather detailed exposition of the process privatization in Hungary between 1989 and 1997, see in particular Mihályi, P.: *A magyar privatizáció krónikája, 1989–1997*

completed entirely even today, although there is no doubt that a very important stage thereof has been closed. As was pointed out by Tamás Sárközy, private ownership had encompassed about 85% of the national wealth by the turn of the millennium.² At the time, the completion or conclusion of privatization can be seen as a question of current politics when the present study is being written. This complexity of problems has practically been on the agenda ever since the coalition government of Socialists and Free Democrats was formed in 2002, and it has received even greater emphasis since the change in Prime Ministers early in the fall of 2004, which involved another shift in government in accordance with the rules governing the Hungarian constitutional organization of the State. This will be treated in a later section of my study.

In consideration of what I have set out above I can not but seek to outline the most essential aspects of privatization in Hungary and to sum up the main provisions of the relevant legislative enactments. From this it follows, furthermore that the present study will not be concerned with certain economic consequences of privatization. Although it is true that certain economic effects of privatization have long been felt, some of the longer-term economic implications should be expected to come into the open in times ahead.³

A statement to this effect may even be made *nolente-volente* in respect to the subsystem of law. The dumping of economic regulations in the early 1990s obviously reflected the impact of the period as well as of the circumstances in which the relevant legislative provisions were adopted. The upshot of all this made itself felt at the level of legislation or legal practice in the space of a few years. In some questions or concrete legal cases, however, such as litigations connected with privatization, the legislative provisions adopted at the time continue to have significant effects and may even today exert a fundamental influence on certain legal relations between subjects at law of economic life.

(A Chronicle of Privatization in Hungary, 1989–1997), Budapest, 1998. For a history of privatization in Hungary up to 1993 in English, see in particular Frydman, E.–Rapaczynski, A.–Earle, J. S. et alii: *The Privatization Process in Central Europe*, vol. I. Budapest–London–New York, 1993. 95–145.

² Sárközy, T.: *A magyar tulajdoni rendszer átalakulása és a privatizáció hazai szabályozása* (The Transformation of the Hungarian Property Regime and the Hungarian Regulation of Privatization). In: Török, G. (ed.): *A tulajdonjogi rendszer változásai a XX. század végére* (Changes in the Property Regime by the End of the 20th Century). Budapest, 2001. 70.

³ For a summary of some macroeconomic questions of privatization, see Simon, A.: *A privatizálási stratégiák makroökonómiája* (The Macroeconomics of Privatization Strategies). *Közgazdasági Szemle*, Nr. 9 of 1992. Also see Clarke, T. –Piteles, C. (ed.): *The Political Economy of Privatization*. London–New York, 1994.

The history of privatization in Hungary so far can be periodized from several aspects. Perhaps the possibility of a periodization in a historical perspective is not yet at hand, because the necessary long-term view does not yet exist for objective reasons. At any rate, privatization in Hungary can be divided into the following periods, it being understood that the different periods are well characterized by the main legislative provisions adopted in the particular periods, notably

1. stage of spontaneous privatization (1985–1989);
2. stage of state-controlled privatization (1990);
3. stage of state-“directed” privatization (1990–1991);
4. stage of privatization under the SPA (Short for State Property Agency (Hungarian ÁVÜ, short for Állami Vagyonügynökség)-programmes (1991–1992);
5. stage of self-privatization (1992–1995);
6. the “third” regulation of privatization, strategic privatization (1995–).

Evidently, other periodizations of privatization are equally possible, and, as it has been indicated, the researcher of a later period will also be able to discover other relevant momentous stages of privatization. However, before I examine the different stages of privatization through an interpretation of the relevant legislative provisions, it appears appropriate to discuss the causes underlying privatization and to point up the basic conditions thereof.

II.

As it is known, the turn of 1948 made Hungary a part of the so-called eastern or people’s democratic bloc. Apart from the rather short-lived Council Republic of 1919, there was introduced in this country a form of government practically without any tradition. As it was stated in the Constitution of 1949, Hungary became a People’s Republic, which survived down to the proclamation of the Republic in 1989. The people’s democratic form of government followed the Soviet-type political system and was based on a single-party State. For the present consideration, it means above all that the State’s unity as owner and public power was consummated, which is to say that national property meant state property in the first place. Emphasis is deserved in this respect by original Art. 4 of the Constitution (Act XX of 1949), reading as follows:

“Art. 4. (1) In the Hungarian People’s Republic the bulk of the means of production is owned as public property by the state, by public bodies or by

cooperative organizations. Means of production may also be privately owned.

(2) In the Hungarian People's Republic the force directing the national economy is the state power of the people. The working people gradually dislodge the capitalist elements and consistently build up a socialist system of the economy."

A relevant provision concerning property relations is also contained in Art. 6, which reads as follows:

"Art. 6. The mineral resources, the forests the waters, the natural sources of power, the mines, the large industrial enterprise, the means of communication such as railways, road, water and air transports, the banks, the postal, telegraph and telephone services, the wireless, the state-sponsored agricultural enterprises such as state farms, machine stations, irrigation works and the like are the property of the state and of public bodies as trustees for the whole people. All foreign and all wholesale trade is carried on by state enterprises, all other trade is under state supervision."

At the same time the Constitution recognized property acquired by labour (para. 1 of Art. 8), but Art. 8 (2) provided that private enterprise and private property must not prejudice the public interest. From this it appears plastically that private property merely receives, in point of fact, subsidiary recognition and that, contrary to the centuries-old development traceable to Roman law,⁴ the economic and social order of the one-time People's Republic reflected an effort to grant a privileged status to public or state property.⁵ Recognition of property acquired by labour also implies the necessity of examining the origin of property. Nor is it accidental that the socialist legal order often contrasts personal property with private property, a concept embracing things capable of ownership by private persons.⁶

⁴ As it is known, Roman law was basically grounded on private property, and this statement can be deemed to be true even if one considers that, at the time of its emergence, Roman property cannot naturally be identified with the property concept of modern times. See in particular Diódsi, GY.: *Ownership in Ancient and Preclassical Roman Law*. Budapest, 1970.

⁵ For an analysis of the socialist constitution, see in particular Bihari, O.: *A szocialista államszervezet alkotmányos modelljei* (Constitutional Models of the Socialist State Organization). Budapest, 1983.

⁶ The concept of personal property emerged for the first time in Art. 10 of the Soviet Constitution of 1936.

This property regime is basically noticeable in the Civil Code (Act IV of 1959) as amended several times. The category of the law of things is relegated to the background under the regime covered by the Civil Code.⁷ Property in socialism is postulated as a relationship between people rather than between people and things. This is likewise revealed by the structure of the Civil Code, in which the law of persons is followed, as the third part, by the law of property rather than the law of things. It should be stressed that the same arrangement prevailed in the other socialist countries, as well. In Bulgaria, for instance, the Property Act of 1951 (*Zakon za sobstvenosta*) contained similar regulations, while similar principles were formulated by the Czechoslovak Civil Code of 1964 (*Obcansky Zákoník*).⁸ This solution is, to some extent, contrary to the regime governed by the Pandectist codes in the narrower sense; under it, the rights in rem play a fundamental role as rights of a person in his own things or in things of others.⁹

In conjunction with this it is necessary to refer to the fact that commercial law or some parts thereof (company law, law of securities, law of competition, etc.) practically ceased to be applied. The Commercial Code (Act XXXVII of 1875) formally remained in effect and retained a certain role until the adoption of the new Act on the Law of Associations, as will be discussed at a later stage. Of course, non-application of the legislative provisions relating to commerce

⁷ The Civil Code borrowed the concept of personal property from the Soviet Constitution. Original Articles 92 and 93 of the Civil Code provide the following:

“Art. 92. (1) Goods directly serving or promoting the satisfaction of citizens’ personal needs (family homes, furnishings and articles for personal use, etc.) are personal property.

(2) Assets belonging to household plots, serving the purpose of auxiliary farming are also personal property.

(3) The law may determine the size of dwelling-houses that can be personal property.

Art. 93. The owner may make free use of his personal property for the satisfaction of his personal needs.”

Although the Civil Code of Hungary’s first code of private law, mention is deserved by the fact that the Draft Private Law of 1928, which did not come into force, commanded much attention on the part of courts. See in particular Hamza, G.: *Az európai magánjog fejlődése. A modern magánjogi rendszerek kialakulása a római jogi hagyományok alapján* (The Development of European Private Law. The Emergence of Modern Private-Law Systems on the Basis of Roman-Law Traditions). Budapest, 2002. 176–177.

⁸ See Hamza, G.: *Die Entwicklung des Privatrechts auf römischrechtlicher Grundlage unter besonderer Berücksichtigung in Deutschland, Österreich, der Schweiz und Ungarn*. Budapest, 2002. 184 and 227.

⁹ See in particular Lent, F.–Schwar, K. H.: *Sachenrecht. Ein Studienbuch*. München, 1976. 3–5.

greatly hindered the process of legislation on economic matters at the beginning of the 1990s.

It stands to reasons that the Socialist state organization based on public property intended to create the economic possibilities for that property regime. It should be stressed that this was done in some measure on the basis of the principle of *filius ante patrem*, since nationalizations had partially started as far back as 1945. On 17 March 1945 there was issued a Government Decree on the land reform. On 6 December 1945 a decision of the National Assembly took coal mines and electricity works into public ownership. In terms of figures this means that before 1945 private property had a share of about 60% in the sphere of production, whereas in 1988 the share of state property was about 92,9%, thanks, among others, to the nationalizations effected in the 1940s and the 1950s.¹⁰

A role in shaping the structure of industry was played, along with nationalizations, by the fact that during the said period, in the late 1940s and the early 1950s, the State itself formed numerous large enterprises, which were held by the State. According to the contemporary legislative enactments, the founder of a state enterprise was the competent sectoral ministry, and the foundation document of the foundation document of the state enterprise was also signed by the sectoral minister himself. This period saw the foundation of several enterprises, which are still operating, are not naturally state-owned any more, but were later transformed or privatized.¹¹ The contemporary structure of the state enterprise was, of course, a true reflection of the prevalent economic conceptions, under which Hungary was to become a big power in heavy industry. Even if that did not come to pass, it may be said that the large enterprise structure became a determinant element of the Hungarian economy, or the people's economy as it was called at the time.

The Hungarian agriculture was collectivized, also on the Soviet model, practically as the result of forcible entry into cooperative farms. Politics thought cooperative land ownership to be temporary, on the understanding that the final goal was to be complete nationalization, the adequate form of which was the state farm. The law of cooperatives, their structure and the transformations in the

¹⁰ Mezey, B. (ed.): *Magyar jogtörténet* (History of Hungarian Law), Budapest, 1996. 198.

¹¹ To give an example in the field of the building industry, the public buildings construction company was such an enterprise in overground construction. After the systemic change it became a public buildings construction corp. and today it is known as European Construction Corp.

wake of the systemic change will not be discussed in the present study, as they are not closely related to our topic.¹²

The system of economic direction was based on plan instructions, which is to say that one can speak of a planned economy which—now a commonplace—had no particular regard for the needs and challenges of the market. It may nevertheless be said that certain forms of privatization, the so-called spontaneous privatization, had emerged as early as the 1980s. However, one should go back to 1968, the year of the introduction of the new economic mechanism, for an explanation. Without giving a detailed analysis of that mechanism here and now, I cannot fail to emphasize that the new economic mechanism went much further than the command economy did to make allowance for profit orientation, enterprise autonomy and market coordination.¹³ Although the 1970s witnessed a certain degree of recession after the introduction of the economic mechanism, the larger measure of enterprise autonomy can be presumed to have contributed to the creation of possibilities for future privatization.

It is Decree No. 28/1972. (IV. 3.) of the Minister of Finance and Act VI of 1977 that can be said to have shown the first signs of enterprise autonomy in the domain of law. The Decree of the Minister of Finance was concerned with economic associations operating with foreign participation and allowed western enterprises to establish associations as a kind of joint venture with Hungarian enterprises on Hungarian territory. The suitable legal form was represented, *mutatis mutandis*, by the limited liability company and the joint stock company¹⁴ as covered the Commercial Code of 1875 referred to above. On the other hand, Act VI of 1977 dealt with enterprises. While in its original version that Act provided for the sectoral direction of state enterprises and laid emphasis on supervision by the founding organization, it regulated in detail the responsibilities of the directors of state enterprises and the participation of workers in direction. Art. 27 (3) of the Enterprises Act contained an extremely important provision on enterprise assets:

¹² A concise overview of the Hungarian law of cooperatives is provided by Mrs. Domé, GY.: *A szövetkezetek jogi szabályozásának múltja, jelene és jövője* (The Past, Present and Future of the Legal Regulation of Cooperatives). *Veres-émlékkönyv* (Essays Presented to Veres), 1999. 79–93.

¹³ For a summary see Frydman, R.–Rapaczynski, A.–Earle, J. S. et alii; *op. cit.* 95–96. For some legal questions of the new economic mechanism, see Fesztl, N.–Tamás, L.: *Az új gazdasági mechanizmus polgári jogi vonatkozásainak néhány problémája* (Some Problems concerning the Civil-Law Aspects of the New Economic Mechanism). *Studia Iuridica Auctoritate Universitatis Pécs Publicata* 54 (1969), 3–36.

¹⁴ See Sárközy, T.: *A magyar tulajdoni rendszer... op. cit.* 75.

“Art. 27. (3) The enterprise shall be responsible for its obligations with the assets entrusted to and managed by it.”

The creation of a certain degree of financial independence is to be interpreted in close relationship with the provisions of Act III of 1974 on Foreign Trade, which stated this:

“Art. 13. In the interest of building its foreign market organization an enterprise entitled to engage in foreign trade may, within the limitations established by law, appoint delegates abroad, employ a foreign natural or legal person as commercial representative, set up a representation, a branch or an office, found an enterprise or obtain enterprise interests abroad.”

As it can be seen, this Act allowed state enterprises to acquire a right of its own to carry on foreign trade and, in given cases, to operate a representation abroad. In addition to implying numerous career opportunities, the permission to engage in foreign trade not only involved participation in economic activities abroad, but also contributed significantly to the development of enterprise autonomy, which can therefore be seen as a precondition for future privatization as well.¹⁵

III.

By the early 1980s Hungary had witnessed the emergence of a special economic order, owing to a considerable degree of national indebtedness at one extreme and, at the other, to the rise of what Tamás Bauer called neither a planned nor a market economy, as was also embodied in numerous legislative provisions.

On the one hand—at the level of small undertakings—this was manifested in the adaptation of the civil-law society, as known to the Civil Code, to economic activity, a dogmatically not too fortunate solution, for the civil-law society was not basically destined to serve economic purposes. This form of civil-law society clearly reminds us more of the limited partnership or the general partnership, which can be regarded as the traditional partnerships

¹⁵ For a summary of legal regulations on foreign trade, see Vattay, GY. (ed.): *A külkereskedelmi tevékenység jogi kézikönyve* (A Legal Handbook of Foreign Trade Activities). Budapest, 1991. For a summary of enterprise law of that time, see Sárközy, T.: *A szocialista vállalatelmélet jogtudományi alapjaihoz* (To the Juridical Foundations of the Socialist Enterprise Theory). Budapest, 1981.

covered by commercial law. It is to be mentioned that, from 1978 onwards, artisans—three of them at the most—had been permitted to form general partnerships, but no scope was left for cooperation between other forms of association (e.g. silent partnership). Clearly enough, all this was far from confirming to the basic constitutional principle of economic undertaking.

On the other hand, introduced by Law-Decree No. 15 of 1981, the business partnership represented a special form of economic cooperation. It was allowed to consist of not more than 30 members or employees, but it could be considered to be a genuine form of small undertaking.¹⁶ A great number of business partnerships had been formed until the adoption of the first Act on economic associations, and it was only the second Act on economic associations (Act CXLIV of 1997) which required the business partnership or the business partnership operating with the liability of a legal entity to be transformed into a general partnership within two years from the entry into force of the Act, while entitling it to be transformed into some other economic association, too.¹⁷

The contemporary legislation of the greatest importance to the large enterprise structure was Law Decree No. 23 of 1984, which introduced a significant reform¹⁸ by allowing establishment of the self-governing enterprise with an enterprise council and the workers' general meeting, these organs being even competent to appoint the director, who also had a considerable say in the composition of the said bodies, so that this arrangement led to a notable interaction of the posts involved, that is to say that a momentum for a kind of symbiosis between them was generated by the law itself. One might as well say with some simplification that the enterprise council performed several such functions as were referred to the competence of the highest organ in the case of an economic association.¹⁹

¹⁶ On its entry into force the old Associations Act included provisions on the business partnership, while repealing Law-Decree No. 11 of 1985.

¹⁷ Art. 300 (3) of Act CXLIV of 1997 on Economic Associations contains the following provision: "By modifying its contract of association within two years from the entry into force of this Act, the business partnership or the business partnership operating with the liability of a legal entity may continue to operate as a general partnership, or the business partnership shall be transformed into another economic association. If it fails to do so, the Registry Court shall declare it to be defunct." Also see Lenkovics, B.: *A szocialista vállalkozási formák polgári jogi kérdései* (Civil-Law Questions of the Socialist Forms of Undertaking). Budapest, 1983.

¹⁸ The full title of the Law-Decree is law-Degree No. 23 of 1984 instructing economic organizations to engage in specific economic activities.

¹⁹ For example, Art. 8, para. 1 (a), of the Decree enforcing the Enterprise Act provides that the enterprise council is entitled to inspect the balance sheet of the enterprise, which is

From the foregoing one may draw the conclusion that, owing precisely to the aforementioned structural elements and reforms, the Hungarian economy was not prepared for privatization, for an economic transformation, in as small a measure as the other people's democratic states of the eastern bloc were. As against the Balkan people's democratic countries or the Soviet Union, for instance, it was Poland and one-time Czechoslovakia that could be regarded as such "*socialist reformer countries*" (Tamás Sárközy).²⁰

As compared with Western European or American privatizations, privatization in Hungary certainly exhibits a specific feature in that there was a need here not only for privatization, but, on the one hand, for the appropriate transformation of the enterprises to be privatized and, on the other, for a simultaneous settlement of economic issues by high-level legislation, notably for a fundamental economic legislation as well.²¹ Relying on a graphic description by Tamás Sárközy, one can detect a significant difference between efforts to privatize the shares of British Petrol by, e.g., introducing them in a stock exchange or in a market with an otherwise significant purchasing power, or to subject to privatization, for example, a State Hair-Dressing Enterprise in a society that is not based on the primacy of private property and hence not markedly rich as regards its broad segments.

Although one should pay heed to the thesis-like statement that privatization is to be construed as termination of state ownership in favour of non-state owners (namely that privatization involves a change on owners),²² adoption of the first institutionalized measures called for a legislative enactment on associations. The first Associations Act (Act VI of 1988 on Economic Associations, the old Associations Act) created the institutional frameworks necessary for effecting the otherwise spontaneous privatizations not controlled by the State.²³

typically a responsibility or right that, in the case of an economic association, must be conferred on the highest organ.

²⁰ For a summary of privatization in Central and Eastern Europe, see Sándor, I.: *Privatizáció Közép- és Kelet-Európában* (Privatization in Central and Eastern Europe), in: Czuczai, J.: *A magyar privatizáció alulnézetből* (Privatization in Hungary from Bottom-View), Budapest, 1994. 177–236.

²¹ For privatization in Western Europe, see in particular Sándor, I.: *Privatizáció Nyugat- és Kelet Európában* (Privatization in Western and Eastern Europe), in: Török, G. (ed.): *A tulajdoni rendszer változásai... op. cit.* 46–70.

²² See Sárközy, T.: *A privatizáció joga Magyarországon (1989–1993)* [The Law of Privatization in Hungary (1989–1993)]. Budapest, 1993. 48.

²³ It may be mentioned as a point of interest that the Commercial Code (Act XXXVII of 1875)—with the exception of its provisions on commercial bonds and warehouse transactions—was repealed by the old Associations Act.

The old Associations Act—just as Act CXLIV of 1997 on Economic Associations, which succeeded it—rests on a dualist concept, meaning that the forms of economic association are regulated by legislative provision in a manner different from regulation by the Civil Code, or the Code of Private Law.²⁴ What the old Associations Act sought to establish was a system differing from that created by the former socialist legislation in a socialist state organization then still existing.²⁵ The changing needs of the economy and, not least, the requirements of the changed international political environment

“... made a case for an enterprise system resting on the following pillars: the freedom of economic undertaking and of association; economic units based on a shareholders’ system, notably associations, cooperatives, individual undertakings and firms, and other units (e.g. state enterprises, non-profit companies, subject to duly differentiated rules).”²⁶ (quoted from Ferenc Mádl)

At the same time, the first version of the old Associations Act imposed some additional restrictions. For example, a natural person was not entitled to form a one-man joint stock company, or associations in exclusively private ownership were allowed to employ not more than 500 workers. Of course, it became relatively quickly possible for these restrictions to be sidestepped by founding several one-man limited liability companies, each employing 500 workers separately. Foreign investors were similarly accorded appropriate possibilities, coming to find themselves in the same position as Hungarian entrepreneurs. It is to be noted that for only one year up to 1 January 1990, namely after the entry into force of the old Associations Act, the joint permission of the Minister of Finance and the Minister of Trade was required for an economic association to possess foreign property in excess of 50%.²⁷

²⁴ On the question of the monist and dualist concepts, see in particular Vékás, L.: *Az új Polgári Törvénykönyv elméleti előkérdései* (Theoretical Preliminary Questions of the New Civil Code). Budapest, 2001. 38–74.

²⁵ The old Associations Act came into force on 1 January 1989, when Hungary was characterized by the one-party system and the form of government was the people’s republic. As mentioned earlier, the Republic was proclaimed on 23 October 1989.

²⁶ See Mádl, F.: *Állam és gazdaság. Forradalom a jog útjain a Közép- és Kelet-európai országokban* (State and Economy. Revolution Treading the Paths of Law in the Central and Eastern European Countries). Budapest, 1997. 52.

²⁷ Art. 8. (1) of the old Associations Act stated the following: “The joint permission of the Minister of Finance and the Minister of Trade shall be required for the foundation of an economic association mostly or entirely in foreign ownership, for transformation into such association, and for acquisition of a majority share by foreigners, such permission to include

It should be stressed that in 1988 a separate Act (Act XXIV of 1988) was passed on foreign investments in Hungary. The Act sought to promote international economic cooperation and to encourage inflows to Hungary of foreign working capital. It is still in effect and contains highly relevant provisions in respect of, e.g., companies in customs-free zones.

In view of the foregoing it can be stated that the old Associations Act had created the particular institutional frameworks required for the switch to a market economy, since it was familiar with the most fundamental forms of association, such as general partnership, limited partnership, merger, joint venture, limited liability company, and joint stock company.²⁸ (It should be underlined that, unlike the German law of association, the Hungarian law of association is unfamiliar with the concept of “partnership limited by shares”.) Of course, the old Associations Act was not by itself sufficient to adequately regulate all economic legal relations as there was a need for legislation on the money market, registry procedure and bankruptcy as well. All of the related norms had to be elaborated within a rather short period of time, considering the need for a relatively rapid regulation appropriate to the specific requirements of the economy, and, owing to the nature of the socialist economic order, the said legislative provisions had previously been absent from the Hungarian legal system.²⁹

Act XIII of 1989 on the transformation of economic organizations and economic associations (Transformation Act) was the first legislative enactment more closely related to privatization. On the one hand, it allowed transformation of the formed small undertakings (e.g. business partnership) into economic associations and, on the other, it left room for large enterprises to be transformed into an economic association, chiefly joint stock company or limited liability company. It could not yet be regarded as an *ex asse* privatisation Act, since it did not ordain privatisation of state property, which has proved to be an essential element of privatisation, but created a kind of possibility for privatization. At the same time it was particular useful to spontaneous privatization, which

a permit of the foreign exchange authority. The permission shall be deemed to be granted if the application was not rejected within 90 days of its submission.”

²⁸ See Gábor, F. A.: The Quest for Transformation to a Market Economy: Privatization and Foreign Investment in Hungary. *Vanderbilt Journal of Transnational Law*, 24 (1991), 269–303.

²⁹ In connection with bankruptcy proceedings, currently governed by Act XLIX of 1991, it should be noted that Law-Decree No. 11 of 1986 on the Liquidation Procedure contains elements of bankruptcy law for the most part, but exhibits peculiar features in several aspects. That enactment was amended on a comprehensive scale by Law-Decree No. 26 of 1988. See Miskolczi Bodnár, P.–Török, G.: *A magyar csődjog alapjai* (The Foundations of the Hungarian Law of Bankruptcy). Budapest, 20002. 85–90.

means above all privatization not controlled by the State and preceding state-controlled privatization. The main beneficiaries (not within the meaning of positive law) of such privatization were the chief executives of certain state enterprises, who relied on the aforesaid legal frameworks (i.e. the old Associations Act and the Transformation Act) for having a state enterprise or some more valuable parts thereof (e.g. immovables, means of production) transferred from state to private ownership. All this was naturally coupled with numerous abuses and disproportions. It is not by chance that in 1990 the question of spontaneous privatization came into the focus of internal political life, with consideration to be given both to its advantages (spontaneous termination of state ownership) and to its disadvantages (possible bargaining away of state property). All these considerations called for a halt to spontaneous privatization and for its replacement with state-controlled privatization.

IV.

Before reviewing the positive-law rules of privatization it is appropriate to list, using Tamás Sárközy's terminology, the three methods of privatization by legal transactions, i.e. by reliance on other than peremptory rules of law:

- (a) privatization by sale of state property;
- (b) privatization by partial transfer of state property to associations;
- (c) privatization by complete transformation of state enterprises into economic associations.³⁰

a) This method was, in point of fact, already applied in part by way of spontaneous privatization. The question of how the problems of value and proportion manifested itself is a different point. This method is also known to institutionalised privatization, but sale above a certain value limit is subject to notification.

b) Partial transfer of state property to associations virtually means that a state enterprise and another person jointly establish a new economic entity, whose initial assets are contributed in part by the other person and in part by the enterprise. In this case the enterprise secures non-cash contribution, i.e. physical assets, while the other partner makes a financial contribution. Thereby a part of the enterprise property (means of production, immovables, etc.) becomes the property of the new enterprise, while the enterprise acquires in its place a business share or shares, depending on the form of association. This is called privatization by contribution. Clearly, it is equally possible for the

³⁰ See Sárközy: *A privatizáció joga... op. cit.* 53.

enterprise to eventually provide a know-how as a contribution. In this kind of privatization the other partner was very often a foreigner making the financial contribution, whereby a joint venture was actually set up. It is easy to see why this form of privatization was of particular advantage to the foreign partner, as in this way the foreign partner was able to become a member of a completely new economic association, behind which there stood a state enterprise as owner. Hence he did not have to face any of the many problems likely to arise in purchase of an old firm (e.g. long-standing litigation, other debts, obligations), and the need for an *audit* of the *due diligence* type was also eliminated. At the same time, cases were rather frequent in which the former state enterprise transferred a considerable part of its employees to the new economic association. It was very salutary to do so, for, on the one hand, the trade unions did not protest against that avenue of privatization, while, on the other hand, the other partner could be sure that the new association had a pool of suitable professional personnel at the time of starting business. This allows the conclusion that through such arrangement the foreign partner not only participated in privatization, but practically purchased a market, since he was able—with a new association possessing in a given case a team of tried and tested professionals and appropriate means of production—to participate in the Hungarian market and eventually even to quickly occupy a decisive position on the market.³¹ That phenomenon might also naturally lead to a depletion of the state enterprise or actually duplicate the enterprise, since the state enterprise and the new association established with the assistance of the other partner were in a position to operate concurrently.³²

c) This procedure can be considered in effect, as the first step to privatization, for, normally, it had not yet led to a full privatization of the state enterprise, but did, upon transformation, enable an external entrepreneur or investor to acquire part of the enterprise's shares or business share. An important provision on this point is contained in Art. 19 of the Transformation Act, reading:

“Art. 19. (1) Transformation of a state enterprise operating under the general management of the enterprise council and the workers' general meeting (delegates' meeting) shall be conditional on the requirement for the amount of the stated (initial) capital of the future economic association to exceed by at least 20% or by one million forints the amount of the enterprise assets as shown in the balance sheet and for the external entrepreneurs to obtain a

³¹ It is a different matter that eventual acquisition of the market in this way could also pose problems related to the law of competition

³² See Sárközy: *A privatizáció joga... op. cit.* 60.

share in the association to the amount of the surplus assets, such surplus to be charged against the stated (initial) capital.

(2) The business share (shares) of the economic association formed upon transformation of a state enterprise shall, in proportion of the share to the stated (initial) capital, pass into the ownership of the external entrepreneurs mentioned on para. (1).

(3) Transformation of a state enterprise operating under supervision by state administration, other state economic organization, an enterprise of a legal person and the external entrepreneurs obtaining a share in the association.”

Upon transformation, the newly established economic association is obviously general successor in title to the enterprise transformed. Thus, in the case of self-governing enterprises, external entrepreneurs are entitled, subject to specified financial conditions, to obtain a share in the association to the extent of surplus assets. This is the case of privatization by increase of capital, the core and substance of which lies in the requirement for the enterprise transformed to automatically obtain larger capital as the result of privatization. As it is stated in Art. 19. (3) above, if a state enterprise is under supervision by state administration, namely it is not a self-governing enterprise, transformation is permissible without the participation of an external entrepreneur. In such a case the enterprise, now obviously operating in the form of association, remained in state ownership, a step practically preparatory to privatization. The possibility was naturally there for numerous borderline cases to arise. During the period under discussion it was possible, for instance, for a state enterprise to continue operating with the structure of a state enterprise, but to be entered in the trade register and to receive a register number. This was of importance chiefly in the case of enterprises engaged in considerable foreign trade, for the foreign partner, when making an international contract, expected that the state enterprise should also have such parameters, including a trade register number, as an economic association had.

It should be emphasized that the aforementioned Transformation Act contained an important provision also in respect of the local self-government authorities then councils). Art. 21. (1) reads as follows:

“The business share (shares) equal to 20% of the enterprise assets as shown in the balance sheet, falling to the enterprise out of the stated (initial) capital of the economic association formed upon transformation of a state enterprise operating under the general management of the enterprise council and the workers’ general meeting (delegates’ meeting), shall be due to the

state property management agency, while the business share (shares) equal to the value of the inner-city land as shown in the balance sheet of the enterprise in the process of transformation shall be due to the local council of competence by the locus of such land. No exception from this provision on land may be made in the agreement mentioned in Art. 17. (3).”

As is expressed in the above provision, the shares (business share) equal to the value of the inner-city land as shown in the balance sheet of the enterprise in the process of transformation are due to the local council of competence by the locus of the land, that is, to the actual predecessor in title of the local self-government authority, the implication being that the enterprise property was virtually deemed to be the property of the people, so the councils predicated the expectation that the land used by the state enterprise should pertain to the competent council. For that matter, this is one of the explanations why the local self-government authorities, too, became owners as a result of the privatization of numerous large enterprises.³³

It should be noted that there had been formulated several other conceptions in connection with privatization. Among them it was the idea of property voucher or note, or of people’s share, which would have served to involve large segments of the population in privatization by way of quasi gratuitous grant. Though not large segments of the population, the workers’ collectives were indeed enabled to participate in privatization by means of the so-called workers’ shares,³⁴ a special arrangement on the American model being the Employee Part-Owner Programme.³⁵

Also, a special method of privatization was the use of compensation vouchers, which, dogmatically, was reprivatization in the first place, as it was intended to enable one-time owners to regain their proprietary status.³⁶

³³ The present study does not discuss questions concerning privatization of the property of self-government authorities. On this topic see in particular Török, G.: *Az önkormányzatokat a belterületi földek után megillető járandóságok kiadásával kapcsolatosan felmerült jogviták* (Legal Disputes about Allocations Due to Self-Government Authorities for Inner-City Land), in: Török, G. (ed.): *A tulajdoni rendszer változásai... op. cit.* 111–157.

³⁴ The rules on workers’ shares were laid down in Art. 244. of the old Associations Act. It is to be mentioned that the new Associations Act uses the concept not only of workers’ share (Art. 187), but also of workers’ business share (Arts. 145-146), thereby leaving

³⁵ See in particular Act XLIV of 1992 on the Employee Part-Owner Programme. That Programme was intended to ensure workers’ ownership chiefly on the model of the American ESOP.

³⁶ The present study is not concerned with a description of compensation processes. On the constitutionality of compensation, see Sajó, A.: *A részleges kárpótlási törvény által fel-*

V.

The first step toward institutionalised privatization can be said to have been taken by Act VII of 1990 on the State Property Agency (SPA) and on the Management and Utilization of the Property Pertaining to It. The SPA functioned as a budget-dependent organ, its basic purpose being to separate the functions of the State as owner and public power. Its primary responsibility was to manage the state property pertaining to it.³⁷ It was directed by an 11 member Board of Directors, while operative management was entrusted to the managing director. The decisions of the Board of Directors were binding on the managing director.

In my view, the goals of setting up the SPA are excellently summed up by the Handbook of Privatization, which was published in 1993. The Handbook summarized the activities of the Agency and served as a practical guide to investors intending to participate in privatization:

vetett alkotmányossági kérdések (Constitutional Issues Raised by the Partial Compensation Act). Állam és Jogtudomány, No. 1–4 of 1992. 190–209. For a concise summary in English of the compensation processes, see Koppányi, Sz.: *Summary of the Most Important Issues of the Hungarian Nationalisation of the Industry after World War II, and of the Compensation after the Transformation of Regime, with Particular Respect to Foreign Ownership*. Collega. No. I of 2002. 17–24.

³⁷ Act VII of 1990 defined the concept of property pertaining to SPA in the following wording:

“Art. 7. By virtue of this Act there shall belong to the State Property Agency,

a) out of the assets of state enterprises and other economic organizations transformed into economic associations under the Transformation Act,

aa) any business share and any share that did not pass into the ownership of external entrepreneurs, in the case of enterprises, trusts and other state economic organizations that operated under supervision by state administration;

ab) business shares (shares) equal to 20% of the state assets as show in the balance sheet, falling to such essets out of the stated (initial) capital: the portion determined by agreement (Art. 17. /3/ of the Transformation Act); and the business shares (shares)—not affecting the right of sale—which the economic association may retain for the purpose of sale under Art. 23. (1) of the Transformation Act. In the case of state enterprises that operated under the general management of the enterprise council and the workers’ general meeting (delegates’ meeting);

b)the property which, operating in economic associations not subject to subpara. (a), was owned by the State prior to the entry into force of the Transformation Act and is still owned by the State at the date of entry into force of this Act;

c)the assets remaining in state ownership after the liquidation of state economic organizations and any such state property as is transferred to the SPA by separate statute or decision of Parliament.”

“The declared goals of setting up the SPA were

- to separate the functions of the State as owner and public power;
- to create appropriate tools and organizational frameworks for the implementation of the property reform;
- to estimate the market value of state property;
- to strengthen the position of the State as owner with a view to protecting state property and consistently implementing the State’s privatization policy;
- to ensure control over the process of spontaneous privatization in keeping with the short- and long-term interests of society;
- to devise the most suitable forms of operating state assets;
- to facilitate the operation of state property on the basis of capital interest and the selection of suitable owners;
- to promote implementation of the economic strategy, including reduction of the state debt.”³⁸

The Act laid down the rules of property management and tenders. An outstanding role in the latter question was played by firms specialized in privatization, which participated in the process of tendering jointly with representatives of SPA and the given enterprise subject to privatization. The specialized firms sought to make use of foreign experience on the one hand and to realize their own ideas on the other. Adaptation to Hungary of foreign schemes of privatization met difficulties for the reasons set out above, while the specialized firms had little domestic experience. There were found several special solutions even under this scheme of arrangement. Thus, there were cases, in which the specialized firms themselves wanted to obtain a share in the property of privatised companies, but such plans were not supported by the SPA Board of Directors.

Under the terms of Act LXXIV of 1990 (Minor Privatization Act), which was adopted in the fall of 1990 on privatising the property of state enterprises engaged in retail trade, public catering and consumer service, the process of privatization affecting the related businesses had run its course by the end of 1994. In several cases the Act allowed the former operators of businesses covered by the Act to privatise the business units operated by them.

Privatization was taking place under the Spa programmes during 1991. An obvious effect on privatization was exerted by the legislation on compensation (Act XXV of 1991 on partial compensation, with a view to settlement of

³⁸ See Mrs. Ferencz, Földvály K. (ed.): *Privatizációs kézikönyv az Állami Vagyontulajdonosi Tevékenységről* (Handbook of Privatization on the Activities of the State Property Agency). Budapest, 1993. 13–14.

property relations, for damage unjustly caused to citizens' property) and by the Concessions Act (Act XVI of 1991 on the privatization of use). A significant influence on privatization was similarly borne *nolente-volente* by Act XLIX of 1990 regulating liquidation, bankruptcy proceedings and final settlement, as sizable state property passed into private ownership during the liquidation of state enterprises.

The year 1992 was of paramount importance to legislation on privatization, as Act LIII of 1992 on the management and utilization of entrepreneurial property permanently remaining in state ownership, Act LIV of 1992 on the sale, utilization and protection of property temporarily remaining in state ownership, and Act XV of 1992 amending the legislative enactments on the entrepreneurial property of the State were passed in that year.

Act LIII of 1992 determined the enterprises that were to remain permanently in state ownership. Government Decree No. 126/1972. (VII. 28.) on economic organizations permanently remaining, wholly or in part, in state ownership under authority of the Act specified the range of economic organizations within the said category.³⁹ Act LIII of 1992 founded the State Property Management Corp. (ÁV RT) to manage the property permanently remaining in state ownership. The ÁV RT. was a one-man, state-owned joint stock company, which, unless otherwise provided by law, was subject to the rules of the old Associations Act. It was directed by the Board. Its task was to transform enterprises permanently remaining in state ownership into economic associations and to exercise proprietary rights (a kind of property management). Chapter V of the Act laid down detailed rules for the transformation of state enterprises.

Act LIV of 1992 governs the utilization of property temporarily remaining in state ownership. Its scope of application can most easily be defined on the basis of Art. 2, which contains a negative definition:

“Art. 2. This Act shall not apply to

- a) property subject to Act LIII of 1992 on the management and utilization of entrepreneurial property permanently remaining in state ownership;
- b) those of treasury assets whose utilization for purposes of undertaking is excluded by separate statute;
- c) those assets—covered by Act XXXIII of 1991 on transfer of certain state-owned assets to the ownership of self-government authorities—which

³⁹ I mention by way of example that at the time the Decree was adopted the Hungarian Oil Industry Corp. (MOL), IKARUS Vehicle Manufacturing Corp. and the like belonged to this category of organizations. For that matter, the size of state property was likewise determined by the Decree.

will become the property of self-government authorities after completion of the procedure by the property transfer committee;

d) the property of the Hungarian National Bank, the State Development Institute, and the Centre of Banking Institutions.”

As it can be seen, the treasury property remained outside the scope of property capable of privatization. The property temporarily remaining in state ownership was still amenable to management by SPA. The Act laid down the rules for the transformation of enterprises into economic associations. The highest decision-making organ of SPA was the 11-member Board of Directors, and operative management was entrusted to the managing director. The proprietary rights in respect of property covered by the Act were exercised by SPA, its function being to carry out privatization.

The related enactments may summarily be called Status Acts, and it should be stressed that those of the state enterprises which were not terminated by final settlement or liquidation were required by the Act to be transformed into joint stock companies or limited liability companies within three years, while the companies permanently remaining in state ownership were managed by the national holding, the ÁV Rt. as a “giant with feet of clay” (Péter Mihályi).⁴⁰

However, this legislative package did not fully clarify the relationship between ÁVÜ (SPA) and ÁV Rt. The latter branched out the former, while the abovementioned Privatization Acts contained no provisions on e.g., transfer of property between the two organizations.

In 1994 there was a change of government in Hungary; the first, right-wing coalition formed after the systemic change was replaced by a socialist-liberal coalition, with the Hungarian Socialist Party as its leading party and with the Alliance of Free Democrats as its second member. The Government pursued the definite goal of ending the parallel operation of ÁV Rt. and ÁVÜ as well as of creating a set of legal conditions for the privatization of large public utility companies and commercial banks. Legislative preparatory work for the implementation of these goals began right after the government had been formed. Consultations and preparations, not free from political disputes, finally resulted in the adoption of Act XXXIX of 1995 on the sale of entrepreneurial property in state ownership, which is still in effect (Privatization Act).

The Privatization Act set up the State Privatization and Property Management Corp. (ÁPV Rt.) to carry out privatization and disbanded ÁVÜ and ÁV Rt. Its Art. 9 provides that ÁV Rt. must be renamed ÁPV Rt. as from the entry force

⁴⁰ For an evaluation see in particular Mihályi: *A magyar privatizáció... op. cit.* 163–194.

of the Act, while Art. 10 dissolved ÁVÜ and conveyed its rights and obligations to ÁPV Rt. under the rules of universal legal succession. ÁPV Rt. is a one-man joint stock company possessing registered and not negotiable shares. (Subject to the exceptions made by the Act, ÁPV Rt. is governed by the provisions of the Associations Act as basic underlying rules.) It is owned by the State. Its foundation document was approved by the Government on 17 June 1995. Its collegiate management is entrusted to the Board of Directors composed of 9 to 11 members, while its operative management is the responsibility of the general manager.

The Privatization Act lays down detailed rules for privatization and regulates various techniques of privatization. Along with the traditional methods of privatization, the Act is familiar with preferential privatization techniques, which are the following:

- instalment sale;
- sale with reservation of ownership (privatization leasing);
- buyout by senior executives and employees;
- facilities for acquisition of property by employees;
- start-up credit;
- Employee Part-Owner Programme.

As it is also indicated by the designations, the privatization leasing is not the classical leasing, but sale with reservation of ownership, which is, for that matter, rather common in business transactions.⁴¹

Of course, the Privatization Act is similarly aware of the concept of permanent state ownership. As regards temporary utilization of property incapable of privatization at the time of the adoption of the Act, there is a possibility open to making three types of contract for property management, notably

- contract of agency to preserve the value and substance of property;
- contract for work, labour and materials to achieve specified returns (dividend, acquisition of interest);
- portfolio contract, including the right of alienation and the obligation to achieve a specified increment of property.⁴²

The Annex to the Privatization Act identifies the associations operating with a share in the property of companies in permanent state ownership, indicating

⁴¹ On privatization leasing see in particular Novotni, Z.: *Technika vagy jogügylet? Gondolatok az un. privatizációs lízing koncepcióról* (Technique or Legal Transaction? Thoughts about the So-Called Concept of Privatization Leasing). Magyar Jog, No. 4 of 1993. 220–224.

⁴² See Articles 62–69 of the Privatization Act.

the proportion of state property and the minister or organ exercising the rights of state membership (shareholder's rights).

VI.

It may be stated in summary that one cannot disregard either the legal and economic issues or the political aspects of privatization. Since the summer of 2002 power in Hungary was again held by a socialist-liberal government coalition, and completion of privatization is practically a question of current politics. All this is evidenced, furthermore, by the fact that on 5 December 2004 a referendum was held at the initiative of the Workers' Party and with effective support from the opposition. One of the questions put to the vote was an eventual halt to the privatization of hospitals.⁴³ The referendum was unsuccessful, because neither question received identical answers from at least 25% of citizens entitled to vote. The turnout amounted to over 3 million voters representing 37.5% of all citizens having the right of vote. It should be stressed that the votes were only a few ten thousand short to oblige Parliament (a specificity of referendum) to adopt a decision prohibitive of privatization in public health.

From the foregoing it follows that the full and definitive conclusion of privatization and presumably the dissolution or transformation of the instructions of privatization are still some time away, albeit it is equally unquestionable that certain strategic measures of privatization in Hungary have already been implemented. I trust that this study of mine has succeeded in outlining the history thus far of privatization in Hungary, describing the background to and the reasons for privatization, and highlighting the major wellsprings of related efforts that will help to draw some conclusions—with due attention also paid to certain international experiences—concerning the determinant tendencies for future action as well.

⁴³ The other question submitted to the referendum—the dual citizenship of Hungarians living beyond the borders—is irrelevant to the present topic.