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This paper was presented to Centre for Russian and East European Studies of University of Birmingham on June 1988 when I was Honorary Senior Research Fellow there. Much of Part I, II and the first half of Part III are the summary of my past writings on Hungarian, Czechoslovak and Polish reforms in Japanese, which were the results of my short visits to Hungary (1977 and 1985), Czechoslovakia (1977), Poland (1980) and Yugoslavia (1980 and 1986).

I am very grateful for Ph. D. Thesis of Dr. Judy Batt " Economic Reform and Political Change in Eastern Europe. A Comparison of the Czechoslovak and Hungarian Experiences" (now published from the MacMillan Press), which stimulated me to re-examine my former writings. I agree with her that there have been no political reforms in Eastern Europe, so I also used the words " political change" instead of " political reform".

Professor Ron Amann, Director of CREES, and Dr. Judy Batt kindly read my paper and made precious comments for me. I am very grateful again for them, whose critical remarks shall be considered in my future study.

I. Introduction

Soviet and East-European economic reforms, which first emerged in mid-Sixties, were based on the recognition of various different interests existing in those societies. Traditionally, " socialist" state was supposed to represent the interest of whole society, while state enterprises as principal economic components were supposed to be the subordinate parts of " one single factory ", and the interests of individuals as producers as well as consumers were supposed to be perfectly represented by " socialist ", " workers' " state. Meanwhile the new thinking in mid-Sixties was that the existing state could not perfectly represent the interest of the whole society, because it could neither manage the economy as " one single factory ", nor could guarantee individual needs beforehand.

It was evident that there were at least three groups of different interests (as Wlodzimierz Brus pointed in " The Market in a Socialist Economy "), namely, the interests of state, enterprises and individuals, which were to be coordinated. Between state and enterprises, enterprise autonomy as an independent economic unit should be guaranteed, and the state should concentrate on the long-term macro-economic balance : these are to be the main tasks of economic reform. Between each enterprise and its working collective, the difference of interests should be coordinated through participation, collective management, and finally, workers' self-management : this means that the democratisation on the workplace should be needed. And between state and individuals, there should be more say of individuals on their personal and public affairs to represent their own interests : that means that political democracy, or democratisation on the national level, is to be needed.

Therefore, in my view, to reform the existing socialist system it is necessary to integrate these three aspects (economic reform, self-management and political democracy), which may lead to an optimal combination of economic rationality and political democracy. However, except in the unique and unsuccessful case of Yugoslavia since 1950 and in the short-lived Prague Spring all efforts for reform in Eastern Europe (including 1965 Kosygin reform in the USSR) hitherto concentrated solely on the partial modification of the existing system of economic planning and management, without any real step to self-management and political democracy. Officially, those economic reforms were the extension of previous economic policies partially modified, intending to adapt to the changing resource availability, to the needs of so-called intensive growth, without fundamentally changing previous institutional framework.

Those partial reforms could only be justified temporarily, as far as they would improve economic conditions of population and political dissatisfaction would be economically compensated. Once this economic compensation fails, the deficiency of those partial reforms would be seriously realised. Moreover, those partial reforms have already left a lot of theoretical problems unresolved: such as the meaning of market in a socialist economy (the existence of mixed economy not only during the short period of transition but also throughout the foreseeable future), the coexistence of different (state, cooperative and private) ownership of the means of production, as well as the acceptable limit of social inequality. Perhaps the pragmatic shelving of those theoretical problems was one of the main reasons of success of the introduction of Hungarian economic reform since 1968, but these theoretical problems remain as the sword of Damocles likely to be utilized by the conservative forces to brake the further reform.

In a practical world, I admit, it is doubtful whether abovementioned integrated reform could ever be actualized in the framework of the existing socialism. How can a socialist mixed economy function effectively, without damaging the accustomed social benefits and the quality of life hitherto enjoyed? How the workers' self-management (democratisation on the workplace) can be introduced in harmony with effectiveness, without resulting economic chaos as in Yugoslavia? And the most sensitive task would be political reform. What kind of political reform would be possible, and how the transition to a new political system could occur peacefully? However, it seems that they have no alternatives. They can not retreat but try.

II. Main characteristic types of reforms in Eastern Europe

In this part, I classify briefly main characteristics of reforms chosen in four East-European countries, from the viewpoint of afore-mentioned need for an integrated reform: namely, self-management in Yugoslavia, political democracy in Czechoslovakia (in 1968), economic reform in Hungary, and recurrent failure of reforms in Poland.

II-A. Yugoslavia

As is well known, Yugoslavia under Tito was expelled by Stalin from the Eastern bloc in 1949, and after that Yugoslav leadership earnestly tried to find their own identity, criticizing Stalinist bureaucratic state socialism. They claimed that they rediscovered Marx who had insisted that the state should be gradually dying away in a future society and the workers should be genuine masters of the society in place of bureaucrats. On 27 June 1950 the Fundamental Law on Workers' Self-Management was adopted, and since then working collectives of "socially-owned" enterprises elected workers' councils, which autonomously managed the enterprises through managing committees. Decision-making was thus decentralized to the enterprise level, and so centralized planning should be abandoned. Since the beginning of Sixties, various economic reform measures were taken in order to introduce "market socialism".

However, in my opinion, what Marx argued was the self-management of the whole society by self-concious direct producers' collectives, not that of individual enterprises as independent commodity-producing units. Self-management of individual enterprises solely by the people working there should not be considered as a final goal, but as transitional measures to the self-management of the society as a whole. And so during this transition (we can not say how long it will be) workers' self-management should be coordinated with macro-economic balance of national economy and with the democratisation of the society as a whole.

Workers' self-management in Yugoslavia was introduced (and remained) under one-party rule, which was not so different from Stalinist conception of politics. It is true that transition from one-party rule to some kind of direct democracy was proposed in principle, but actual political process always tended to centralize political power, whenever political and economic difficulties occurred. Dr. Ivan T. Berend (now President of Hungarian Academy of Sciences) once told me that he had thought in 1956 that the workers' councils system should be the only solution of the situation, but after twenty years he found that behind the system lay strong political centralization.

Yugoslavia's miserable economic performance—now with more than 300% inflation, large sum of foreign debt, mass unemployment and decrease of real wage—cannot be attributed solely to its self-management system. However, it becomes clear that under this system counter-crisis measures of the Federal Government are impracticable. Wladyslaw Gomulka, who had been purged earlier as "Titoist", criticized Yugoslav system in 1956 immediately after his rehabilitation that "if each enterprise would be owned by workers' collective or cooperative, all laws ruling capitalist economy would function extensively and with worse results than ever". This argument was used at that time evidently as a pretext not to introduce self-management into Poland. However, it is evident at the same time that, apart from the objection from the side of the Soviet leadership, Yugoslavia's poor economic performance has been one of the main reasons which made other East European countries hesitant to introduce Yugoslav experiment of self-management.

II-B. Czechoslovakia

In relatively highly industrialized Czechoslovakia, administrative-directive system of planning resulted in abrupt worsening of economic performance at the beginning of Sixties, which demanded radical re-examination of its economic policies. Thus a considerably market-oriented economic reform was introduced in 1965, which in turn soon clarified the need to eliminate the political obstacles against this reform.

In 1963, just after the first tentative economic reform was abandoned, Czechoslovak economy deteriorated sharply and marked the first negative growth under planned economy. Many economists (including Ota Sik, who at that time headed the Institute of Economics of Czechoslovak Academy of Sciences) argued this as a result of extensive (quantitative) growth strategy enforced by administrative-directive planning. The Third Five-Year Plan (1961-1965) was interrupted and a radical economic reform was introduced, which intended to create a "normal market conditions" in the sphere of external trade, domestic trade and investment. This economic reform was favourable for the overall economic growth, but the introduction of flexible price system as a key part of the reform enabled the monopolized large state enterprises to increase prices easily, which resulted in an inflationary price spiral in 1967-1968.

Meanwhile, the progress of economic reform sharply confronted with the traditional administrative institutions and necessitated political changes. The Action Programme of the Communist Party of Czechoslovakia, adopted in April 1968, pointed that the previous economic policies based on directive-administrative method had led to imbalance, inefficiency, economic stagnation and deterioration of living standard, and further analyzed that the deeper reason why the out-dated economic management system had survived was a distortion of political system, lack of socialist democracy and degeneration of revolutionary dictatorship into bureaucratism. Therefore, pre-conditions of economic reform should be development of socialist democracy within and outside the Party, overcoming bureaucratism and subjectivism and so on. Moreover, the Action Programme clearly declared that the political power in a socialist society could not be monopolized by a single party or a single alliance.

As is well known, after the military intervention of the Soviet Union and four other East-European countries (Hungary reluctantly joined the military intervention, and so they claimed later that it was the intervention of " four and a half " countries) in August 1968, not only political but also economic reforms were abandoned. Therefore, we cannot know whether the intended multi-party parliamentary democracy would work successfully in Czechoslovakia, if there were no military intervention. Among the inherent problems in Czechoslovak economic reform, one of the main problems (which was criticized after the " normalization " as the principal failure of the reform) might be overall rise of price level due to the lack of domestic competition, and the other that they could not utilize the external economic relations to stimulate the international competitiveness due to the lack of currency convertibility.

However, time was too short for the Czechoslovak experiment to show its feasibility. Last but not least, Czechoslovak reforms at that time intentionally postponed the measures to guarantee the active participation of workers into the management, from the viewpoint " to avoid over-burdening of workers' collectives " (Jiri Kosta). So the Czechoslovak reforms in 1968 is often characterized as a technocratic reforms, and this might influence for the passive attitude of Czechoslovak workers both to reforms and to the intervention.

II-C. Hungary

During the 1956 " events " (as they call since then in Budapest) in Hungary, workers spontanneously organized workers' councils which resulted in the formation of Nagybudapesti Központi Munkástanács (Greater-Budapest Central Workers' Council) in November. Kádár Government ordered to disperse it within a month and never approved it thereafter. When I asked on the possibility of workers self-management in Hungary to Rezsö Nyers (" Father of Hungarian Economic Reform ", as he was responsible for the introduction of economic reform in 1968 as Secretary of the Central Committee of the Party in charge of economic policy untill March 1974), he answered clearly that in Hungary they could not introduce workers' council system because the Soviet Union disagreed.

As is explained later, Hungarian economic reform in 1968 was introduced very cautiously to concentrate on economic spheres, avoiding major political change. Apparently there were two main reasons : firstly, they had already experienced the Soviet military intervention in 1956, and so in 1968 they made utmost effort not to irritate Soviet leaders. Moreover, it was increasingly clear that the Czechoslovak experiment at that time was receiving mounting pressures from outside. It was said that Kádár in Budapest warned Dubcek in Prague whether Dubcek recognized what a powerful opponent he had to face in the Soviet Union. Secondly, after 1956 " events ", especially since 1962, there was a considerable degree of political relaxation and a mood of reconciliation in Hungary, which was supposed to guarantee the precondition to introduce economic reform without further political change. While in Czechoslovakia, where the regime had experienced no major " events ", the process of de-Stalinization delayed untill 1968, which resulted in " overburdening " of Czechoslovak 1968 reform.

So, Hungary could start its economic reform without radical democratisation on either side : on the national level it retained former one-party rule without promising political pluralism ; on the workplace there was no self-management, only with some attempt for workers' participation through existing trade-union organizations. However, as we shall see later, these deficiencies of Hungarian reform now appear as main obstacles braking further reform.

II-D. Poland

In Poland, with much debates and several attempts to introduce economic reform since 1956, no effective economic reform has existed so far. According to Janusz Zielinski (1973), 1956–1959 was the period of emergence of reform conception; 1959–1965 was the period of interim debates and attempts; and in 1965–1968 a gradual reform was introduced. But the March event of Warsaw University in 1968 and Gdansk uprising in December 1970 forced Gomulka regime to collapse together with the reform. The period after 1971 was defined by Zielinski as that of "promise for reform" of Gierek regime.[1]

Immediately after his re-emergence in 1956, Gomulka praised the initiatives of Polish workers for the reform of and for the participation to enterprise management. Seven months after, however, he criticized (as cited earlier) the very conception of workers' self-management in Yugoslav style. Conferences on workers' autonomy (KSR) being established formally in state enterprises in December 1958, the activities of KSR soon became stagnant since then. One of the reasons might be attributed to the complicated composition of KSR themselves, consisted of workers' councils, trade union organizations, enterprise Party committees and the representatives of the Union of Socialist Youth and engineers. Moreover, the narrowly limited range of independent decision-making of state enterprises made this system insignificant. Without accompanying radical economic reform the

1) Janusz G. Zielinski, Economic Reform in Polish Industry, Oxford University Press, 1973, pp. 14–15.

workers' autonomy could not work practically.

Indeed, the Economic Council (Rada Economiczna) attached to the council of Ministers was established as early as in November 1956, chaired by Oskar Lange and assisted by Wlodzimierz Brus and Michal Kalecki, in order to prepare proposals for economic reform. And already in 1957 " Thesis " on economic reform was published, which insisted to develop enterprise autonomy and participation of workers' councils to the management. However, the regime criticized the activity of Rada Economiczna, which was finally liquidated in 1963.

After that, in 1965, " partial, gradual and experimental " economic reform, similar to the Kosygin reform in the Soviet Union in the same year, was introduced and followed in 1969 by a " comprehensive " reform. However, this time, wave of strikes protesting against the price increase and wage freeze (introduced as pre-conditions of economic reform in order to re-establish the balance between demand and supply) in December 1970 crushed both reform and the regime. Zielinski pointed that the main cause of the failure of that reform was, apart from the lack of consensus within the Party and unfavourable conditions of the domestic economy, that the reform had tried to transform the system of management without abolishing the traditional planning method and institutions.[2)]

Thereafter Poland under Gierek regime renewed the attempt to introduce " new economic and financial system " in 1973, which was also destined to fail as a result of nation-wide protest in June 1976. P. G. Hare and P. T. Wanles (1981)compared the successful introduction of 1968 Hungarian economic reform with the failure of 1973–1975 Polish reform attempts as follows : firstly, Poland intended to introduce economic reform without reducing the strain of high economic growth, which led to enhance domestic and external imbalances, causing popular dissatisfaction. Mean-

2) J. G. Zielinski (1973), pp. 310–312.

while in Hungary, the Third Five-Year Plan (1966-1970) intended to sustain steady economic growth, maintaining domestic and external balances, and so no impending grave social tension was assumed in Hungary at the introduction of 1968 economic reform.

Secondly, in Hungary the "guided-market model" was introduced wholly at the beginning of 1968, simultaneously abandoning the traditional administrative-directive planning. Meanwhile in Poland, 1973-1975 reform was a mixture of traditional and new systems, and Polish policy-makers were easily to lose self-confidence once they faced difficulties. This led eventually to sweeping retreat from the reform measures.[3)]

The situation in Poland since 1980 so far has been almost the same, as far as economic reform concerns. According to Zvi Gitelman (1987) :

> In September 1980 a Reform Commission was created in Poland to draft a plan for an economic reform. The reform plan proposed was most directly influenced by the Hungarian NEM [New Economic Mechanism], but it proposed a piecemeal introduction of changes, in contrast to the Hungarian across-the-board introduction on January 1, 1968. Moreover, critics of the Polish plan pointed out, the Hungarian reform was introduced at a time of economic stability, whereas the Polish was being proposed for a period of crisis, if not chaos. Finally, a major price reform was needed to bring prices toward market levels before a reform could work. None of these conditions had been satisfied in Poland.[4)]

In summer 1980 Solidarity movement sharply criticized Polish government for the failure of reforms, and demanded them to resolve the accumulated problems immediately. The Polish re-

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3) P. G. Hare and P. T. Wanles, "Polish and Hungarian Economic Reforms-a Comparison", Soviet Studies, Vol. 33, No. 4 (October 1981), pp. 491-517.

4) Zvi Gitelman, "Is Hungary the Future of Poland ?", Eastern Europe Politics and Societies (EEPS), Vol. 1, No. 1 (Winter 1987), p. 151.

gime at that time had to cope with the insurmountable quadruple tasks: to introduce political democratisation close to that of Prague Spring, Hungarian model of economic reform and Yugoslav model of workers' self-management, with impending need to overcome economic crisis.

On the other hand Solidarity movement in itself had its own problems. It started as an independent (from the Party, from the state and also from the management of enterprises) autonomous trade union. When it demanded self-management of enterprises, fundamental problem arose how to distinguish the role of independent trade union from that of self-management organization (responsible for management of enterprises). This problem was indeed realised in the documents prepared for the first (and so far the only) national congress of Solidarity in September-October 1981. A considerable part of Solidarity movement, furthermore, proposed to form an independent political party. Solicarity in itself could not answer finally to the question whether it would remain as an independent and autonomous trade union, or transform itself to a self-management organization, or become a political party in order to struggle for political power.

On the other hand, Jaruzelski regime since 1981, in which the majority was reluctant to introduce radical democratisation, gave priority to overcome the impending economic crisis at any cost and chose to declare the Martial Law apparently to prevent the predictable Soviet military intervention. However, in order to overcome economic crisis the regime needed popular support for the necessary austerity measures, which could not be obtained by force.

A secret government poll taken in late 1985 or early 1986 found that nearly three-quarters of industrial workers and managers rated the Polish economy as unsatisfactory to hopeless, while virtually none of those questioned believed that the government's economic policies were correct.[5] Polish government spokesman

5) Zvi Gitelman (1987), p. 153.

Jerzy Urban also admitted in March 1988 that the most unfavourable condition for the reform in Poland was the prevailing social pessimism.[6] In order to overcome this pessimism, the Polish regime needed at least to re-open the dialogue with Solidarity, which resulted in a round-table conference including Solidarity in February 1989. However, this round-table conference at best restored pre-Martial Law situation, and problems remained so far unresolved for a comprehensive reform in Poland.

III. Reform in Hungary

III-A. Lessons of 1956 "events".

The original conception of Hungarian economic reform was brought forth in the debate on economic mechanism during the first Nagy government of 1953–1955, and after 1956 " events " the debate regained momentum since 1963, which resulted in the final introduction of New Economic Mechanism in 1968.[7] In summer 1956 János Kornai published a pioneering article titled " Overcentralization in Economic Management ", and just before the uprising (14 October 1956) wrote an audacious essay on Szabad Nép (the then Party daily organ) to call for " rooting out bureaucracy ", which he later admitted to have been " excessive and naive ".[8]

Needless to say, the 1956 " events " had much wider influence, not limited on the economic policy-making. Nation-wide bloodshed was undoubtedly a national tragedy, which was later realised as a kind of catharsis. Péter Rényi (deputy editor-in-chief

6) Jerzy Urban, " Polyaki i povyshenie tsen ", Novoe Vremya, No. 13, 1988, p. 31.

7) L. Szamuely, " The First Wave of the Mechanism Debate in Hungary, 1954–1957 ", Acta Oeconomica, Vol. 29 (1982), No. 1–2, pp. 1–22; do., " The Second Wave of Economic Mechanism Debate and the 1968 Reform in Hungary ", Acta Oeconomica, Vol. 33 (1984), No. 1–2, pp. 43–46.

8) J. Kornai, " Bureaucratic and Market Coordination ", Osteuropa Wirtschaft, 29 Jahrgang, Dezember 1984, pp. 306–319.

of the new Party organ Népszabadság until May 1988) wrote in 1985 that " the majority of Hungarians were, after 1956, tired of excessiveness, thoughtless recurrent changes of policy, manipulation of popular illusion, nationalistic demagogies, utopian promises and unrealistic enthusiasm ".[9] This situation helped the Kádár regime to succeed in stabilization.

Kádár regime, in turn, promised not to retreat to pre-1956 situation. Kádár himself declared at the end of 1961 that " whereas the Rakosiites used to say that those who are not with us are against us, we say that those who are not against us are with us ".[10] In August 1962, former leaders who had been responsible for the pre-1956 regime (Mátyás Rákosi, Ernö Gerö and their followers) were expelled from the Party, and one year later all political prisoners who had been arrested and sentenced to imprisonment after 1956 were released. In this atmosphere (adding to these domestic changes, we should take note that the easing of East-West tensions and the reform movement in the Soviet Union under Khrushchev, notably the appearance of the article of E. G. Liberman on Pravda in September 1962, might have had significant influences), " the Socond Wave of Economic Mechanism Debate " emerged.

Therefore in Hungary, just before the introduction of economic reform, a considerable degree of social consensus existed, which means that people recognized the necessity neither to retreat to pre-1956 state of affairs, nor to repeat the bloodshed of 1956. The stark realities of life suggest, thet economic reform in general tends to reduce more or less the aquired benefits or privileges of people, and so there might be very few people who would actually gain from the reform, at least in its initial stage. Bearing this in my mind, I asked in Budapest in September 1985

9) P. Rényi, " Tragedies, Catharses, A New Life ", New Hungarian Quarterly, No. 97 (Spring 1985), p. 46.

10) Népszabadság, January 21, 1962.

to Professor Ernö Zalai of Karl Marx University of Economics, what had promoted reform, where could we find the actual driving forces for reform. The answer was, that the driving forces were the generally shared dissatisfaction to the previous (pre-1956) state of affairs and the consensus not to retreat to the past.

The reappraisal of 1956 " events " as a whole is now in progress, but already in 1986, on the occasion of 30 years' anniversary, the editor of New Hungarian Quarterly pointed that " in these thirty years many of the demands of the autumn of 1956 have not only fulfilled but overfulfilled by far ".[11]

III-B. Conception of 1968 reform

" The Resolution of the Plenary Meeting of the Central Committee of the Hungarian Socialist Workers' Party on the Reform of Economic Mechanism " in May 1966 pointed the main characteristics of the reform as an organic combination of plan and market, creation of more rational and flexible price system, as well as an organic combination of domestic and external markets. At that time László Csapó described the situation as follows:

> After 1956 we had introduced several partial changes in our planning and management. However, it became clear that those measures were insufficient. Almost two years' collective analysis and examination we reached the conclusion that a radical change, an overall reform of planning and management was inevitable. Basic idea of reform is that we should abandon " directive model " as a whole. Instead of establishing detailed obligatory targets for all economic activities, we should lead and plan our economic development by economic regulators (price, tax, customs, exchange rate, interest rate, monetary incentives, market, supply and demand and so on) which coincide with our commodity-market economic

11) Boldizár Iván, " These Thirty Years ", New Hungarian Quarterly, No. 104 (Winter 1986), p. 3.

environment. We intend to introduce and work out so-called "guided market" model.[12]

As to the example of targets of this "guided market model", Béla Csikós-Nagy (1968) enumerated six items:

1) Centralized planning of production will be abolished, and production pattern will be formulated by direct negotiation between enterprises;
2) Centralized material and technical allocation will be abolished and the market for the means of production will be established;
3) Centralized distribution of investment will be substituted by self-financing of enterprises;
4) Obligatory plan targets will be abolished, and enterprises will behave to maximize their profits;
5) Centralized wage regulation will be substituted by combining wages with enterprise profits;
6) Administrative price system will be substituted by market price system.[13]

Thus, the conception of Hungarian reform was similar to the reform proposal in Czechoslovakia at that time made by Ota Sik and others, and both might have originated from Polish reform ideas proposed by Lange, Brus and Kalecki in late Fifties. As an economic reform, Hungarian reform was more advanced than its Czechoslovak counterpart in pursuit of maximum utilization of market mechanism; however, as far as political reform is concerned, Hungarian reform lagged far behind from Czechoslovak experiment of democratisation. Though in Hungary a certain degree of political change had already emerged until then, it might be said that Hungarian reform in its beginning considerably underestimated the necessity of political democratisation which

12) László Csapó, "Central Planning in a Guided Market Model", Acta Oeconomica 1, 1966, pp. 238–239.

13) Béla Caikós-Nagy, "Pricing in Hungary", IEA Occasional Papers, No. 19, 1968, pp. 12–13.

would guarantee the success of further economic reform. Of course, it cannot be denied that the suppression of Czechoslovak reform by external forces only eight months after the introduction of Hungarian economic reform compelled Hungarians to concentrate their efforts more and more on economic matters only.

III-C. The first decade of reform (1968-1978)

Principal measures taken in the New Economic Mechanism (NEM), introduced on January 1, 1968, could be briefly summarized as follows: state economic plan was limited only to stipulate main directions of national development, structural changes and proportion of accumulation within national income, without any obligatory plan targets for the state enterprises; managers of state enterprises could exercise the managerial rights with individual responsibility, and enterprises could retain around 40% of their profits for the reserve, development and sharing funds (this means that the decentralized investment of enterprises, including bank credit, was limited practically less than half of the total investment); differentiated premium targets were introduced separately for managers, staffs and workers, and while managers could receive nearly double of their salaries, wages of workers should be negotiated between management and trade union within the upper and lower limits prescribed by the state; a flexible price system was introduced, including fixed prices for important goods, maximum prices against arbitrary price increase, limited prices (with upper and lower limits) and free prices mainly for whole-sale trade.[14]

Five years after the introduction of NEM, Hungarian govern-

14) István Friss (ed.), Reform of the Economic Mechanism in Hungary, 1969; Ottó Gadó (ed.), Reform of the Economic Mechanism in Hungary, development 1968-1971, 1972;
Julius Rezler, "An Evaluation of the Hungarian Economic Reform of 1968" Jahrbuch der Wirtschaft Osteuropas, Band 4 (1973), pp. 381-390; and others.

ment authorities emphasized the positive results of the reform, defying the accusations from abroad as the " restoration of capitalism ". They retorted that, as far as there existed the social ownership of the means of production and the decisive role of government economic policy, no "restoration of capitalism" could be imagined. At that time deputy prime minister Mátyás Timár (1973) stated that 1968 reform had been successful beyond expectation, pointing that :

1. Planning works were improved, and the combination of direct control from the centre with indirect regulation measures was successful ;
2. " Planned and regulated market " played a positive role, and production pattern corresponded to the demand ;
3. The effectiveness of flexible price system was proved, and prices were maintained within the planned limits ;
4. "Profit motivation system" became, as a whole, a strong stimulus to enterprises ;
5. Investment regulation through expansion of enterprise self-financing, widening of credit availability and curtailment of centralized investment of the government was, in general, appropriate ;
6. Export pattern was improved through direct particpation of producer enterprises, and external economic relations effectively stimulated domestic market.

In conclusion Timár warned that, though overall social effects of NEM had been favourable, there existed in some part a tendency to brake the reform, overemphasizing the difficulties and deficiencies. He himself admitted the existence of negative phenomena, such as growing dissatisfaction of workers with the widening of wage differentials, display of status symbols by higher earning social groups and overzealous pursuit for profit-making. And Timár pointed that the economic reform was to be a pre-condition for socialist democracy, appealing to enhance "factory democracy" through the active participation of trade unions.[15]

Meanwhile, after 1974, reform process in Hungary seemed rather retreating. Aiming to prevent the direct impact of world commodity price explosion on domestic market, Hungarian government disbursed massive subsidies to state enterprises, while wage regulation was eased in consideration of the dissatisfaction of low-income workers against the widening of wage gaps. Also in 1974 Hungarian trade balance with the West recorded a huge sum of deficit, which forced the government to introduce a series of measures to restrict the import. Maybe as a scapegoat, Rezsö Nyers was relieved from Central Committee Secretary in charge of economic policy in March 1974, and one year later in March 1975 finally relieved from Politburo (he was nominated as director of the Institute of Economics of the Hungarian Academy of Sciences, still holding the post of chairman of the Economic Commission of the Hungarian Parliament, and was reinstated in Politburo in May 1988). Two months later, reformist prime minister Jenö Fok was also relieved, taking the responsibility of economic policy failure (his successor was low-profile György Lázár, who was replaced by Károly Grósz in June 1987).

These might suggest, on one hand, the growing difficulties to utilize the "regulated market mechanism" especially at the time of major fluctuation of world economy (in contrast the favourable first five years of Hungarian reform coincided with the years of considerable world trade growth), on the other hand, the existence of a strong opposition against further reform. Indeed, 1968 reform in itself got some setbacks already at its initial stage. Rezsö Nyers told me when I interviewed him in December 1977 at the Institute of Economics in Budapest, as

15) Mátyás Timár, "Results of the New System of Economic Control and Management and its Further Development", Acta Oeconomica, Vol. 10 (1973), No. 3-4, pp. 277-301.

follows :

> The situation now in Hungary is different from the expectation of 1968 in four points. Firstly, state enterprises continue to hold monopolistic positions, resulting to weaken competition between them. Secondly, reaction of consumers to the price changes of consumer goods was not so strong as expected, which in turn resulted in weaker reaction of consumer prices to the needs of consumers. Thirdly, a violent fluctuation of world commodity prices after the oil price explosion put the domestic price system into confusion. Fourthly, different from the original proposal, administrative institutions for industry branch control survived, which enabled branch ministries to rely on the direct control of enterprises, rather than on the indirect regulation as expected. (Later in 1981, branch ministries were finally abolished and a single Ministry of Industry emerged as a result.)

In short, apart from unfavourable external conditions, both Hungarian state enterprises and consumers behaved far less rationally than expected, which was utilized by the bureaucrats as the pretext to strengthen direct control. The reason why the state enterprises would not strive to improve efficiency might lie, in addition to their monopolistic positions, in their " soft budget constraint" as János Kornai defined. Capitalist private enterprises have commonly to correspond market prices, relying mainly on their own resources (credits and loans have to be repaid anyway), under constant threat of bankruptcy in severe market competition (" hard budget constraint "). On the other hand, existing socialist state enterprises (including Hungarian ones after 1968 as Kornai admitted)[16] have long enjoyed favourable positions not only for price-setting (thanks to their monopolistic status and their adhesion to decision-making authorities), but also for availability of

16) János Kornai, Contradictions and Dilemmas. Studies on the Socialist Economy and Society, the MIT Press, 1986, p. 48.

state subsidies and bank credits, which they have no need to repay or can postpone to repay indefinitely, so that no enterprise in deficit faces the threat of bankruptcy ("soft budget constraint").

Maintaining this type of "soft budget constraint", the emphasis on "profit motives" in economic reform easily led enterprises to raise the prices of their products, or to bid state subsidies. Thus enterprises can continue to invest without considering efficiency, which results in macro-economic loss with huge state budget deficit. Without combining "profit motives" and "hard budget constraint" together, state enterprises would not behave as rationally as expected. This means that socialist state enterprises have also to face the real threat of bankruptcy in severe market competition.

The reason why consumers were so passive is, that they had little choice for consumer goods or services because of shortage, or more precisely, the reproduction of shortage.[17] In the existing socialist economies the supply of basic consumer goods and services has long been kept below the demand, because of years of industrialization drive centred on heavy industries. Adding to this "absolute shortage", there also exists "relative shortage", because of low prices artificially set below their costs, which discourage the suppliers to correspond to the growing demand. But then, why consumer prices have been set so low? Maybe that is because of the fixed idea, that the superiority of socialist regime over capitalism should be demonstrated by the fact that consumer prices are low and stabilized. This fixed idea has also been utilized politically to avoid popular dissatisfaction against undemocratic political system to explode.

On the other hand, how individual producer will try voluntarily to improve productivity? Under capitalism, workers have to work hard in order not to drop out of competition between workers (drop-out means unemployment). But under socialism,

17) J. Kornai, ibid., pp. 6–7.

there has been no threat of unemployment, and so every worker has been guaranteed the minimum standard of living whatever his result may be. If the regime would try to increase productivity of workers only through the material motivation, it would be necessary to widen wage gaps, and even to introduce unemployment (refusal to guarantee the minimum standard of living). Otherwise it would be necessary to enhance the humane elements of work, such as workers' initiatives and satisfaction on the jobs. Here comes the need for the democratisation on the workplace, with the prospect for the workers' self-management of the enterprises.

János Mátyás Kovács, research fellow at the Institute of Economics in Budapest, answered to an interview in July 1985 as follows:

> In the last twenty years reform economists always compared the potential for reform to the reform steps which were originally planned and actually accomplished by the New Economic Mechanism (NEM) of 1968. I might say, parenthetically, that almost everyone agrees that the NEM was only a half reform, in the sense that the liberalization of the capital and labour markets did not go very far and the institutional system of the economic management was not altered fundamentally, i. e. the branch ministries, as an example, remain intact. It was a half reform in spite of the fact that the compulsory planning directives sent down from the centre were abolished. What is more, the NEM of 1968 was a compromise, if we compare it with the initial programme adopted by the Party in 1966. The shortcomings of the NEM have made Hungary's reform economists interested in going one or two steps further and introducing another, more comprehensive reform. Such steps would also be intended to go beyond economic reform in the narrow sense and address

18) John B. Hall, "Reform-Bargaining in Hungary: An Interview with Dr. János Mátyás Kovács", Comparative Economic Studies, Vol. XXVIII, No. 3 (February 1986), p. 26.

political reform as well[18].

In conclusion of this part, I also cite here Aladár Sipos, then director of the Institute of Economics, who with Márton Tardos in 1986 summarized five years' research project on the organizational system of Hungarian economy. They pointed economic results and deficiencies in the period 1968–1978 as follows:

1) In the course of its development, the Hungarian economy was capable of raising the efficiency of management by resolving the internal inconsistencies of the directive (mandatory) planning system, and of securing for its citizens, as producers, a growing freedom in choosing jobs and exploiting creative opportunities and taking them closer to consumers' sovereignty;
2) It also became clear that the hierarchically organized state and cooperative enterprises cannot get their autonomy by simple declaration. The actual evolution of enterprise autonomy is hindered by, a) the virtual and confused dependence of firms on the territorial, functional and branch administration, and on the institutions of the Party......b) the large number of financial prescriptions which provides an opportunity for the control agencies to prevent firms from freely using their money stocks...... c) finally, the lack of capital and labour markets......
3) The structural interdependence of organizations......is characterized not only by a significant reduction of the number of the firms (in the interest of reducing unit costs), and the lack of competing firms, but also by the fact that firms suited for satisfying similar demands, having similar production lines, develop such a division of labour that competition is reduced 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 revenue—because of the lack of bankruptcies and automatisms for founding new firms......

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

5) The slowing down of the reform process after 1972 was primarily a consequence of the fact that, under the impact of the disturbances in management accompanying the changes and because of the insufficient care in elaborating elements of the 1968 reform, the autonomy of 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......The central economic leadership, occupied with restriction of enterprise autonomy and strengthening its own position substantially, had lost, by the mid-Seventies, its ability to perceive problems. As a consequence, it was late to recognize the external shocks the country suffered between 1973–1979 and thus hardly reacted to them......

6) Experiences of the period between 1968–1978 demonstrated 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, and in the monopolistic commercial relations......There is a particular contradiction observable in the fact that the modernization of the control system could only take place by decision of the higher power......

Between 1973-1978 the economic leadership put off the solution of the emerging problems and it hardly changed the earlier consumption and investment tendencies of the country which objectively involved Hungary spending at the expense of foreign indebtedness.[19]

III-D. The second decade of reform (1979-)

To analyze the Hungarian reform process more minutely, the process might be divided into four or five periods; optimistic first stage of reform (1968-1973), period of recentralization (1974-1978), re-emergence of reform process (1979-1982), period of compromise (1982-1984) and a new wave of reform measures (1984-). The last period might have been interrupted by the introduction of austerity measures in the middle of 1987. However, for simplification I here treat the recent decade in the lump, which some may divide as the second and the third stages of the Hungarian reform.

The second decade of the Hungarian reform was characterized by various efforts taken to overcome the deficiencies included within the original 1968 reform conception. As one Hungarian economist pointed, "in the early 1980 s, the government had realised old and formerly neglected proposals of the reform economists before they had the chance (or the courage) to advocate

19) A. Sipos-M. Tardos, "Economic Control and the Structural Interdependence of Organizations in Hungary at the End of the Second Decade of Reform", Acta Oeconomica, Vol. 37 (1986), No. 3-4, pp. 241-244.

them again. Perhaps the most radical steps, such as the formation of small entrepreneurial units within state enterprises, splitting up large trusts, amalgamation of the branch ministries into a single Ministry of Industry, joining the IMF and the World Bank, and the like, had been taken by the government before the upswing in reform thinking started. This policy, labelled by the government as the new path of development, preceded in certain points the period which is often called the third wave of the reform. (The first wave came before 1956, the second one before 1968.) Many proposals which had been considered either taboo or of secondary importance when the New Economic Mechanism was being discussed and drafted between 1965 and 1968, were made public in this most recent round of reforms."[20]

1) Reorganization of enterprises

"One of the questions of major portent, but unresolved even today, is the enterprise structure, more precisely the dominance of big firms and the lack of small and medium ones."[21] According to the estimate of Gábor Révész of the Institute of Economics, even in 1980 enterprises employing more than 1,000 persons employed 70% of industrial employees in Hungary (as in Poland), while the corresponding data were 60% in Britain, 50% in Federal Republic of Germany, and merely 40, 30 and 20% in Italy, Austria and Switzerland.[22]

From 1979 on, Hungarian government began to break up large industrial organizations through the formation of subsidiaries and so-called small ventures. "However, the strict division of labour between big firms and their subsidiaries, the avoidance and lack of competition remained essentially the same as had been earlier

20) John B. Hall, op. cit., pp. 28–29.

21) A. Sipos-M. Tardos, op. cit., p. 245.

22) G. Révész, "On the Expansion and Functioning of the Direct Market Sector of the Hungarian Economy", Acta Oeconomica, Vol. 36 (1986), No. 1–2, p. 105.

the case."[23] Péter Ákos Bod of the State Planning Office summarized "the typical sources of losses of the institutional system" 16 years after the introduction of NEM as follows: slow market reaction of big enterprises; "the management style within Hungarian state enterprises is still predominantly overcentralized and short-term for a real market-oriented behaviour"; "big organizations in a small economy cannot but lead to monopoly situations" (independent from market control but subordinate to strict state regulations) which result in a loss of cost-sensitivity; "the state enterprises are forced to carry on activities which would not be justified by business considerations but serve the public purpose" (such as domestic price level, external trade balance, and maintaining the planned accumulation rate); "the week in week out decision-making as well as the strategic planning in the state enterprises is characterized by a detailed administrative rules and several obligations to supply records to superior authorities."[24]

An attempt was made in September 1986 to force enterprises closer to a "relatively hard budget constraint". A new "strict" bankruptcy law was introduced, which would frighten loss-making enterprises into more efficient economic behaviour. But so far the law has not been applied very strictly. "In the first half of 1987, 212 companies were in the red, making losses of about Ft 8 bn. Five to 10% of all companies were totally insolvent for at least a couple of months out of the year. One recent study suggested that 100 bankruptcies annually over the next few years would be justified. But since September 1986 when the law was introduced, only eight major companies have faced proceedings under the bankruptcy law. In five of the cases the government felt the companies were important to the nation. Central funds

23) A. Sipos-M. Tardos, op. cit., p. 247.

24) Péter Ákos Bod, "On the Scope and Organizational Fabric of the State Sector in Hungary", Jahrbuch der Wirtschaft Osteuropas, Band 12, 1 Halbband (1987), pp. 121–122.

or credits were made available to bail out the loss-makers. A sixth company was allowed to reschedule its debts by its creditors. Proceedings are still underway against two companies......Considering the number of loss-making companies of Hungary, why have so few enterprises entered into bankruptcy proceedings? The answer lies in the traditional political, social and economic habits that make up Hungary's present hierarchical institutions."[25] In 1986 Hungarian state budget, "Support of Economic Organizations" amounted to Ft 141.7 bn, almost equivalent to "Expenditure on Social Security", which brought total budget deficit to Ft 45.3 bn.[26]

As to the small-scale economic activities needed, on January 1, 1982, various types of small enterprises were authorized. According to G. Révész, in the statutorily licensed private small-scale industry, altogether 160,000 workers are recorded in Hungary. 75,000 of them are full-timers, 15,000 are retired, 50,000 work beside having a full-time job elsewhere, and 20,000 are employees. In addition, there are 7,000 registered helping family members and 6,000 apprentices. He estimates, however, the total actual number of workers in the directly market sector (without agriculture) as 1,150,000, which is equivalent to 770,000 full-time workers (including agriculture, nearly 4 million equivalent to one and a half million full-timers).[27] Another information indicates that, by the end of 1986, the private sector accounted for 7% of net material production in Hungary, up from 3.5% in 1980. About 35,000 private enterprises exist in Hungary, and over 266,000 people are employed full-time by them.[28]

The dual structure (namely, so-called first—state sector—and

25) East European Markets, October 16, 1987 (Vol. 7, Issue 21), pp. 8–9.
26) Statistical Yearbook 1986, Hungarian Central Statistical Office, 1988, p. 401.
27) G. Révész, op. cit., pp. 108–113.
28) East European Markets, November 13, 1987 (Vol. 7, Issue 23), p. 4.

second—private sector—economy)[29] results in dual income level in Hungary. Wages in the state sector are significantly lower than in the private sector. It is said that the income of autonomous small ventures exceeds that of those living on wages and salaries to a higher degree in Hungary than in countries with capitalist market economies.

Naturally, this situation caused the hostile attitude of trade unions against the private sector, especially against VGMK (Vállalaton belüli Gazdasági Munkaközösség, which means Enterprise Economic Work Collective). VGMK was introduced in 1982, when a new legislation permitted private persons to establish, via a contract of association, economic work collectives (GMK) for service-related activities, for small-scale production as well as for auxilliary activities assisting the work of economic units. The VGMK is a GMK whose members are exclusively workers or pensioners belonging to one particular enterprise and using primarily the tools of that enterprise. Trade unions had no means of legal right to control the length of working hours or the working conditions of those contract workers of VGMK. The wages of VGMK men, which could be 5–10 times greater than the income during normal working hours, were the members' own affair and this fundamentally undermined unions' power of collective bargaining.

Unions accused VGMK as "they spread a materialistic outlook, take away time from family, private life, leisure, study, training and politics." Unions also accused VGMK of illegal practices, of deliberately under-producing during normal working hours to ensure VGMK work and preparing everything during their normal working hours so that during VGMK hours no tools or materials would be missing, conditions apparently unattainable

29) János Kornai told me in 1985 that he did not like the word "second economy" because it sounded as if it were illegal as "black economy", though in Hungary it was quite legal.

in normal working hours.[30]

Katalin Falusné-Szikra of University of Economics in Budapest pointed that the main cause of wages and income disparity between the first and the second economies was the shortage present in the whole economy and the deriving weakness of competition. She urges to mitigate this disparity through modernization of state-sector (increasing the performance and decreasing the number of employees) which would lead to higher wages level for fewer workers, and through strengthening competition in the second economy. "Drastic interference with the incomes of the small entrepreneurial sector is a boomerang. Application of the tax squeeze puts a brake on supply, increases supply difficulties, and pushes entrepreneurs towards illegal activities and illegal incomes. The expansion of competition in this sphere requires an increase in the number of those working in the small entrepreneurial sector full-time, as well as removal of the obstacles that set narrow limits to the development of certain enterprises and to the interest of entrepreneurs in expanding their activities......
The ending or appreciable relieving of the chronic labour shortage (thanks to the released labour from the state-sector) would enhance competition in the small entrepreneurial sector......
Perhaps the above prove sufficiently that the problems of wage and income disparity between the first and second economies cannot be solved with isolated measures. It depends on the whole of the economic system and the economic policy whether the conflicts caused by small enterprises will be relieved or aggravated."[31]

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30) Stephen Noti, "The Shifting Position of Hungarian Trade Unions amidst Social and Economic Reforms", Soviet Studies, Vol. XXXIX, No. 1, January 1987, pp. 72–74.

31) K. Falus-Szikra, "Wage and Income Disparities between the First and Second Economies in Hungary", Acta Oeconomica, Vol. 36 (1986), No. 1–2, pp. 96–102.

2) Introduction of collective management

It is said that Hungarian reform entered into a new stage in 1984, because on April of that year the Central Committee of the Hungarian Socialist Workers' Party adopted a resolution to introduce collective management of enterprises. Ferenc Havasi (then Central Committee Secretary in charge of economic policy, later on June 1987 removed to First Secretary of Budapest City Party Committee and finally relieved from the Politburo on May 1988) at that time explained this resolution, distinguishing three types of enterprise management to be introduced, as follows:

Firstly, the previous form of enterprise management—a manager appointed by a founder—shoud be maintained for communal and public utility enterprises, as well as for productive and non-productive enterprises thus classified for state interests by the Council of Ministers. In this form of control the enterprises may create management councils, as well as supervisory committees that also include the main consumers of their products and services. Applications will be considered for appointments to executive posts through competition and they will be generally for limited term.

Secondly, medium-size and some large state enterprises should operate under the control of 'enterprise councils', which exercise some right of disposal over social property and the role of the employer vis-à-vis the manager. It may appoint and relieve the manager in agreement with the founder (minister, head of national agency, competent local government council).

The members of an enterprise council (usually consists of 25 members) are the delegates of workers (more than half of total council members; delegates should be elected by secret vote of the workers' collective for a definite term) and the representatives of management (appointed by the manager among senior staffs according to definite rules). The secretaries of the Party, trade union and the Communist Youth Union (KISZ) organizations of the enterprise will participate in the enterprise council without the right of voting. There had been the other idea that one-third of the members of the council should represent the working force, another one-third should include the manager and his expert aids, and the remaining one-third should be appointed by the central state agencies such as ministries and banks, but this was rejected for fear that it would restrict enterprise autonomy.

Thirdly, in smaller enterprises, the assembly of workers or a meeting of their delegates will exercise some of the rights related to ownership, and those of employer vis-à-vis the manger. The manager and the management will be elected and recalled by the workers. However, in the case of bankruptcy enterprise property should not be divided among the workers, but the state as the founder would dispose the property.[32)]

Katalin Bossányi (1986) reported that, of the 327 enterprises directly controlled by the Ministry of Industry, 58 were placed under administrative control (traditional sectoral management type, more enterprises than expected initially), 213 were to be managed by enterprise councils, 44 by meetings of delegates, and 12 by general assemblies.[33)] More recent but rough estimate showed that, in 1987, 1,300 out of 1,700 enterprises in industry were transferred to self-management, of which 1,000 were managed by enterprise councils, 300 by general assemblies of workers' collectives.[34)]

It is said that since 1984 there were no sharp conflicts within this system because most enterprises willingly accepted the proposals from supervisory authorities, and preferred the previous

32) F. Havasi, " Further Development of the System of Economic Control and Management in Hungary ", Acta Oeconomica, Vol. 32 (1984), No. 3–4, pp. 209–210 and additional explanation given to me by Dr. Péter Ákos Bod in 1985.

33) K. Bossányi, " Economy on the Way to Democratization. The switch-over to collective management in Hungarian industry ", Acta Oeconomica, Vol. 37 (1986), No. 3–4, pp. 285–286.

34) Ekonomicheskaya Gazeta, No. 14/1987, p. 19.

traditional management type in order to avoid management responsibilities. The Ministry of Industry and large enterprises, together with sectoral trade unions and the Hungarian Chamber of Commerce were not so much interested in decentralization, while the National Planning Office and the Ministry of Finance were in favour of such development. Apart from the different interests within administrative authorities, there were fundamental problems between the functioning of enterprise councils and the role of trade unions. The delegate of local trade union has no right to vote, while the local trade union committee has legally the right of approval in wages, welfare funds and employment, which in fact is equal to the right of veto.[35]

Moreover, as Jan Adam (1987) pointed, there is a danger that the new management structure headed by an enterprise council will be reduced to a formality. The experiences with the Yugoslav workers' councils show that a shrewd director is in a position to manipulate the workers' council. In the Hungarian system, the possibility of manipulation will be facilitated by the provision that the councils need not be convened more than once a year and managers can sit on the councils as representatives of employees, and also because the former directors remained in their positions. The percentage of genuine blue-collar workers sitting on the councils is very small, while the councils are packed with subordinates of the director (managers, engineers, administrators, etc., whose promotion depends on the director) and chairmen are predominantly from these categories.[36]

When I visited Budapest in 1985, Dr. György Jenei of National Management Development Centre (Országos Vezetöképzö Központ) explained me that the new management system was utilized by directors to maintain their posts. When a supervisory

35) K. Bossányi, op. cit., pp. 299-300.

36) Jan Adam, " The Hungarian Economic Reform of the 1980 s ", Soviet Studies, Vol. XXXIX, No. 4, October 1987, p. 613.

authority criticizes an incompetent director, he can retort that workers support him because they elected him. And when workers criticize him, he can explain them that frequent intervention from supervisory authority is the cause of poor performance of the enterprise. As was mentioned above, nearly half members of enterprise council are the director's subordinates, so he can easily manipulate the council for his support. Dr. Iván T. Berend (now President of Hungarian Academy of Sciences, former rector of Karl Marx University of Economics in Budapest) at his second visit to Japan in 1987 answered to my question that the Hungarian enterprise councils were neither workers' councils in Yugoslav style nor the organs of self-management.

3) Financial policy

In 1984 Lajos Faluvégi (then the head of National Planning Office) unveiled the following government programme of step-by-step reform measures. "In the first step, in 1985, the system of income and earnings regulation will change and the system of producer prices in the competitive sector will be made up-to-date. New forms of enterprise management [as I stated in the previous section] will appear. The organizational system will change and the further development of the banking system will begin. In 1986 the measures of regulators will be adjusted to objectives and requirements of the 7th Five-Year Plan (1986-1990)......In the third step—presumably in 1987—we should like to introduce a uniform system of personal income taxation......as well as to further develop the system of normative turnover taxes operating with a few tax rates. At the same time, the banking system would be further modernized and the process and institutional system of reconciliating interests completed."[37]

Actually, in 1985 the system of regulators was changed and

37) L. Faluvégi, "Economic Efficiency, Control and Management", Acta Oeconomica, Vol. 33 (1984), No. 3-4, pp. 201-209.

the system of taxation was intended to be rationalized. The tax on profit was reduced, while a tax on enterprise property was introduced and the tax on wage was increased. As to the price system, "a great promise in the price mechanism was the gradual abolition of administrative price formation rules in manufacturing and 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."[38] However, the programme of the reform of the banking system had been put off.

Professor Tamás Bácskai of University of Economics (who had been member of the board of the National Bank of Hungary until July 1984) told me in 1985, that he had insisted the need for the decentralization of banking system, against which the main obstacle had been the existence of Gosbank-type mono-bank, integrating such functions as bank-note issuing, enterprise financing and foreign currency transactions. He had been forced to resign from the National Bank, because there had been a strong opposition within the Bank against the decentralization. Finally, as a result of sharp criticism to the Bank from the Economic Commission of the Party, the introduction of inter-bank competition was decided in 1986 (effective on January 1, 1987).

This situation was also confirmed by Jan Adam (1987) as follows:

> After long debates and maneuvering, the mono-bank system is coming to an end......Starting from January 1987, the National Bank is in substance to exercise the functions of a Central Bank under conditions of central planning. Credit functions vis-à-vis enterprises and cooperatives will now be fulfilled by five fully-fledged commercial banks.

38) A. Sipos-M. Tardos, op. cit., p. 225.

After a short transitional period, in which enterprises will have to deal with a commercial bank assigned to them, they will be free to deal with bank (or banks) of their choice. The new banks are joint stock companies; the main shareholders appear to be enterprises and organizations.

Private persons are unlikely to be allowed to buy shares; it is, however, assumed that the banks will issue bonds which will be open to private persons......

On balance, it can be said that the reorganization of the banking system have furthered the autonomy of enterprises in investment decisions and may further it even more in the long run. However, several factors still impede the expansion of the autonomy of enterprises in this area.

Of importance is the present shortage of funds for investment as a result of high taxation and a shortage of foreign exchange. Another factor, related to the first, is that the high taxation, which is partly caused by subsidies to inefficient enterprises, hampers the expansion of efficient enterprises. The fear that the authorities may withdraw idle funds from enterprises—a quite frequent practice in the past—impedes both the autonomy of enterprises and economic efficiency.[39]

The recent situation of Hungarian banking system and financial policy was reported by some Soviet publications, interested in Hungarian experiments. In November 1987 Pravda introduced one Sándor Demjan, director of newly-established Credit Bank of Hungary. According to him, the difficulties of Hungarian economy came not only from external conditions, but also from inconsistent reform measures, such as maintaining the monopolistic position of the National Bank. Since 1983, enterprises could issue bonds and joint stock companies could be founded. From 1985 on, the National Bank gradually withdrew from domestic credit financing, and five commercial banks were born in 1987. The initial capital

39) Jan Adam, op. cit., pp. 620–622.

of his Credit Bank was Ft 8.9 bn, of which the government held Ft 6.9 bn and the other Ft 2 bn was held by enterprises. One vote in the board of governers of the bank was given to each Ft 100,000 share, and the biggest share-holder outside the government was Tisza Chemical with 5,000 votes (Ft 500 million). Enterprises can now establish commercial banks (their initial capital should be more than Ft 1 bn, but banks with Ft 500 million may be permitted for financing special innovation). The National Bank of Hungary becomes the bank of banks, which stipulates the bank rates and the reserve funds of other banks.[40]

When a Budapest rubber factory Taurus intended to issue "property bond" for its development, there were pros and cons among its employees. Some welcomed to expect yields higher than those from bank deposits, some doubted if it would serve for unfair enrichment. However, in the end of the debate, the Party organization, trade union, Communist Youth Union, management and enterprise council all supported the idea, and so employees could buy bonds within the limit between Ft 5,000 and 100,000. About 1,500 of 9,500 employees bought bonds amounted to Ft 32 million, which bore 17.2% dividends at the end of 1987. In 1988, the upper limit of individual holding was raised to Ft 200,000, and the dividends to be 20% thanks to the improved performance of the enterprise.[41] Director of Taurus, Ms Ilona Tatai, was promoted to the Politburo member on May 1988.

But the fundamental problem remains in the reformed Hungarian financial policy, whether Hungarian currency (forint) is playing the role of real money. This problem is far more acute in the sphere of international transaction, where the lack of convertibility of Hungarian forint is fatal.

40) "Znat' vygodu", Pravda, 16 November 1987.

41) Vladimir Gerasimov, "Lichny pay—v obshchiy kapital", Novoe Vremya, No. 15 (8 April 1988), p. 33.

4. External debt constraint

"After the 1984 resolution of the Central Committee of the HSWP, and then in early 1985, at the time of the 13 th Congress of the HSWP, a particularly optimistic atmosphere developed...... By the end of 1984 it had become clear that, through the market-oriented tone of government resolutions, and as a result of formal and informal administrative actions towards enterprises, the country improved its positions on the international credit market and succeeded in emerging from the credit crisis. On the other hand, precisely on the basis of the achievements, it was assumed that the complex market-oriented programme of streamlining the system of economic control and management, even if modest relative to the radical proposals, would be sufficient for accelerating the growth rate and for a well-founded development of the economy."[42]

However, economic results did not support this assumption. With much lower than planned growth rates of net material product (1985: −1.4%; 1989: 0.9%; 1987: 1.5%), Hungarian foreign convertible currency debt rose from (gross) 8.8 bn US dollars and (net) 7.3 bn at the end of 1984 to (gross) 17.7 bn and (net) 10.9 bn at the end of 1987.[43] The reasons of economic policy failure (in the sense of economic performance) are complex, but the failure might be partly due to the fact that the 1968 Hungarian economic reform was a half-reform (as was criticized in the earlier section), and partly due to the fact that the international competition in the world market was too severe for the spoiled Hungarian industry especially during the period

42) A. Sipos-M. Tardos, op. cit., p. 259.

43) Statistical Yearbook 1986; East European Markets, Eeb. 12 and 26, 1988 (Vol. 8, No. 3 and 4). The National Bank of Hungary published the figure of net convertible currency debt as 10.9 bn dollars at the end of 1987 (2.1 bn less than that of 1986), whereas OECD estimated net 15.8 bn debt at the end of 1987 (2.8 bn more than that of 1986)- International Herald Tribune, March 4, 1988.

of world stagnation.

At the beginning of 1987 Károly Grósz (Politburo member since 1985, then First Secretary of Budapest City Party Committee) openly criticized the government economic policy that, although the policy had changed to be restrictive since 1979 in order to stop the accumulation of foreign debt, "and yet, in the past seven years there was no considerable or even only noteworthy appreciable growth in the resource of the Hungarian economy." Due to the defficiencies of incentives, technical renewal was virtually absent, no significant changes in the branch structure of industry occurred.[44]

According to Balázs Botos of the Research Institute of Industrial Economics in Budapest, Hungarian industrial export to the West was even more heavily dependent on basic branches (metallurgy, chemicals and building materials) and food-processing in 1984 than in 1976.[45] Gábor Bakos of the Institute of Economics in Budapest told me in 1985 that Hungary could depend no more on the increase of agricultural exports, partly because of the barriers of EC regulations, and partly because of the limit of export potentials of Hungarian agriculture itserlf. So Hungary should further strive for increasing industrial exports containing high technology, but this concerns indeed the fiercest battlefield of international competition. Dr. Bakos expected to achieve higher international competitiveness in this field without sacrificing the hitherto attained quality of life, which I myself thought too optimistic. They say in Budapest now that while the Japanese worker may put in four hours for himself, four for the Emperor (this, I am sure, is misunderstanding. Not for the Emperor, but for his company) and four for Japan, his Hungarian counterpart puts

44) "Problems and Opportunities in the Hungarian Economy. A Conversation with Károly Grósz", New Hungarian Quarterly, No. 105 (Spring 1987), pp. 102–104.

45) B. Botos, "Changes in the Structure of Hungarian Industrial Foreign Trade", Acta Oeconomica, Vol. 37 (1986), No. 1–2, pp. 129–142.

in four for himself, has no Emperor to worry about and cares nothing about Japan (so he works four hours only).[46]

As the foreign debt accumulating far beyond expectation, Károly Grósz was appointed as Prime Minister in June 1987, and susterity policy was adopted at the September session of Hungarian Parliament. Grósz stated bluntly at the Parliament that from the beginning of 1988 Hungarians must be prepared to take a perceptible cut in their standard of living. Together with the introduction of incremental income tax and VAT, consumer prices would rise between 14 and 18% to cut personal consumption. In order to cut the budget deficit, subsidies to unprofitable enterprises would be stopped and the Liquidation Law must be ruthlessly implemented.

The introduction of porsonal income tax (distinct from the former practice of levying tax on the enterprise wage funds) and VAT (as in EC) had originally been planned as measures for the reform of tax system as a whole, which would cover all personal incomes including the income from the second economy, now turned into the measures to curtail domestic consumption in order to convert domestic rosources to external markets. The projected debt service of 1987 amounted to 3.1 bn dollars including both amortization and interest, which was equivalent to 65% of Hungarian exports to the West.[47]

VAT was introduced on July 1, 1988 in three grades: 25% to the industrial products and luxuries, 15% to tourism and transportation, 0% to foods, energy, medicines, sports and arts. Personal income tax was introduced at the same time, in 7 grades ranging from 0% for the annual income under Ft 48,000 to 60% for the annual income over Ft 800,000 (25% for the average annual income of Ft 76,250).[48] Already in October 1987 it was

46) The Guardian, May 5, 1988.
47) East European Markets, Feb. 12, 1988 (Vol. 8, No. 3), p. 8.
48) The EIU Country Report. Hungary, No. 1, 1988, p. 14, p. 16.

said in Budapest that they were with Ethiopean wages and Swedish taxes (real wages already fell by 8% between 1979 and 1986).[49]

In January 1988, consumer price index abruptly rose by 18.5% against January 1987. Although the Central Statistical Office estimated the price rise through 1988 to be below 15%, a survey carried in January in Budapest showed that a quarter of people surveyed expected the rise by 25%, and other one third by over 30%. The new VAT and personal income tax are said to be causing chaos especially among private enterprises and artisans. In January 8,500 of Hungary's 157,000 private artisans returned their licences, while a further 4,500 stopped all professional activity.[50] One taxi driver in Budapest is reported to have said after the recent (May 1988) Party Conference that "why more economic reforms when the old ones only gave us inflation, taxes and unrepayable debts?"[51]

IV. Economy and Politics in Hungary

As Dr. Judy Batt summarized in her Ph. D. Thesis, "in the different [from Czechoslovakia] political conditions in Hungary, economic reform was embraced by the regime as a means of securing political stability and popular legitimacy. Political crisis was avoided, but at the cost of compromise in the economic reform." She later pointed that "the paradoxical result of the limited decentralisation, or diffusion of central control, which occurred with the introduction of the economic reform, was the ineffectiveness of the central political leadership in countering the recentralising pressures emanating from below."[52]

Rezsö Nyers with Márton Tardos already pointed in 1984 the

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49) International Herald Tribune, October 24-25, 1987.

50) East European Markets, March 25, 1988 (Vol. 8, No. 6), p. 4.

51) Financial Times, May 24, 1988.

52) Judy Batt, Economic Reform and Political Change in Eastern Europe. A Comparison of the Czechoslovak and Hungarian Experiences, Mac Millan, 1988, p. 236.

dilemma that the slow-down of reform process might melt down the "capital" of political trust, but for further reform formally accepted social policy achievements would have to be questioned. These achievements are, for example, job security and price stability.

> The lack of enterprise dismissals has for consequence not only that poorly working people can misuse, often to the disadvantage of their colleagues, the inertia of the management system, but also that one is reassued of being able to keep his job until his pensionable age, unless he commits a "capital" offence. In regard of the demands of adjustment to the changing world, and especially of the unfavourable position of Hungary, this cannot be further maintained...... Price stability has for long been recorded as a success of the socialist economy. However, a rigid interpretation of this had to be paid for dearly. As a matter of fact, price stability had an important role in the development of a shortage economy. Since 1968 the Hungarian economy has made important as well successful steps to reduce shortages, and in the meantime, unfortunately, ever higher price increases have become necessary......Efforts have to be made that, without the rate of inflation rising, a larger scope be granted for changes in market prices, if we really want to enable enterprises to react autonomously on the financial pressure put on them by changing their supply.[53)]

The challenge to job security and price stability would cause transitional social tensions. Here comes the problem of the relationship between politics and economy.

> ......the solution of the topical economic policy tasks involves three problems : first, management practice under changing

53) R. Nyers-M. Tardos, " The Necessity for Consolidation of the Economy and the Possibility of Development in Hungary ", Acta Oeconomica, Vol. 32 (1984), No. 1–2, pp. 14–15.

circumstances requires broad political backing ; second, transitional social tensions are to be expected in factories and enterprises ; third, the task can only be solved with a wide social support.

With slow economic growth and significant changes in the economic conditions, these problems will not lead to grave disturbances only if, relying on the favourable experience, the relationship of the Party with the masses can renew to come up to the expectations of the new situation. What is needed for such renewal ? It is important that members of society be allowed to clearly articulate their direct interests in their everyday life and in the economy, and that, with the development of the system of political institutions, a solution be found to the problem that the increasing efforts of strata and groups at asserting their interests should lead to social consensus in each important question.

The development of economic manangement demands, therefore, a perfection of political democracy. Parliament, and the existing institutions for safeguarding of interests—among them first of all the trade unions—have to be prepared to face new tasks. Besides, organization of safeguarding the interests of a few social or partial groups so far without protection also necessitates a considerable organizational change.

The relationships between politics and economic management are, therefore, clear : economic progress is the precondition of maintaining a calm social environment. And this aim, even though it may seem to be a contradiction, can olny be achieved by developing socialist democracy and thus by the articulation of partial interests.[54]

Two years later, in an article with a title "Efficiency and Socialist Democracy", Nyers defined his conception of democracy as : the participation in decision-making of representatives of

54) R. Nyers-M. Tardos, ibid., pp. 17-18.

every interest ; an understanding and acceptance of the majority decision by the minority ; open and democratic checking of the economic processes ; and an effective feedback system in economic control activities in the interest of making corrections already underway. He emphasized the decisive importance of "a greater democratisation of planning" through the Parliament and local councils.[55]

Thus Nyers concentrated at this time mainly on democratisation of economic control and management to regain popular support for further economic reform. As George Schöpflin (1988) pointed in his paper to NASEES conference, "reform" may be used to mean making the system function more efficiently within its existing frame of reference, a way of upgrading the goal rationality of the existing practice of power.[56]

Political reform in Hungary is needed, in my view, by following reasons. Firstly, political trust for the post-1956 regime which had existed at the introduction of 1968 reform was gradually melting away during these two decades, and it is necessary for any further reform to regain popular support by political means. Secondly, as Nyers pointed, a further pursuit for improving economic efficiency would endanger social achievements hitherto accepted as guaranteed. János Kornai once stated that there was contradiction between the efficiency conditions on the one side, and the ethical principles of socialism such as solidarity and security on the other, and "one of the best qualities of Hungarian practice in recent years might be that it has not sought at all to create the illusion of having found a final solution, but assumes the task of experimenting and exploring ways and means."[57] Contradictions and dilemmas without final solu-

55) R. Nyers, "Efficiency and Socialist Democracy", Acta Oeconomica, Vol. 37 (1986), No. 1-2, pp. 8-9.

56) George Schöpflin, "One-party pluralism : Silk Purse or Sow's Ear ?", NASEES, 1988, p. 3.

57) J. Kornai, Contradictions and Dillemmas, pp. 124-138.

tion need the guarantee for more open debates. Thirdly, as far as Hungarian economic performance had been favourable (as in the first five years of 1968 reform), "economic compensation" for the population could work against political dissatisfaction. Dissatisfaction caused by the lack of wider democracy might be compensated partly by the affluence of consumer goods. Naturally, however, this "economic compensation" cannot work under the conditions of economic difficulties. Rather, the need for "political compensation" would emerge in such a case. In order to persuade people to cooperate with the regime at the sacrifice of their own living standard, the regime needs the legitimacy as the genuine representative of their interests by democratising the political life. Fourthly, as the characteristics of the Hungarian reform showed, the regime tried to reform mainly on the sphere of economic policy. The danger from outside against political reform was clear at that time, as the suppression of the Prague Spring demonstrated. However, it is also clear that any economic reform in a socialist economy has to be followed by corresponding radical political changes, because it cannot be separated from politics. A market-oriented socialist economy cannot be compatible with Stalinist-type political system, which was in turn compatible with the administrative management of economy. In that sense, the inherent deficiency of the 1968 Hungarian reform should be overcome in due time, whatever the economic performance might be.

But in practice, what concrete form of political reform can be introduced within the existing socialist system? Nyers (and many others within the Party) urges the activisation of existing parliamentary system for the first step. In this direction, in 1983 new Election Law was introduced, which stipulated compulsory multiple candidacy. Though multiple candidacy already existed as early as in 1971, it was not compulsory and the number of constituencies with multiple candidates gradually decreased since then (49 in 1971, 34 in 1975, 15 in 1980). At the 1985 general election under the new law, there were 152 cases in which a nominee was recommended by individuals. Of these 152, 78 became actual candidates (others were excluded because of the lack of one-third vote in the nomination phase), and 43 were finally elected. This number was equal to 11% of the total Parliament members (387) and 12.2% of the local constituencies (352). (35 MPs were elected nationally.)

"The low proportion of the independents in general, their high party membership ratio (33 of 43)......indicate the limited significance of their election ; however, it is still an unprecedented development in the history of socialist elections."[58)]

This may be a kind of "one-party pluralism", which different social interests are to be coordinated under the leading role of the Party. However, Bennett Kovrig (1987) argues that "(in Hungary) since the Party remains the sole ultimate aggregate of interests, there can be no competing institutionalization of pluralism......Although the Party has become less obstrusive in daily life, it retains its controlling functions through paralell structures, Party units within non-party institutions, and its cadre authority ......The Party exercises full discretion over appointments to some 90,000 posts and an 'advisory' right with respect to an additional 350,000 positions."[59)]

There might be three types of "socialist pluralism" : the first is the above-mentioned "one-party pluralism ; the second, which has formally existed in some socialist countries including China, is the situation in which a gigantic monolithic leading party is

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58) Barnabas Racz, "Political Participation and Developed Socialism : The Hungarian Elections of 1985", Soviet Studies, Vol. XXXIX, No. 1, January 1987, pp. 43–45.

59) Benett Kovrig, "Hungarian Socialism : The Deceptive Hybrid", EEPS, Vol. 1, No. 1 (Winter 1987), p. 124. NB : Kovrig cited these figures from an inner-party journal published in 1974. Figures might have changed since then, perhaps not substantially.

surrounded by several small parties with only auxiliary roles; and the last type is the multi-party parliamentary system, which allows the alternation of the ruling party, as was proposed at the Prague Spring. Undoubtedly, the regime in Hungary intends to limit the implication of pluralism within the framework of one-party system. Károly Grósz, who became General Secretary in place of Kádár at the May 1988 Party Conference, declared before the Conference that in the present stage of Hungary the existence of plual parties was impossible.[60] He also retorted at the Conference against the critics of one-party system, saying that the system had been formed historically as the expression of people's will, and that the Party could continue its leading role if it would overcome the deficiencies.[61]

On the other hand, in present Hungary, especially just before the May 1988 Party Conference, there existed an increasing tendency to demand the multi-party pluralism. Kádár admitted at the Conference that 45,000 members had recently left the Party,[62] while spontaneous organizations such as Democratic Forum, Network of Free Initiatives, Federation of Young Democrats and Democratic Union of Scientific Workers, outside the Party, the existing (communist) youth organization (KISZ) and the official trade unions (SZOT).

It seems at present they are not so large in members, mainly consist of a few thousands of intellectuals, without massive support from the workers. So, if the Party can reform itself as Grósz expected, "one-party pluralism" would work at least for a while. Rather, a question arises how the massive party (with members still more than 800,000, which is over 10% of the adult population) can reform itself, first of all by democratising its inner-party life. If it be possible, inner-party democracy might

60) Valeriy Musatov, " Perelomny rubezh ", Novoe Vremya, No. 20 (13. V. 1988), p. 35.

61) Pravda, 23, V. 1988.

62) Pravda, 21. V. 1988.

in some extent substitute multi-party democracy. Political reform in Hungary, in my view, has to start within the Party. The May 1988 Party Conference wholly rejuvenated the Politburo, and no one in the new Politburo except Rezsö Nyers (he had been excluded since 1975) was the Politburo member before the latest 13 th Party Congress (March 1985).[63] Indeed this was even more thorough change of leadership than that of Czechoslovakia in January 1968. Is this a course to a second Prague Spring without intervention, or to a chaos as in Poland?

After I finished the first copy of this paper, in November 1988, Miklós Német, former Central Committee Secretary in charge of economic policy, was nominated as new Prime Minister. Before that, rumours had supposed that Imre Pozsgay, the main proponent for pluralistic political reform within the Party, was the candidate for new Prime Minister. And on the opening day of Central Committee the Financial Times gave a false report that Nyers, leading reform economist, was to be nominated as Prime Minister. The next day the Financial Times corrected the report that Német, a young technocrat, was nominated by the Central Committee as candidate for Prime Minister uder the pressure from the Party leadership, against the strong support from the Budapest Party organization for Nyers. The spokesman of the Central Committee was reported to have said that "popularity was not the decisive factor; thare have baen other considerations."[64] (Later, Hungarian Parliament nominated Nyers as Minister of State in charge of Economy).

This suggests that the most urgent task of Hungarian government is still to overcome the critical situation of economy by any means, putting off political reform for an unseeable future.

(16 March 1989)

63) Népszabadság, 23. V. 1988.
64) Financial Times, 23 and 24 November 1988.