HUNGARY

A Decade of Economic Reform

Edited by
Paul Hare, Hugo Radice
and Nigel Swain

Hungary: A Decade of Economic Reform

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P. G. HARE, H. K. RADICE
and N. SWAIN

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Preface

The idea of writing this volume first arose in discussions between two of us (Hare and Radice) in 1977. We had previously worked individually on various aspects of the Hungarian economy, our interest being stimulated by the comprehensive reforms of 1968, which introduced what was then called the New Economic Mechanism. Unlike many of the reforms elsewhere in Eastern Europe, the Hungarian reforms, despite some setbacks, survived right through the 1970s. It is this long experience of reformed economic management that makes Hungary such an interesting country to study. This experience both demonstrates that there are viable alternatives to the traditional centralised model of planning of the Soviet type, and may also have some lessons for Western countries seeking to develop new forms of economic regulation and control.

By providing a generous research grant, the Social Science Research Council made it possible to translate rather sketchy ideas for assessing the first decade of Hungary's reformed system of economic management into the reality of a book. Nigel Swain (the third editor) was employed as a research fellow for the project, which culminated in a small research colloquium held at Stirling University at Easter 1979. The papers presented there, now revised and updated, form the main content of this book.

Research on Hungary is facilitated by the volume of good economic literature produced there, including excellent statistical publications. Most of the papers by Western economists presented here were based on individual research visits to Hungary, so they required co-operation and support from a large number of economic institutions and involved interviews with many academic economists, officials and enterprise staff and managers. The fact that such co-operation and assistance were forthcoming on an impressively generous scale is a testimony to the openness of economic debate in Hungary. We have all made good friends too in Hungary; it is a hospitable country, and the restaurants of Budapest are a strong incentive to further research. We thank, on behalf of all the Western contributors to this volume, our many Hungarian colleagues and friends for their support.

We would also like to thank the British Library and the library of the Institute of Soviet and East European Studies, Glasgow University, which proved to be valuable sources of Hungarian literature, and the University of Stirling for hosting our colloquium.

Finally, the revised papers were admirably typed, despite the abundance of unfamiliar Hungarian names, by Mrs E. Bruce, Mrs A. Cowie, Mrs C. McIntosh, Mrs W. Sharp (Stirling University) and Miss A.

Gaskin (Leeds University); their help at all stages of preparing the manuscript was quite invaluable.

PGH (Stirling) *April 1980*
HKR (Leeds)
NS (Cambridge)

Note on the authors

The editors

P. G. Hare Senior lecturer in economics, Stirling University. He has a D.Phil. (Oxford) on Hungarian planning techniques and has published several articles on the Hungarian economic reforms, notably in *Soviet Studies* (1976) and the *Cambridge Journal of Economics* (1977).

H. K. Radice Lecturer in economics, Leeds University. He has written several articles on the Hungarian economic mechanism in general and on co-operation agreements between Western and Hungarian firms in particular.

N. Swain Sociologist, completing a Ph.D. thesis on Hungarian agriculture for Cambridge University. He was employed as a research fellow on the project supported by the Social Science Research Council, which led to this volume.

The remaining authors

A. Abonyi Assistant professor of politics, Department of Politics, Queen's University, Kingston, Ontario. He is currently working on a Ph.D. concerning the introduction of new technology by Hungarian enterprises.

I. Gábor and **P. Galasi** Lecturers in economics, Karl Marx University of Economics, Budapest. They have written several articles on the labour market and the second economy in Hungary.

G. Kozma Senior research fellow, Institute of Economic and Market Research, Budapest. In recent years he has mainly studied international factors affecting the Hungarian economy.

P. Marer Associate professor of international business, Indiana University, USA. He has written extensively on Hungary in the past. More recently, his research work has been concerned with international trade in general, but this volume provided him with an opportunity to combine these two themes.

M. Marrese Associate professor of economics, Northwestern University, USA. He recently completed a Ph.D. thesis on investment in Hungary and is now working on wage regulation and other aspects of the Hungarian economic mechanism.

X. Richet Lecturer in economics, Université de Paris X, Nanterre, France. He has a long-standing interest in general features of the Hungarian economic mechanism and in economic reforms in Eastern Europe.

Hungarian Sources Mentioned in the References

1 Publishers

Akadémiai Kiadó	Academic Press
Kossuth Könyvkiadó	Kossuth Publishing House
Közgazdasági és Jogi Könyvkiadó	Economic and Legal Publishing House
Közoktatásügyi Kiadóvállalat	Educational Publications Enterprise
Szépirodalmi Könyvkiadó	Literary Publishing House
Tancsics Könyvkiadó Vállalat	Tancsics Book-Publishing Enterprise

2 Newspapers and Periodicals

Figyelő	*The Observer* (weekly economic newspaper)
Gazdálkodás	*Farming*
Gazdaság	*The Economy*
Ipargazdaság	*Industrial Economics*
Ipargazdasági Szemle	*Review of Industrial Economics*
Közgazdasági Szemle	*Economic Review*
Külgazdaság	*External Economy*
Marketing és Piackutatás	*Marketing and Market Research*
Mezögazdasági és Élelmiszeripari Értesitő	*Bulletin of the Ministry of Agriculture and Food Supply*
Népszabadság	*National Freedom* (main daily newspaper)
Pénzügyi Szemle	*Financial Review*
Statisztikai Havi Közleményei	*Monthly Statistical Bulletin*
Statisztikai Szemle	*Statistical Review*
Valóság	*Reality*
Vezetéstudomány	*Management Science*
Világgazdaság	*World Economy*

3 Other Publications

Agrárgazdasági Kutató Intézet Füzetei	Pamphlets from the Agricultural Economics Research Institute
Beruházási-Epitőipari Adatok	*Investment and Construction Industry Data*
Ipari Adatok	*Industrial Data*
Ipari Addattár	*Industrial Data Collection*
Ipari és Épitőipari Statisztikai Értesitő	*Statistical Information on Industry and Construction*
Külkereskedelmi Árstatisztikai Adatok	*Statistical Data on Foreign Trade Prices*

Külkereskedelmi Statisztikai Évkönyv	*Foreign Trade Statistical Yearbook*
Magyar Füzetek	Hungarian Reports
Magyar Statisztikai Zsebkönyv	*Statistical Handbook of Hungary*
Mezőgazdasági Statisztikai Zsebkönyv	*Statistical Handbook for Agriculture*
Mezőgazdasági Szövetkezetek Gazdálkodása a Számok Tükrében	*The Operation of Agricultural Co-operatives in Figures*
Statisztikai Évkönyv	*Statistical Yearbook*
Szövetkezeti Kutató Intézet Évkönyv	*Yearbook of the Co-operative Research Institute*
Szövetkezeti Kutató Intézet Közleményei	Reports of the Co-operative Research Institute
Termelőszövetkezeti Jogszabályok	*Statutory Provisions for Producer Co-operatives*
Törvények és Rendeletek Hivatalos Gyujteménye	*Official Collection of Laws and Decrees*

4 Other Official Sources

Gazdaságkutató Intézet	Economic Research Institute
Központi Statisztikai Hivatal	Central Statistical Office
Termelőszövetkezetek Országos Tanácsa	National Council for Producer Co-operatives

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Part One

General Issues

Chapter 1

Introduction

1 The context of economic reform in Hungary

Hungary is one of the smaller countries of Eastern Europe, with a population of only 10 million and an income *per capita* of about £1,000 in 1975; this is close to the average income level in Eastern Europe. But Hungary's relatively modest economic weight does not detract from the importance and interest of its innovations in the sphere of economic policy, which have deservedly attracted worldwide attention and critical discussion. It is these innovations which form the subject matter of the present volume. Of course, Hungary was not alone in Eastern Europe in introducing economic reforms in the 1960s, and it is essential to see the Hungarian reforms against the background of reforms going on elsewhere, as part of a reform movement. Moreover, even within Hungary the comprehensive reforms introduced in 1968, as the New Economic Mechanism, did not simply happen overnight; instead, they were preceded by several attempts to carry out minor reforms, which achieved only limited success, and by two years of impressively careful preparation. In carrying out their reform programme the Hungarians sought to learn from their own past mistakes as well as from the experience of other countries. Since 1968 many details of the original reform package have changed, but enough remains of the reform principles for us to be able to claim that the Hungarian economic mechanism has proved itself to be a viable alternative to the traditional centralised Soviet model of a planned economy. This is not, however, to claim that the performance of the economy has been as satisfactory as the leadership might have wished, as the chapters that follow make abundantly clear.

(a) *Economic management under traditional central planning*

From 1950 until the introduction of the 1968 reforms, Hungary was managed in accordance with the familiar Soviet model of centralised planning (Nove, 1977; Berliner, 1976; Joint Economic Committee, 1976). The principal instrument of economic management was the plan; five-year plans determined the broad framework of economic development in each period, while annual (and often quarterly) plans, disaggregated down to enterprise level, provided the basis for operational management. Enterprises received sales or output targets and allocations of the major material inputs; in addition the plan specified cost reduction targets and the permitted wages fund for each enterprise. All these targets were based on plan calculations that sought to satisfy a large number of economic balances, taking into account the results achieved in the previous plan period.

Kornai (1975) pointed out that in practice the traditional methods of plan formulation employed in the centralised model do not permit the precise satisfaction of all such balances. This is partly because the information required to construct a detailed national plan cannot be assembled and processed in its entirety; the sheer volume of information is simply too vast. Moreover, all statistical agencies take some time to organise the data that they collect from enterprises and individuals into a form suitable for use in planning exercises. In addition, numerous indicators that enter into planning calculations (e.g. input norms) are at best approximations and with technical progress are likely to change quite rapidly in several branches of the economy. All this produces a situation where the planners are compelled to concentrate attention on a relatively small number of important economic balances while taking others into account only in a very rough and ready fashion. The result is inevitably a plan that is detailed but very approximate – hence the usual need to amend many enterprise plans in the course of their execution. Thus, the centralised model has the appearance but not the reality of precision. The practical inability to formulate reliable detailed plans was one source of pressure in favour of some type of economic reform, both in Hungary and elsewhere in Eastern Europe.

Aside from these problems of plan information, shortcomings of the enterprise-level incentive system added to the pressures for reform. The management of enterprises was rewarded on the basis of its performance in relation to plan. In particular, bonuses were paid for fulfilment of the output plan, whether or not this happened to satisfy the needs of customers. Ideally, of course, the plan itself should take account of the structure and level of demand, given the level of income and the prevailing price system. But there are lags in adjustment, and even the most detailed plans do not give enterprises output targets specified in terms of individual commodities. Instead, these targets were usually stated in value terms for commodity groups. Consequently, enterprises always had some degree of flexibility in varying their product mix towards 'easy' products to ensure fulfilment of the plan, although this meant on occasion producing goods not in demand. Given the short-run character of the enterprise incentive system, with bonuses based on performance in the current year, it is not surprising that enterprises often appeared reluctant to introduce new technology or new products, unless specifically instructed to do so in the plan. Such effects of the incentive system tended to take much of the initiative for innovation away from enterprises, where most of the relevant information was likely to be found, to the higher levels of the planning hierarchy, which had a stronger desire for innovation and technical change but less of the required information.

The incentive system also undermined the quality of plan information; for if enterprises perceive that the output levels that they will be instructed to achieve and the inputs with which they will be supplied to meet the planned levels of output depend on information supplied by themselves, it is clear that enterprises will err on the side of caution. Feasible outputs are likely to be underestimated, while input coefficients are overestimated. In response to such behaviour, the planners tend to operate according to the so-called ratchet principle of planning, whereby the next period's output target is based on the current period's performance plus some average allowance for growth (see Gács and Lackó, 1973). In effect, therefore, the interaction between enterprises and planners creates a rather conservative economic mechanism, with a bias against change in any particular enterprise.

(b) *Arguments for reform*

Now, these failings of the centralised model are not peculiar to Hungary, and very similar observations have been made about all the Eastern European planned economies. Nonetheless, it would be a mistake to conclude that the centralised model of a planned economy is totally inefficient and ineffective, for it has generated impressive growth rates of output and employment, notably during the 1950s and 1960s. However, the nature of the growth process seems to have changed somewhat during the 1960s. In Eastern Europe itself it is now quite conventional to distinguish between extensive and intensive periods of growth; the former refers to growth based on massive increases in inputs of both capital and labour, while the latter involves growth accompanied by rapidly increasing capital intensity. Thus, the 1950s, when savings and therefore investment, rates were rapidly expanding and large numbers of workers were moving out of agriculture into industry, was a decade of extensive growth. More recently, it has become apparent that labour reserves are largely exhausted and that future growth depends crucially on raising the productivity of an almost static labour force. This requires many factories to be re-equipped with better capital, raising the degree of automation or mechanisation throughout the economy in a process of intensive growth. Since the capital intensity of industry has actually been rising ever since 1950, it is hard to discern from the official statistics just where the transition from extensive to intensive growth took place. However, in the perceptions of policy-makers it played an important role in the mid 1960s, when discussion of possible economic reforms reached a peak of intensity almost everywhere in the region. There are two reasons why the transition between the two types of growth should have so seriously troubled the policy-makers and stimulated thoughts of economic reform.

First, much of the earlier period of industrialisation was devoted to the establishment or expansion or a range of basic industries (e.g. steel, heavy engineering, generation of electricity) to the relative neglect of light industry and infrastructure. The traditional centralised techniques of planning seemed to be relatively well adapted to manage such priorities, since each of the industries of interest has a fairly narrow and well-defined product range as well as a reasonably well-tried menu of available technologies. The prospect of entering a more intensive phase of development was bound to call into question many of the technical choices that had been made in these industries, since it was rapidly becoming more important to save labour. The fact that the emphasis of economic policy was also beginning to shift in the consumers' favour also called into question the traditional planning techniques themselves, for their application to Hungarian light industry had already been heavily criticised (Kornai, 1959), and it was soon widely recognised that they could not handle the diverse and rapidly changing product mix and technology in such industries as textiles and pharmaceuticals.

Secondly, the realisation, already noted above, that continued growth would increasingly have to be based on productivity gains was expected to place new demands on the planning apparatus. The types of information that accumulated in the planning system in the course of operating the traditionally centralised model (i.e. material and labour input norms, and achieved output levels for the existing list of goods and services in production) were not necessarily the most useful when it became necessary to change the pattern of production quite drastically rather than merely replicate the existing pattern at a higher level. While the centre could play an important part in promoting technical development (e.g. by organising co-ordinated investment programmes in certain key sectors), much of its contribution was likely to be more passive. Enterprises, and perhaps branch organisations, had the fullest information about market trends, potentially attractive new products and technical changes affecting them, so that, if the centre provided resources and/or organisational help, lower level initiative could then be relied on to do the rest. Indeed, an essential task of economic reform in a number of countries has been to devise means whereby the above type of decentralised decision-making may function well in practice; we have already observed that it does not do so in the centralised model.

In the Hungarian case, probably to a greater extent than elsewhere in Eastern Europe, foreign trade considerations served to strengthen the case for economic reform. Around half of Hungary's national product was and is exported, with just over a third of these exports going to Western (convertible currency) markets and the remainder to other countries of the Council for Mutual Economic Assistance (CMEA); the structure of imports was quite similar to this, of course. Hungary's development was heavily dependent on imported raw materials, the bulk of which have always come from the Soviet Union. But it was very likely that in the future the country would have to obtain increasing supplies from elsewhere, particularly from Western markets. This meant that more exports had to be sold on these markets in order to earn the necessary hard currency, and for this to happen on a significant scale it was clear that the quality of many Hungarian products needed to be dramatically improved. Moreover, many of the large investment projects could only be viable if part of the output could be exported, since the efficient scale of plant was often capable of producing more output than the domestic market alone could absorb. Again, therefore, investment had to be carried out with export prospects in mind right from the start – an approach that seemed to be quite inimical to the balancing procedures that characterised the centralised-planning model, for the latter tended to plan trade by starting from the import requirements of the domestic economy, constructing balances of supply and demand for the major products and then identifying surplus products that could be made available for export. Within such a framework trade flows were unlikely to be very efficient, and any influence of trade prospects on investment decisions was at best very indirect. As Bolthó (1971) pointed out, this approach to trade was already being criticised in the late 1950s, and Hungary (along with Poland) was one of the first socialist countries to develop export efficiency indicators in an attempt to inject greater rationality into trade flows. However, by the mid 1960s it had come to be believed that only a fairly radical reform of the economic mechanism could significantly improve the country's trade performance.

(c) *General features of reform proposals in Eastern Europe and the USSR*

We have seen that Hungary, as well as its partners in the CMEA, by the early 1960s had several reasons for giving serious consideration to economic reform. While most of the reasons were valid throughout the region, the responses in terms of specific reform proposals, and even more in terms of reforms actually implemented, showed considerable diversity. Since this is not the place for a full account of reforms except in Hungary itself (for reforms elsewhere see Bornstein and Fusfeld, 1974; Bornstein, 1973; Feiwel, 1969; and Nove, 1977), it is appropriate to concentrate on the general features of the Eastern European reforms rather than on their concrete details. The reforms that the region experienced may conveniently be grouped into a number of general categories as follows: