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Is Hungary really different?

Edited by

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INTRODUCTION

More than a quarter of a century, in the fall of 1981 the cover of the Journal Euromoney was illustrated with a picture of Matrjoska-dolls. Just like on the cover of this book. The Matrjoskas had the name: Hungary, Rumania, Poland. The last one was already lying on the bottom, Rumania was a bit shaky, Hungary still standing.

This was the indebtedness crisis in East-Europe that time. The authors of the leading article asked themselves: "Is Hungary really different?" The image of Hungary was that it had a modified centrally-planned economy, which was different from the other socialist countries.

And, really, it was different. This is what some of the studies try to enlighten for the reader. It was different because political leadership did not want another 1956. There were some market elements built in the so-called "economic mechanism". People were quite satisfied. There was no severe shortage in consumption goods. They could even go abroad every 3rd year, with the "big amount" of 50 dollars. They had the "best barrack in the laager".

Now Hungary is again different from its neighbor-countries. But now we are the last ones among them. Why? The studies will give an answer to this question.

There are some more essays in the book. Two of them are again connected with the cover: they deal with the oil price explosion in the 1970s… Some others show what trade fashions were in the COMECON, how agriculture developed in Hungary, or how the West viewed us in diplomacy. A study deals with the very great contemporary challenge: "graying" of the economy… After the unsuccessful long term plan to incorporate a socialist economy it turned out that capitalism is the best birth control in the world.

We hope that the now very shaky Matrjoska-Hungary will stay standing and will be a bit more successful in the future.

Prof. Dr. Katalin Botos DSc

FROM THE CHANGE OF REGIME TO THE CHANGE OF REGIME. HUNGARIAN ECONOMY FROM THE WORLD WAR II TO 1990

By Katalin Botos

The 'golden age' of the emergence of centrally-planned economic control and management, 1948–1956

After World War II and, esp. following the year of the change of regime the large-scale experiment which had taken place over the previous three decades in the Soviet Union was launched in Hungary, too, similarly to the countries attached to the sphere of Soviet interests. May the spontaneous market forces be substituted by planned human actions? May catching up with the advanced industrial countries, which have achieved their own development level through the operation of market mechanism at the sacrifice of considerable shocks and social tensions, be accelerated in the same way? May social problems be solved by the elimination of the private property of production forces which, in compliance with the doctrine of Marxism, is the source of all troubles?

In the so-called debates over socialism in the 1930s Ludwig Mieses and Friedrich A. von Hayek from among the theoretical economists already pointed out clearly that, in the absence of prices, information that was responsible for the economic efficiency of production and consumption would not be available. Consequently, the basic economic question posing what, for whom and by what methods must be produced in order that the optimum of effectiveness should be achieved could not be answered. At the same time, for outsiders, this statement was frequently contravened by the impressive results of the Soviet Union. The leftist intellectuals who visited the Soviet Union did not notice that these sham results demanded terrible social sacrifices which could not be increased for long because the idealistic approach considered to be the precondition of the operation of the system was unrealistic and alien to human nature; it disregarded the fallibility of human beings. And under the elementary threat of the world war the possibility to assess the sacrifices was even less. But the result, i.e. the fact that the Soviet Union with its allies became a member of the Club of Winners, too, and had negotiations about the distribution of world power with the leading countries of the world strengthened the belief that socialist planned economy was, at least, one of *the passable routes.* This and, only this, can explain that in spite of the scruples aroused the political takeover by communists became possible in a relatively short time in Middle Europe.

However, the fact that despite the abuses, cruelties and the highly exploiting economic regulations the society had not protested against the system of the 'existing socialism' for years could be attributed to the organized *totalitarian terror.* The growing spread of terror was the consequence of international situation. The secret of the atomic bomb which the allies did not share with the Soviets and the actual deployment of the bomb was a shock to the Soviet leaders and strengthened the formerly expounded thesis that capitalist countries were planning the elimination of the communist system in the near future through launching another war. To prepare for this a war-time economy was suitable since the sources necessary to the development of war economy had to be pressed out of the population of the country – and those of the satellite states as well – by force. And that presumes the possibility of giving orders as well as the drastic punishment if the orders are not carried out.

Even if it had not derived from the ideology of the system, nationalization would have come in very handy for wartime economy since it is the position of ownership that makes

possible to give orders directly. In 1948 firms with more than 100 employees, in 1949 firms with more than 10 employees and those with foreign ownership were nationalized. Thus, no overt war economy needed to be introduced because under 'peaceful' conditions war preparations could be made. Here, the use of quotation marks are justified because the harassments terrorizing the society, the permanent enemy-making, trials and death-sentences generated almost a war-psychosis on a social scale. Actually, a real man-hunt supported by law broke loose in Hungary. The number of prisoners approached 400 000, out of them 30 000 were condemned for political reasons, and the number of those in detention camps without legal process were between 30 000 and 40 000. Peasantry became target of vexations since private ownership remained relatively long among them. 70 000 people were registered as 'kulaks', i.e. wealthy farmers, what meant permanent and serious vexations for them. Several hundreds of thousands of the population – officers, civil servants, shopkeepers and artisans – lost their jobs and living, and were forced to do physical work. One member in every third/fourth family had a conflict with the organs of power.[1] Terror had been heightened till 1953 that could be considered a landmark. It was characteristic of the system that after the deterioration of the relationship between Yugoslavia and the Soviet Union in the great political arena, instead of the persecution of the supporters of the former regime, Hungarian communists – similarly to the other Middle European countries where there was a communist takeover – started to expel their own followers and allies out of the Communist Party and power. In 1949 they condemned Rajk to death and executed him; in the first half of 1950 the communist administration got rid of the former social democrats, and in the spring of 1951, of a group of Hungarian communists through the rule of the court. The choreography of this formidable dance of death was elaborated in Moscow and it was followed by all the satellite countries in a servile way. If Stalin had not died, the so-called Zionist trial the principal defendant of which must have been Zoltán Vass who was a leading official in economic planning would have come off by the same 'orchestral score'. Similar trials were under preparation in several countries. Also, mass terror was growing. In 1953 there were no families without a conflict with the police or the state security authorities.[2] The totalitarian terror explains the fact how economic decisions against common sense could be made and how they had been imposed upon society over almost a decade.

From economic aspects it is illuminating what the cardinal sin of the Yugoslavs was: with Bulgarians they began to think about a federation, i.e. a customs union. This proved to be not a venial sin much later in the late1970s and the early 1980s either. Even this time, the 'idea of a small CMEA', the breaking of the star-like cooperation, the questioning of the central role of Moscow just too a little extent was a neuralgic point. It was so much so that the head of the GPU coming to Hungary, the later Secretary-General and former Ambassador to Hungary, Andropov prohibited, personally, the young researcher to publish his research findings on this topic (just like the experts who criticized the socialist international financial system), although the solutions of the special Yugoslav route, e.g. the experiment to turn workers' collectives into owners was also popular among Hungarian reform communists almost till the change of regime.

In the late 1940s the servile copying of the Soviet planning model, the establishment of autarky, the forced industrialization and the first experiment of the socialist reorganization of agriculture were characteristic of Hungarian economic policy. From the aspect of foreign trade – the CMEA, the Council of Mutual Economic Assistance was set up in 1949 though – 'mutuality' did not mean any multilateralism. They relied on bilateral relations, natural-

ly, on the Soviet Union, first of all, and the major aim was 'the dismantling of western trade and economic relations. Hungary, a 'ferry-boat country' switched over its foreign trade relations by 180 degrees. While before World War II Hungarian trade relations with the Soviet Union made up lower than 1% of the country's external trade and the German share reached 25–30%, by the early 1950s the situation became nearly reverse. The share of the Soviet trade in Hungarian external trade made up 34% in 1953; Hungary's shares in the trade to the other CMEA countries were the same. In other words, 60–70% of our external trade was dealt with socialist countries what corresponded to the principle of 'two systems and two world markets'. The objective was that the community would be dependent on capitalist world market to the lesser extent in order to be able to prepare for a blockade in the case of war. It follows from the nature of the system and the bilateral relations that there was a strong endeavour to achieve maximal national autarky. How could multilateral relations have been modelled without a considerable number of computers, on checked sheets of paper? How could the changes have been traced through networks, esp. when complying with target figures was emphasized by the aforementioned sanctions? It is best to stay within our own competence, although complying with these target figures was frequently endangered, esp. due to the permanent alterations of plans. Trade with 'brotherly' countries, too, took place through high-level and bilateral agreements and it was included in planning that the data would be fixed as much as possible. The Korean War, which, otherwise, seemed to justify, politically, the fear from a World War III rearranged international price relations considerably (Botos J., 2001). From this time on, CMEA countries traded with each other on fixed prices until 1957 when the so-called Bucharest price principle was introduced. By this it was meant that a five-year average of the prices in the world market was taken into account and the exports and imports of the five-year plans of socialist countries were settled on these prices – technically, converted into roubles. Now it can be seen, that CMEA striving to achieve maximal autarky kept winking at the world market somehow as it borrowed the prices of trading among one another from there.

The practice of price-making and high-level barter agreements fitted in well with the mechanism of domestic economic control. National economic plans were elaborated by the Central Planning Office and were approved by the supreme political administration. The preliminary plans were interpreted for the lowest level of execution, i.e. the company by a multilevel and hierarchical bureaucracy. Proposals for plans were required to be handed in by productive units, too, and while they were harmonized with preliminary plans, plan directives which became obligatory emerged in this way. Every company was given a great number of indices which referred to quantity, quality, the utilization of manpower and financial data, the development and investments to be made. They tried to substitute market regulation with the great number of indices. Out of plan indices the quantitative ones were preferred by those who were obliged to provide them because they could be controlled in a better way, and the instructions to choice and quality were neglected. Without directives all costumes were unified since nothing else but jockey caps and loden coats could be bought in the shops. The quantitative and value indices as well as those of profitability of production had nothing to do with each other. The Stakhanov movements commenced to exceed plan indices were often the causes of tragedies, e.g. in the case of the collier disaster in Tatabánya in the early 1950s. This situation cannot be described better but by the black humour of the age. That time the 'I.I.I' law[3] was valid. (This 'joke', which was obviously dangerous in the age, is cited by Ignác Romsics, the outstanding researcher of the epoch. The joke goes on like this: Idiotism is increased by Idiotism.)

On the joint impact of the selected development trend and the ill-considered implementation the inner tensions of economy became constant and as the costs did not play a role, indeed, production turned to be highly wasteful. Everyday practice was dominated by improvisation instead of rationality. Overhasty economy and economic management disarranged both the inner state of individual industrial branches and the interrelationship of various sectors. This is well characterized by the state of coal production. The 59% growth calculated by heat-value between 1949 and 1954 was lagging far behind that of the industrial groups consuming coal. In 1952 the coal shortage, which was typical in war years, appeared again, and demands could not be met by the imports of half-a-million tons of coal either.[4]

Actually, there were two basic problems in this practice: one of them was that better positions in plan bargains were on the part of economic units since the latter knew what they were able to perform but these executive units could not be expected to aggravate their own situation. That involved wasting implicitly. The other danger – and at the beginning even a bigger one – was total voluntarism according to which every directive could be implemented if the necessary conditions were assigned to under the orders of the party management. This approach seemed to be viable. Almost only technological and physical limits could be calculated upon, i.e. how much iron and steel could be produced, how much the energy- and time-bases were at disposal and in their utilization the members of the new political power gave them total freedom. They were free to decide how much they wanted to spend on capital equipment and on the production of consumer goods to absorb purchasing power; when, where and how many investments would be started, or possibly, halted. The fact that both the objectives and means were determined by the centre hampered automatic control. This had to be substituted by the activities of administration what led to the unprecedented growth of the personnel and, eventually, to the increase of costs. But leaders disregarded the problem of efficiency with reference to emergency situation. 'What economic branches will and will not be developed is determined not by the fact where higher profits may be achieved but by the fact where the rise of basic capital is needed from the aspect of people's economy. We are going to develop the most important branches independently of that whether they are profitable or not profitable' – said one of the competent economist, Andor Berei in his textbook on the planning of people's economy which was published in 1951/52 for the students of the University of Economic Sciences. This approach assumes that the centre knows, definitely, what is needed and devices are assigned to the decision. This could be deduced from the fact that the technological parameters of necessary instruments for defence were known. The only problem was how these instruments could be obtained. Can the financial sources to development be gained from any layer of society? Can enough export-oriented commodity stocks for the assurance of the necessary imports be produced? Perhaps, must or may external credits be obtained? Raising external loans became more and more frequent. The country's indebtedness was growing both in the Soviet relation and to the western countries, too, over the years before 1956. It should be noted, that the notion that sources should be just assigned to objectives was true only for the existent technology. New results of research and development could not be obtained like this: hungry and malcontent people could not be expected to produce new inventions and to have an innovative approach. It is not by accident that in the Soviet Union for the researchers taking part in the later space program an isolated town 'the Star City' was built in which inhabitants 'had already found their communism', i.e. they were able to work without financial difficulties, because it should be seen that under normal conditions

voluntarism planning was hindered by the fact that the minimum life standards of the 'working population' had to be met. And that resulted in the accumulation of both quantitative and qualitative shortages in the given period. Practically, during forced growth and industrialization sources could be guaranteed only by the limitation of the population's living standard.

The method was of multilayer. First of all, the starting point was the practice emerged at the stabilization of forint, namely, the definition of the pre-war salaries and wages by social stratum. The relative state of workers deteriorated to the least extent. Since even the salaries and wages in nationalized firms and offices were decided by the government and the level of consumer prices was fixed centrally, too, calculating a basket based on a determined minimum consumption, the level of the 'required' one which was far below the pre-war consumption with all social strata could be assessed. Problems of provision emerged soon; the high degree of shortage can be demonstrated by the introduction of rationing over the year of 1951. When at the end of 1951 they tried to replace the rationing of evil memory with the help of price and wage measures, the wage increase was half the price growth of consumer goods. The purchasing power of workers was decreased in this way. Consumer price indices grew by 125–179% between 1951 and 1953, while the index of real wages of workers/employees did not reach 100%. The worse value of this index was in 1952 when it showed only 82% according to the data published by the Central Statistical Office in 1957.

The state of peasantry was 'formed' more directly, from the side of income, namely, through the state purchase prices and the ones of products used, through the wide gap between prices of agricultural and industrial products as well as by the operation of the system of compulsory delivery. Instead of the word 'formed' we may say that peasantry was pauperized since the administration's policy towards them served a double aim: politically, it aimed to destroy the independent existence of farmers and, economically, to assure incomes necessary to industrialization. Farmers were pressed hard in order that they would be compelled to wind up their individual holdings voluntarily. During the First Five-Year Plan the burden of delivery to the state trebled and in 1953 the tax arrears of farmers approached one billion forints. The plan just neglected the peasantry's own consumption and, also, their need for sowing-seed. Who joined cooperatives or handed over his/her farm to the state was exempt from tax arrears. The strong yearning for an own land of Hungarian peasantry which was satisfied with the political deception of land distribution aroused obstinate clinging to land. In spite of collectivization using every means the ratio of private farms was higher. Collectivization did not progress at the required pace. The commodity stocks which derived from 'the progressive' type of property did not increase as required, and thus it was unable to substitute the loss due to the low results of the screwed private farms. Between 1951 and 1953 agriculture was not allocated even the investment amount that was earmarked in the plan. It occurred that data made up half or one-third of the plan. It was highly cynical that, despite all this, in his congressional report Ernő Gerő accused peasantry of not following industrialization which was treading with 'seven-leagued boots'. 'It is intolerable that the burden of nationalization would be carried only by industry and industrial workers while the state had to support agriculture permanently – said Gerő. (Cseszka, É., 2003). However, it is a fact that the production of agriculture was stagnant between 1949 and 1952, while industrial production trebled. Of course, due to this, high deficits appeared, esp. because the imports necessary to industrialization had often to be paid for by agricultural exports that decreased inner commodity stocks again.

Production of agricultural produce by sector (%)

	1949	1950	1951	1952
State farms	5.5	11.2	15.6	17.1
Cooperatives	0.6	3.7	8.3	11.2
Working peasantry	77.3	70.6	65.8	65.2
Kulaks	16.6	14.5	10.3	6.5

Source: ÚMKL Begyűjtési M. Terményforg. Table 36.

The leading triumvirate of politics, the team of Rákosi, Gerő and Farkas were tugging the plan indices to and fro: they lifted the plans to astounding heights then re-corrected them when they were forced to devote some more to the production of consumer goods. The absolute voluntarism deteriorated to the extent that in September l956 the President of the Central Statistical Office (CSO) had to direct the attention of the Central Planning Bureau by a letter that after several thousands of plan modifications even the CSO did not know which the valid annual plan was.

Wage adjustments seeking to lessen social unrest were tried to get back by the readjustment of norms what led to strike-like protests sporadically. One method of the neutralization of outgoing purchasing power was the officially voluntary but, actually, forced subscription to Plan Bonds and/or Peace Loans. However, shortage turned to be constant not only in consumption but in production as well and, thus, it became a permanent characteristic of socialist economy.

The period preceding the ‘56 revolution may be characterized by the tug of war between the Moscovite and ‘domestic’ communists, on the one hand, and the fight between the group of the fairly moderate Imre Nagy and the dogmatic fraction of Rákosi. The outcome of the fight was always influenced by international circumstances. However, the ‘basis’ of conflicts was provided by internal conditions. The Moscovite group experimented with the mechanic transplantation and servile copying of Soviet experiences, exaggerating industrialization and the development of heavy industry to the extent that, from time to time, Moscow had to call attention to their mistakes. From the outset, Imre Nagy – he was a member of the Moscovite group though – had a better understanding to the problems of agriculture. This is why Rákosi hesitated to pick him or Rajk, the ‘domestic communist’ as a victim to Titoist trials. Undoubtedly, Imre Nagy’s external relations – first and foremost, the support of Malenkov – averted the danger from him during the first wave of showdown. Stalin’s death in 1953 set the situation for the political line of Imre Nagy to have a chance. The great preparation for war became meaningless because the international conflict expected had not unfolded. Relationship to the Yugoslavs returned to normal and arms stopped silent in Korea. ‘We have been preparing for war and peace has broken in on us’ – said Rákosi to György Aczél, the top ideologist, allegedly.[5] By this the legitimation of the policy followed ceased but its negative sides presented themselves distinctly. Even in this case self-criticism was not done by the Secretary-General and Prime Minister, not only one but two Soviet encouragements were necessitated to do so. After the death of Stalin, on the recommendation of Malenkov, whose position was strengthened, Rákosi had to share his

power with Imre Nagy who was proposed for the position of prime minister – in Moscow. It seems to be obvious that domestic conditions changed not independently of external support at all. When the situation of Malenkov weakened – what was caused by the arrest of Beria who was seen as an ally to Malenkov –, the opposing camp went into action. Only some weeks had passed since the nomination but the dogmatic politicians did everything to make Nagy's political line fail. It was all the easier because Gerő remained Deputy Prime Minister responsible for economy and to him the lobbyists of war industry required to be pushed into the background were very close. From the beginning Rákosi was scheming to fire Nagy because of economic reasons.

And the external and internal conditions were favourable to Rákosi's machination. In foreign policy the new American doctrine that, instead of the policy of holding up, formulated the policy of peaceful liberation brought a change. This floated the possibility of peaceful coexistence and war. The FRG was invited to NATO on 23 October 1954 and this was considered a war threat again to the socialist sector, and as a reaction the Warsaw Pact, which institutionalized the possibility of military presence for Soviet troops that would have had to leave Hungary in compliance with the Peace Treaty in 1955 just like from Austria, was bound in the next May.

On the other hand, the reforms of Imre Nagy did not bring rapid and positive results which could be defended against the attacks of his political opponents. The strengthening of constitutionality and the growth of the role of the parliament, the change of investment ratios, the increased support of agriculture and the proclamation of the respect of private property became the source of political and economic problems in the short run. The movement of cooperatives nearly failed since its total disintegration could be stopped only by raising difficulties to the administrative procedures. Meeting the needs for machines and fertilizers of small holdings and agriculture in general was not smooth and with obsolete technique no quick production growth could be achieved. But the improvement of income relations in agriculture led to considerable outflow of income. However, the stock of goods was not enough to absorb purchasing power. Economy was unable to react to changes that quickly; it can be said that political zigzags were faster than the time necessary to the modifications in real economy. Incomes out flew more quickly than the accumulation of commodity stocks to meet demands took place. The Central Planning Bureau indicated that circulation of banknotes was by 40–50% higher than that in the previous year and this might cause some difficulties. During the Soviet consultations this topic was aroused and Hungarian administration was blamed for it. The growth of indebtedness towards western countries climbed up by 2.5-fold during the first year of the first Imre Nagy's administration and caused more and more grave problems. It was a natural reaction on the part of the Soviet partners that concomitant with the accumulation of debt they were reluctant to satisfy Hungarian demands to a lesser extent – in Soviet relation, practically, we had assets – and Hungarian administration was compelled to cover the imports of important resources on credit and/or to the detriment of the decrease of our gold reserves.

As far as the changes in investments are concerned, it was neglected reluctantly what losses were concomitant with the halting of investments. It happened that an investment ready over 90% was stopped where in the short run the protection of substance and safeguarding cost more than the expenses of completion would have been. Military works had no 'civilian counterparts', thus they could be switched over only with high losses – by the time they began the switchover, they might even stop it since 'hawks' revived again.

The Council of Economic Policy set up in 1954 tried to direct developments to the old tracks. At the same time, more and more experts began to recognize that overall reforms of

economic mechanism would be necessitated because difficulties could not be overcome by ad hoc measures. A committee headed by Zoltán Vass began to elaborate reforms, Közgazdasági Szemle (Economic Review) was published again and economic analysis of scientific standing was renewed in the new atmosphere. The studies of György Péter and János Kornai made a greater number of economic communities think. However, men in the street only were surprised; they were unable to follow the political changes. During a short period of one and a half or two years Imre Nagy was nominated prime minister then became a political nonentity. For the domestic potentates it came just at the right moment that Malenkov was thrown out in Moscow, and by this occasion Imre Nagy was divested at first of his office, then of all his party positions, moreover, his party membership as well.

It occurred what always happens, namely, for the delayed effects the leaders of the period in which these effects present themselves are blamed and it is hushed up cleverly when, actually, the problems emerged and what their causes were. The tensions generated by forced economic growth appeared as if they had been the consequences of measures taken to redress mistakes. According to Rákosi Imre Nagy covered the rise of welfare not through the growth of productivity but he used up reserves, increased the circulation of banknotes and, last but not least, made foreign debts. As if welfare could be 'increased' by a stroke of the pen and to it no production which would induce further import needs and would be accompanied by the outflow of more wages and incomes that is concomitant with the growth of the circulation of banknotes – since there are no bank cards yet – what cards! Not even banks except for OTP and saving cooperatives – were necessitated!

Indebtedness was the question of the hour increasingly, because Hungary's assets towards the Soviet Union turned to be liabilities. By the end of 1955 our indebtedness to capitalist countries made up Ft 2743 billion. For this sum, partly, the unfavourable agreements which derived from our defencelessness and, partly, 'the imports of unnecessary consumer utility goods' – at least, according to András Hegedüs who followed Imre Nagy in the seat of the prime minister – were responsible. Domestic supplies of raw materials and energy were far from continuous; agricultural production was lagging behind expectations and even the latter had to be directed to exports in order that foreign currency could be acquired. Crisis situation emerged in which we had to apply for Soviet assistance. We were applying for Soviet assistance but, at the same time, under top secrecy, the exploitation of Hungarian Uranium and its sale to the Soviet Union on unfavourable price were going on, and in addition, we were required to provide reparations to redress the Yugoslav situation, moreover, to pay compensations for the damages which emerged from economic relations.[6] As if these damages had not been bilateral and they had not been done on the directive of the Soviets!

From the economic and political aspect the population reached the boundary of their tolerance. After the mutual criticism political leaders became discredited and economic situation was miserable. The self-criticism forced by the impact of the party congress and the Rajk revision added fuel to the fire. The solidarity demonstration with the Polish kindled the torch of the fight for us. Half of the claims of the youth were of economic nature that characterizes well the causes of the breakout of the '56 revolution.

World policy entered again in a definite way. The Suez Crisis, which broke out following the days of Hungarian revolution, diverted the world attention 'from the Hungarian affair'. On 29th October Israel attacked Egypt to which the British and the French joined. For the withdrawal from Egypt the Soviet Union expected the others to respect the status-quo of East-Central European power relations – and this was guaranteed by the USA. The

decision determined the fate of Hungarian revolution once for all. It was qualified as 'counter-revolution' and the Soviets looked for a proper person, again, who as an obedient henchman would ensure the proper puffer zone between the Soviet Union and the western world. This person was found in the personality of János Kádár, a so-called 'domestic' communist who was ready to set up a rival government and to call in the Soviet troops 'officially'.

Hungarian revolution was brutally oppressed. The damage caused could be estimated Forint 3 billion. Even after half a century passed, you can find bullet-stricken facades in the side-streets of Pest which preserve the traces of revolutionary battles or rear-guard fighting.

On the second day of the Soviet invasion the government asked for 'friendly help' to normalize the situation. In March 1957 there was an agreement on goods aid worthy of 1000 million roubles and a long-term loan of 750 million roubles with the Soviets what was supplemented by the other CMEA countries, 'depending on their sources'. These loans were spent on social allocations, decisively – the new government tried to purchase social peace. At the same time, the decisions made in the major questions of economic policy resembled ghastly to the text of the 1953 government program. The government set up the Economic Committee and drew forth István Varga, the great bourgeois economist of forint stabilization – he was pushed into the background in the preceding 10 years – and gave him a commission to elaborate an overall conception of economic reform. The government tried to operate a system following a particular route while preserving some positive sides of 'the great socialist experiment', the extension of social care, a freer choice of education and culture and the assurance of a modest life standard with less differences. According to contemporary humour, with the determination of the Forint price of meat the new regime followed the principle that it can be 46, 66 *but it should not be 56!*

However, Imre Nagy dissociated himself from this experiment which added the hundreds of deterrent and punitive death sentences to the blood sacrifice of thousands. He identified himself with the fate of martyrs: he himself became a martyr, too.

Spread of reform thoughts in economy, 1956–1967

After the suppression of the revolution the CMEA supports received made possible the assurance of the minimum level of inner consumption, moreover, the amortization of Hungary's foreign debts of expiry. Consolidation had results rather quickly. (Later, the management of the National Bank of Hungary, frequently, mentioned that *the country was responsible for its international obligations under these extraordinary circumstances, therefore it is just fair that the international financial community should extend foreign exchange credits under favourable conditions.)* During the meeting of 30th December 1956 the Economic Committee agreed to import consumer goods of Forint 600 000 000 and additional imports of US dollars 300–500 000 from capitalist countries with a credit of two-years expiry in the first quarter. At the same time, they decided to stop some investments and the cancellation of adjacent orders since 'the country's debts to capitalist countries had to be consolidated. Of course, the implementation of the plans of 1956 was lagging far behind the original targets. In all the branches – mining, chemical industry and machinery industry – where there were strikes – the lagging behind was 15–20% but the average one was over 13%.[7] This is why 'the socialist aid' was so important. The Economic Committee worked out the proposals to the program of economic policy of the government. The guar-

antee for involving the 1954 reform ideas into the program was that the secretary of the Economic Committee was one of the editors of Közgazdasági Szemle (Economic Review) of that time, i.e. István Antos, Deputy-Minister of Financial Affairs who was a respected expert later, too. Beside communists members of the Committee were former social democrats and members of the Small-Holders' Party as well as independent specialists. According to the structure of the membership the adherents of radical reform were in majority. Pushing aside his personal grievances István Varga popularized the reform ideas both at home and abroad with special efforts, practically, undertaking by this the legitimization of the system as well, however, the refusal of the bulk of his proposals and the revenges continued even in the early 1960s weighed heavy on his mind and he died in 1962.

Even in December 1956 the directives of the Central Committee emphasized that the methods of the past, the mechanical copying of Soviet examples had to be abandoned and domestic conditions should be adjusted to. The major principles were formulated like this:

– In all respects the economic conditions and specialties of the country had to be relied on.

– Individual initiatives and the utilization of expertise should be assisted to the greatest extent.

Great attention should be directed to financial stimulation in all fields for technological development, the improvement of quality, the reduction of production costs and the increase of the productivity of labour. The scope of planning, which continues to be of significance, should be changed and it should be focused on the specification of the most important ratios and development trends of people's economy. Not endangering the building of socialism wider possibilities should be guaranteed to the progress of private sector.[8]

Although political leaders shrank back from the introduction of the radical reform conception, they accepted some measures directing to rationality such as the decrease of the plan indices determined by the government, a not so strict manpower management, breaking away from the volume-centric expectations of plan fulfilment and the introduction of the profit-sharing system in wages.

From 1st January 1959 new production prices were introduced. In its report jointly prepared by the National Office of Prices and the Department of State Economy of the Central Committee of Hungarian Socialist Workers' Party justified that as follows: *'In our economic life the change of prices of industrial production is urged by several groups."*[9]. This rationalized the 1951 measure somewhat. It eliminated the price of donation of domestic basic materials. The new price reflected the actual production costs with reference to the fact that wage rises in 1957 and the cancellation of the prices of compulsory delivery created 'a new situation.'[10]

The essence of the change was that the support of materials produced domestically was ceased and they were brought to the level of real production costs. Consequently, the prices of industrial raw materials jumped to 2 and 3-fold. Although the system of fixed prices remained the same, the production and consumer prices were separated from each other but the unprecedented energy and material wastes experienced that far were lessened. As far as agriculture is concerned, the reform-wing led by Lajos Fehér represented, actually, Imre Nagy's principles of agrarian policy, of course, without reference to him. Theses of agrarian policy published in summer 1957 also were a success. The restoration of the unpopular produce delivery system that had been swept away by the revolution and the restoration of compulsory sowing plans did not take place later either. This put the relationship between the state and peasantry on market basis. Since sales were not compulsory, prices closer to market had to be paid for agricultural produce. The prices of wheat, rye and sugar beat crept

up 1.5-fold nearly over a year. But production in private farms could not survive for long time. The next year, on Soviet pressure, the forcing of collectivization started again. This time, the authorities were ruthless. With aggressive propaganda they used all means to compel Hungarian peasantry to enter the kolkhoz, i.e. the collective farm system.

The organization of the collective farm system, which proved to be lasting this time, disrupted agriculture that recovered relatively quickly after 1956. Since neither machines nor management experiences was at disposal to the proper extent and the new system of interestedness unfolded only gradually, the first results were miserable. Between 1960 and 1962 Hungary was in need of imports of cereals and corn since the net agricultural production dropped by 10% in the years of collectivization.

On the meeting of 13th September 1960 the Political Committee treated the problems of supply; the title of the topic was *Presentation of the problems of the population's food supply in the period of the Second Five-Year Plan.* Party leadership was worried not only about the poor crop results but the fact that the migration of the rural population to more developed settlements accelerated. In the first half of the 1960s 250 000 farmers chose to take this route, annually. In 1963 there were problems even in the country's cereal supply. Only by the mid-1960s autarky was redressed again when the average crop of wheat exceeded 20 q/ha. (Between 1961 and 1965 the yield was an average of 18.9 q/ha in 1938.[11])

Year	Number of cooperatives	Number of members (thousands)	Area (thousand ha)
1956	2089	119	597
1957	3394	156	820
1958	3507	169	958
1959	4489	565	2620
1960	4576	960	3941
1961	4681	1221	4539

Source: op.cit. Fazekas, B. and Csizmadia, E.

However, the reform wing rescued something from the former principles. They established such a new cooperative type that differed from the Soviet model remarkably. It represented a transition between a cooperative and private farming. One of its important elements was that share-farming was introduced and, jointly, the payment system based on work-unit was altered. A family or a group of people (brigade) 'leased' plots of land for the cultivation of which they were given not only work-units but a significant portion of surplus produce, too. This was of special importance until the mechanization of agrarian sector was realized due to investments in collective cultivation. The monthly payment – or advance payment for produce – through which the money-spending of peasantry turned to be more even, became general. However, the introduction of household farming was the most important element. If the work-unit determined was met, every member of a cooperative was entitled to cultivate the size of about one cadastral acre. Keeping of livestock by families was permitted again and, thus, shortage of food eased gradually. From the mid-1960s supply was abundant; moreover, agriculture could become one of the greatest exporters of the country. The bulk of the meat exports of agriculture – primarily, that of pork – was produced by household farms but that was sold through the cooperative under a contract system. This solution was good for everybody. It meant an income planned by

the family, sales results for the cooperative, foreign currency revenue for the country and it was not of less importance that common farming spared investment expenses since the technological requirements concomitant with keeping livestock on a large scale would have necessitated great capital investments for which the ability of accumulation of the newly established communities would not have been satisfactory. Perhaps, it cannot be an exaggeration if we state: *the success of the Kádár regime depended on the cooperation of collectives and household farming to a great extent* since they were able to grow goods production while they did not crashed into ideology spectacularly. It is enough to refer to the fact that in Poland where private farms existed till the change of regime, the serious problems of supply were not overcome. The basis of Hungarian success was that ideology could be harmonized with practice. In the early 1960s the still unquestionable socialist ownership relations did not allow for private farms to get considerable state support. However, Hungarian solution made possible for a cooperative to fulfil the function – by the support of the regime – that was performed by the Raiffeisen-type of cooperatives in market economy. Meeting the need for fodder or perhaps, providing the service of the vet for household farming as well as finding the channels of sales, esp. those of exports were the responsibilities of the cooperative. But the form of cooperative ownership could already be supported that time. Naturally, here, too, 'school figure' had to be done beside free exercises…, i.e. great achievement could be attained by the peasantry only through their own exploitation. Beside the work done in the collective they performed the tasks necessary in the household farms, and thus, it is no wonder that 'their shift' lasted from dawn to sunset.

The dogmatic forces strengthened in the years after 1958. That could be seen not only in collectivization but in other fields of economy as well. Although the greatest role of efficiency against the quantitative approach was acknowledged; but they did not want to expose the growth of efficiency to spontaneous forces. The organizational form of big enterprises as a method of the growth of efficiency was regarded expedient. This led to the organization of trusts in the early 1960s and the prolonged existence of the structure of big enterprises. With the establishment of large economic units, i.e. big companies the work of planning became simpler since data had to be collected from fewer units.

This step was pushed greatly by the international economic environment. In the 9th session of CMEA it was decided that the plans until 1965 of the member countries would be elaborated by the late 1958 and sent to the Standing Committees, which had to make their proposals in the first quarter of 1959. That time the mechanism of international cooperation that determined the foreign trade framework of the development of CMEA countries almost for half a decade was formulated. The practice followed later always was like that: in the mid-period of the Five-Year Plan the Central Planning Bureau submitted its own proposals for exports and imports; to these, of course, the necessary developments were also added. The partners harmonized, bilaterally and item by item, the long-run foreign trade agreements which would be concluded by the Ministries of Foreign Affairs of individual countries. These agreements were specified by the annual trade records, still on the ministerial level. Actually, foreign trade was based on interstate barter agreements where everything was fixed in kind. Intercompany contracts could be concluded only on the basis of these agreements. Prices were made relying on the average world market prices of the preceding five-year plan period according to the Bucharest principle, converted into rouble, then into transferrable rouble from 1964.

The proposals for specialization were made in the Standing Committees. It need not be mentioned that the conductor's baton was in the hand of Moscow, too. The system of inter-

national cooperation in the 1960s paid attention not only to technological aspects but sought to achieve some kind of efficiency on a regional scale. However, it wanted to attain that by voluntarism methods, similarly to those with which the individual countries tried to form the structure of their domestic economies in the 1950s. The autarky of the level of national economy was replaced by that of CMEA level *(by the way, without success)*. Some economies, just like Hungary's, too, became more open in processing industry due to specialization. We had been dependent on import markets in raw materials and energy deliveries that far; from that time on, we lay open at the mercy of export markets! Companies making deliveries for a large market became dependent on their consumers. Where else would 13 000 buses have been sold as in the Soviet Union? With this specification not the companies with large series got monopolistic advantages but importers got into a *monophonic* state. Not the sellers but the consumers became the ones who set the prices. Immense cleverness was needed that under such conditions Hungarian companies would achieve favourable prices with their Soviet partners since the enterprises interested knew that they were the only purchasers. However, owing to the more intensive interestedness of Hungarian companies this could sometimes be successful. Otherwise, with specialization the advantages which originated from concentrated production were required to 'be spread' at CMEA level. Due to the Moscow control centre Hungary was deprived of radio manufacturing which had had several decades' tradition in Orion. The reason was that Bulgarian industry, too, had to assure a 'pulling product'.

Also, the strengthening of economic awareness at CMEA level appeared in the fact that there was an attempt to establish somewhat like an 'own price basis' that would rely on the phenomena of socialist world market. However, that did not take place but numerous economic analyses directed attention to the problems of the financial system. After a decade's delay the system of multilateral settlements was intended to be applied to socialist conditions and seeing how well it functioned in the European Payment Union, the Bank of Economic Cooperation and its currency, the transferable rouble was set up. From this time, the banks authorized, among them the NBH as well, did their settlements through this centre which became multilateral formally. But nothing did change in the practice of bilateral foreign trade agreements, so failed the efforts to decide real exchange rates. It became obvious that starting from foreign trade and without the alteration of inner mechanisms no more efficient cooperation might be established among the CMEA countries (*Aush S., 1969*).

This fact also stimulated domestic reform programs. We seemed to work on ideas parallel to other countries since the Polish Oskar Lange was one of the prominent representatives of market socialism and the reforms proposed by the Czech Ota Sík were very close to the conceptions of Hungarian reformers.

Rezső Nyers, who led the Department of Economic Policy of the Hungarian Socialist Workers' Party, submitted the dusted reform plan based on Varga's proposal that was accepted by the Central Committee in 1966 and introduced in 1968 in spite of the fact that external conditions were less favourable for Hungary. Khrushchev who was considered a supporter of Kádár got out of power in 1964 and was replaced by the anti-reformist and conservative communist Leonid Brezhnev. *From the mid-1960s in the socialist countries the initiatives similar to the Hungarian ones were halted practically.* And in Czechoslovakia 'the socialism of human face' was suppressed by the rumbling of tanks. By Soviet orders even those who – like Poland and Hungary had the same experiments – participated in the military operation. Czechoslovakia sank into the state it had in the previous decade and this influenced Hungarian development very negatively. Hungary was left alone with

its economic reform plans. However, in this situation it was not conformism that determined the policy of Kádár decisively but it was the political experiences between 1953 and 1956 that exerted impacts. Political leaders thought that spectacular cancellation of the programs proclaimed and the zigzags unknown by the population would be more disadvantageous than the softening of the decisions already made and their precautious revision.[12]

Thus, the reform was launched and resulted in essential changes in three fields:

1. Reduction of central planning and the growth of companies' independence;
2. The change of the price system, including the reform of consumer prices, and
3. The modification of wage and income regulation.

The new economic mechanism changed the functions of supervision.[13] While earlier the most important part of supervision was *to comply with the great many rules and directives meticulously,* now the supervision of the essence of the company's economic activities were put in the forefront. It was scrutinized whether the company worked 'in harmony *with the interests of the people's economy* in compliance with *'the expected optimum'* or not.[14]

The reform took into consideration that our country had an open economy and decided to introduce more realistic exchange rates, – in foreign economic relations – naturally, only for companies and not for private persons. For the latter convertible foreign currency was accessible under strict limitations. But in the case of socialist currencies there was a special multilateral agreement on the course of exchange.

The alteration of Hungarian exchange rate policy was a remarkable achievement because it was a spectacular denial of the Soviet statement that rouble was a currency stronger than dollar. The official exchange rate in gold parity showed 1:0.9 in favour of rouble but the Hungarian exchange rates were based on the so called foreign currency 'production'. Based on the comparison of concrete prices it became obvious soon that 'the production of one dollar needed forints 1.5 times more than that of one rouble; and the cross rate was 1:1.5 in favour of dollar. For this unpleasant comparison Hungarian politicians were often blamed in CMEA, stating that we attained too good prices for our exports in the Soviet and socialist markets. And this reproach was somewhat true. Although the sad fact was that we were able to sell our goods at highly unfavourable prices in capitalist markets. The structure of our exports differed greatly in these two relations: while in convertible markets we were competitive, mainly, with our agricultural produce of low price in the world market, in the CMEA barters significant products of processing industry, too, were exchanged.

The Forint based foreign trade regulation was a very important element of company independence. Since in an open economy economical production could be done only through the assessment of the possibilities of foreign trade, the reform introduced the principle: he who had forints shall have foreign currency as well – at least, to the current production. (At the same 'price' there was an access to foreign exchange for investments but greater development programs had to be included in the plans of people's economy previously.) This fact had very serious consequences in the years to come. What was not treated either by economic literature or economic history properly was the fact that one of the main causes of the high indebtedness in foreign exchange of Hungary was the afore-running factor (*Botos, K., 1989*) since companies at all levels, i.e. those of management, workers and employees, were interested in higher and higher profits in forint and, thus, in the acquirement of export markets – as it is entirely normal under the conditions of market economy. But for the acquirement of markets socialist trade provided opportunities since the economy of shortage/planned economy was always able to absorb supplies of relatively good

quality. So Hungarian turnover showed permanent surplus in CMEA relation and the trade balance to capitalist relation continued to be passive. The comparatively good quality in the CMEA market was assured by the content of capitalist imports built in the products. This was called 'the hardening' of products. Since in relation of foreign exchange there was no room for market mechanism, it was not revealed that dollar cost more and more than the originally calculated figure while with prices in roubles the Hungarian companies concerned tried to pursue negotiations skilfully. And when following the oil price explosion our terms of trade in socialist relation began to deteriorate, dramatically, the companies thought that this would open up new prospects for the growth of their exports. In the lack of foreign exchange market the regulating mechanism of active and passive positions were absent, the microsphere did not experience the problems of macro economy. *Reform was merely a semi-reform.*

In the first years of the introduction of the new economic mechanism because of many opponents great care had to be taken not to interfere with the partners' interests in order that it could not be claimed that the reform would have an unfavourable impact on international relations or would induce consequences adverse to socialist principles. Therefore, wage regulation had to exert a stimulating impact and guarantee full employment, at the same time. This was served by the regulation of average wage which provided opportunity for a wage-system commeasurable with performance but it counterbalanced higher wages by the employment of the so-called 'padding people'. However, the institutionalization of unemployment inside the gate had a destructive effect, indeed. At the same time, the principle stating that building of socialism should be concomitant with the improvement of the living standard of the population prevailed. The rise of living standard was regular but uneven.

Denomination	**Sales calculated**	**Stock (pieces/1000 families)**	
		1965	**1970**
Car	70–72	3.1	5.5
TV set	1000	26	50
Radio	1100–1200	78	109
Refrigerator	800	8	30
Vacuum-cleaner	550	14	30
Washing-machine	850	37	54

Source: MOL 288. f. 5/394. pp. 265.

The system of prices was mixed. Fixed prices were liberated only slowly. The prices of basic commodities making up 20% of turnover remained strictly fixed while articles of fashion, import products and leather goods were ranked into the category of free market price. The price system became more flexible and this guaranteed market conditions, at a minimum level, within 'the centrally-planned economy modified'.[15]

Forces hostile to reform launched a domestic attack against the existent economic policy, esp. when the neo-Stalinist Soviet line criticized, heavily, the party management in 1972. Reform cadres were put out of the way and several elements of the old mechanism, e.g. giving direct order to a company, were brought back. Since Hungarian party leadership experienced the positive effects of the reform, and first and foremost, the social peace established, it did not want to return to old methods; it required preserve the company's interestedness. However, the ill-assorted solution applied was very harmful because in

compliance with the spirit of reform the principle according to which orders could be given but damage should not be done to the company was expounded. He who gave orders had to pay for the loss of income. This approach attractive at first sight turned to be vice versa soon, namely: *if I allocate the necessary money, I may give orders to do anything. And I did not need to expect a reluctant implementation.* This system was called an indirectly direct control by Hungarian economic literature (*Antal L., 1983*). And on the top of this, a dramatic change occurred in the world economy: the currency system of Bretton-Woods was shaken and the energy prices exploded. This meant to be a caesura in the development of Hungarian economy.

Janus-faced decades, 1968–1986

For a long time, the coming into power of conservative forces in the Soviet Union ended the experimentations which questioned the political system and ideology and would have opened towards democratic market relations.

In 1969 when the Hungarian economist, Sándor Ausch published his book entitled 'The state, mechanism and perspectives of CMEA cooperation' in English and Russian, just efforts of reverse trend began to unfold in the organization. The book itself aroused extraordinarily fierce debates – the author disappeared both from the international and the domestic public lives soon. His personal fate was wrapped in mystery, even the university assistant to him – the author of this study – did not know what had happened to him. She knew only the fact that she had to take over his lectures on the CMEA financial system at the university.

The political leadership of CMEA arrived at the decision that the principle of two systems and two world markets would be supplemented by the concept of the so-called two integrations, i.e. a decision was made on the launching of the so-called Complex Programs of CMEA, i.e. the further development of CMEA cooperation. This wanted to enhance the role of the common currency; to establish multinational joint ventures and to finance the developments of mutual interest through setting up a financial institution similar to the European Investment Bank.

It need not be mentioned that integration did not achieved any results at all, practically, but it started a great number of additional actions. It turned out, what was obvious, of course, for experts, that without real prices and exchange rates settlements would not be carried out among countries and, interestedness in individual joint ventures might not be attained.

On its deformed way only one thing was realized from these plans. In 1971 the International Investment Bank was established. Copying the statutes of western development institutions this one extended credits in transferable rouble and dollar for projects, which could be consider of common interest. The necessary convertible currency was acquired in international financial markets and the establishment of energy pipes happened to be of common interest 'by chance' but the credits taken by the bank were the burden of the individual participant countries by country risk and in proportion to their ownership…

The Soviet partner announced that, owing to the problems of energy supply and the capital intensiveness of investments, it could meet the energy needs of individual countries only if they participated in the investment costs of the large network of piping. For the Soviet partner investment contributions meant to be the extension of long-term credits on

favourable terms that would be amortized by gas delivery. Partners had to take part not only in financing but in concrete implementation, too. The details were highly unfavourable for the participants. Irrational organization, clumsy conversion of currency and controversial settlements made the venture one of the greatest economic burdens of the age.

Specialists urged other solutions in vain but the Soviets remained adamant. For example, the credit of 1 billion US dollars extended to the Hungarians could have been used more expediently for investments that, remaining in Hungarian ownership, would have been able to produce commodity stocks for exports. Then for the foreign exchange attained energy purchases could have been made in cash.

However, the price explosion in the world market the extraordinary rise of the prices of energy and raw materials that upset the terms of trade of former turnover left its mark on the epoch. The prices increased in the world market made Soviet leadership to abandon the former practice of price calculation accepted at the 9th Session of CMEA.

Thus, the practice of sliding price basis was introduced and from 1974 price negotiations had to be repeated annually, i.e. instead of fix prices set on the average of previous five years a year or so was exchanged in the basis and the average gained became the valid price. *(This contradicts the opinions of several historians who state that this was the time of the switchover to the calculation of prices recurring every five years from the fix prices.)*[16]

The prices of the products in processing industry could be raised considerably more slowly. This time the Soviet negotiating parties became just harder- and harder-heartened and the price documents approved previously with which the Hungarian party intended to support increases were handled more critically, although as far as the western trade was concerned, the companies of the FRG which were our major deliverers in our own technological imports counterbalanced the growth of energy costs incurred by the rise of their export prices without any hesitation. However, it was more and more difficult to prove that Hungarian products were equivalent to genuine western equipment.

Here we had to analyze the altered conditions of CMEA market in depth to reveal what challenge Hungarian leaders had to face. On the one hand, they were forbidden to follow the tracks of reform and, on the other hand, their possibilities in external markets deteriorated to a great extent.

In the early 1970s there was a favourable situation only in one field and that was international credit market. The freshly enriched Arab oil exporters put their dollar claims into the international banking systems and that led to the emergence of a market of abundant supply in the international credit markets. Thus, it was easy to get money what had one, moreover, two drawbacks. On the one hand, foreign exchange ought to have been repaid in foreign exchange, on the other hand, the availability of sources made easier for voluntarist politicians to continue their proposals to meet Soviet claims and satisfy their own ideological pipe-dreams.

Hungarian financial management would have wished to acquire IMF-membership parallel to reform efforts. This seemed to guarantee that by making the currency convertible, the rational management of an open economy would be rendered possible, and in addition, there would be possibilities to raise loans for the abridgement of transitional difficulties. The proposal had come up several times over the 1970s, esp. because the growth of indebtedness became more and more threatening but the conservative Soviet administration averted it regularly. The stock of debts of Hungary was 0.8 billion US dollars that jumped to 3.1 billion US dollars by 1975, then it grew 10-fold by 1980 making up 9.1 billion US dollars.[17]

Therefore, on the recommendation of NBH the solution which seemed to be the most economic one was attempted at. Bonds were issued in international capital markets. The

precondition of this was to meet the country's pre-war debts at fragmentary value and the preparation of a detailed report on the economic state of the country. In 1973, too, Hungarian state bonds were purchased by investors successfully, and that was a clear proof for foreign confidence in Hungarian economy what served as a strengthening of the reform. It is a fact that Hungary was the only CMEA member country accepted by the conservative market. At the same time, the external equilibrium deteriorated owing to the growing unfavourable terms of trade and the rigidity of Soviet policy hampered progress in the field of reform.

The only possibility left was to march forward and to attempt to modernize the economic structure in the framework of planned economy. Besides the earlier development which gave preference to heavy industry some progress in the neglected transport and service infrastructure took place in the 1960s. The share of these sectors in total investments declined half in the 1950s but in the 1970s and 1980s it reached 50% of the pre-war figure.[18] This was almost vital because the development of the long cycles of economy and their growth potential are interrelated with the establishment and spread of wiring and pipes.[19]

Although it contributed to the lessening of former shortages, the development of chemical industry and light industry was not successful enough, partly, due to increasing prices of basic materials and the considerable need for capitalist manufacturing investment since this group of products was far from so good a quality that a mass export offensive could have been based on it. As far as chemical industry is concerned, there were several parallel developments in the CMEA countries and, thus, they made cheaper offers to each other in the market. Only agriculture turned to be a strategic sector. In large agricultural concerns, cooperatives and state farms industrial methods were introduced. The sector stood on meeting Soviet needs and beside this its exports had a significant share in those to capitalist countries. The Soviet partner seemed to regard agrarian produce of vital importance as hard goods for long, and indeed, in the 1980s we traded in close barter businesses in this field; we got oil for meat and cereals.

In the 1970s political leadership struggled with the fact that the acceleration of product growth needed the increase of investments but that would take away the sources of raising the living standard, although for the attainment of social support promises to the growth of living standard, that ought to be kept back somewhat, were announced.

Even if not so roughly as in the 1950s the policy of 'push and pull' was continued till the last days of the socialist system. By 1977 it was formulated once for all that an export-oriented economic policy had to be pursued. However, real changes in economic policy did not occur. It was, simply, due to the fact that indebtedness grew so rapidly that by 1979 *'the debt trap snapped', i.e. even interests had to be financed by newer credits.*[20] Although credit market was still liquid, *the export/debt service indicator* showed such a risk that presuming even the 'Soviet umbrella', our borrowing possibilities narrowed down. However, modernization required technological imports and foreign exchange.

When Regan became president, the USA switched over to a neoliberal policy, which meant to cancel interest limits. A wave of interest rise swept over the whole world (*Botos, K., 1987.*)

Who was in debt position faced a rapid jump of debt service because of the credits of crawling interest and the new conditions of renewed loans. Thus, Hungary was forced to repay far more than the actual credits granted. And although Moscow did not support our country to join international financial institutions, it was unable to assist us with our problem of dollar shortage.

From the NBH report the gravity of the debt situation became obvious for political leaders.[21] Two/thirds of credits extended between 1976 and 1979 covered the deficit of the current balance of payments and one-third served for repayment. The exportability of economy was lagging far behind the pace of the growth of debts, and in 1978 debt service consumed the total increment of the annual national income. Half of the debt stock was short-term, and the reserves of convertible foreign exchange would have been enough only for the payment of three weeks' imports when international financial world bound credibility to the financiability of six months' imports with sovereign debtors. During the consultation on this topic in Moscow Hungarian party leaders were blamed for *the allegedly too high living standard in Hungary* and opposed Hungary's joining to IMF. But the Hungarian party leaders refused the considerable reduction of living standard that would have been hardly enough to the radical solution of the problem. On the one hand, they regarded the domestic stability of the political system as their main assets that differentiated Hungary from the other socialist countries abroad, too, and in such sense credibility was one of their important standpoints. On the other hand, the basis of *'the tacit social contract'* was the inviolability of the results achieved. There was no other way to follow but the slowing down of growth and the reduction of investments. By all means, the permanent increase of living standard was struck off from the agenda. János Kádár, whose position in the party became somewhat stronger, expelled his conservative rivals out of power, Zoltán Komócsin, one of the strongest leftist rival already died in 1974, and Kádár listened to those who thought that problems could be solved by the further development of reform the elements of which were as follows: further flexibility in the stimulation of agriculture; a radical reform in the price system; the introduction of the principle of the so-called price basis of the world market and the great liberalization of the prices of consumer goods. But the financial situation continued to deteriorate: foreign exchange reserves were enough only for 15 days.

In 1981 Hungary submitted its application for membership to the International Monetary Fund (IMF), and the NBH experts managing the situation from day to day sought to prolong the time as long as the IMF co-opted Hungary as a member the next spring. Yet, it took time to get the usual stand-by credits. Throwing his authority into the scale Kádár went to Germany to ask for credit from the German government and in summer, BIS and the expensive consortium credits of American banks helped to go through the months heavy with the suspicion of insolvency.

Here a serious – and according to the author – a tragic mistake of economic policy the consequences of which are very important from the aspect of Hungarian indebtedness should be mentioned. As has been pointed out, regulation in the field of foreign exchange was only fragmentary. When the impacts of the price explosion of world market began to reach our country and, significant price increases had to be taken into consideration, a part of the Hungarian economic and financial specialists were ready to meet the expectations of the politicians that *'through the use of regulatory system inflation should be stopped at our frontiers'*. When dollar was devalued, the financial management *re-valued forint automatically* against dollar and posted up the rates of foreign exchange market to its own subscriptions. Naturally, this exerted an influence on the average level, too. However, from 1976 the so-called active exchange rate policy that relied on the difference between domestic and external price changes was introduced. From 1968 to 1979 Hungarian forint was revalued by 24% as compared to convertible currencies. Until 1975 the exchange rate of transferable rouble was untouched but the change of socialist prices stimulated throwing in the exchange rate as a panacea urgently; in 1976 there was a revaluation in rouble relation,

too, decreasing the exchange rate by 12.5%. Thus, the automatic inflow of price effects slowed down, although it was continued to achieve that the profitability level of exports between the two relations should prefer capitalist ones. This step affected the balance of payments unfavourably since the exchange rate was realized both in exports and imports.

The former 150% difference shrank to 136% in the cross rate of dollar and rouble, and in the case of similar products it was unambiguous where domestic interestedness swing, therefore the socialist obligation of exports grew more and more burdensome and, among others, this led to the emergence of special close constructions later. But it was also a problem that capitalist imports became relatively cheaper – at least, as if the exchange rate had remained unchanged or, perhaps, it had been devalued. Thus, administrative devices had an increasing role and these could be used, primarily, in compliance with the reform in territories where there were no current imports. Naturally, when financial difficulties appeared, all devices were used; however, import pumping was not limited by the exchange rate. The only positive impact of revaluation was the stimulation for the improvement of the formulation of the prices of the foreign exchange of exports what could be assessed somewhat in the change of prices. (*Botos J., 1982*.) However, the principle of smaller resistance led to the growth of demand on export-stimulating constructions as the export receipts calculated by exchange rate was relatively modest and the company lobby did a favour to the government that it 'assisted in the mitigation of the capitalist export problems'. Proclaimed packages for export stimulation were only a form to improve the income state of the circle of large companies since it could be proven that the advantages were granted to big enterprises. It may be quoted as an absurd effect that the endeavour to attain the export objectives at any means grew imports since participants would have liked to protect themselves from the problems of subcontractors. From both the aspect of quality and contractual discipline imports were securer than a domestic or – Heaven forbid – a CMEA deliverer. It was a general problem that in the lack of interestedness the actual impacts of external trade and market did not reach to economic units and many important phenomena remained the trouble of the state. It was already formulated that time that, at least, the right of external trade ought to be granted to producing firms to get nearer to external markets.

It can be seen that the general political thinking was unable to get rid of the notion that *the system of regulation is only a device* which can be used to achieve aims this or that way by those who are responsible for policy. The concept that opened gates wide to voluntarism led to the situation that the 1970s would be those of marking time and dug the debt trap from which the Hungarian society was unable to get out even after the change of regime.

Effects of the strait-jacket

Within one week after the submission of the Hungarian application for IMF membership the Polish party, too, announced his similar request. Polish domestic policy was already in a state of commotion; the movement of Solidarity became a force and changes to break political framework were in the air. In December 1981 orthodoxy demonstrated its power again: it forced out emergency measures, i.e. military rule in Poland.

Indeed, fluctuations of world policy provided very interesting, or rather, contrasting framework for the democratization of Central-Eastern Europe. When Hungarian reform was started, it was surrounded by the detente of the two world powers. The emergence of Helsinki Treaty to put on the brakes to arms race was considered as a success by the Soviets

– and it was just that what strengthened the position of conservative forces and made the reform halt. Although the 'third basket', the declaration of human rights made some space for freer thinking, the dissidents in Hungary had existential difficulties soon.

When by the time of the second oil explosion, the countries struggling with the burden of accumulated debts – esp. Hungary and Poland – wanted to start more radical reforms, the Soviet–American diplomatic relation cooled down. The 'Empire of the Evil' as Reagan depicted the Soviet Union accepted the challenge, indeed, and wanted to demonstrate power in Afghanistan – of course, not independently of economic interests. True enough, the action proved to be a suicidal adventure but it was not a favourable atmosphere for the beginning of the second decade of Hungarian reform at all. As has been mentioned previously when the representative of the Soviet Union that suffered from the change of secretary-generals of gerontocracy visited Hungary gave political leaders the list of 'personae non gratae' whose ideas were considered antisocialist.

However, IMF membership could not be annulled. It came in very handy for political leaders to refer to international financial organizations when unpopular measures had to be taken. In Hungarian society there had not been such an unpleasant picture on this institution at all as in many developing countries that time, and the one which had emerged in Hungary, too, by the turn of the millennium. It is not easy to hate everybody at the same time! American mode of life and, generally, the institutions of the western world meant to be symbols of freedom, so society swallowed down the fact that authorities hid themselves with those. Eventually, the restrictive measures proposed by IMF were not so alien to the population. And leaders put on *the strait-jacket* voluntarily, i.e. adjusted – had to adjust – themselves to the requirements of IMF.

Although the international financial institutions appreciated the results and furtherance of Hungarian reforms (the price reform, the introduction of the uniform forint/dollar exchange rate etc.), they insisted upon taking spectacular measures for the improvement of the equilibrium by all means. And there was no other rapid solution of this but slowing down. The pace of *economic growth* declined to 1.7%. *Investments were curbed considerably;* between 1981 and 1985 they decreased by 3.3% annually. At the same time, the sectorial distribution of investments indicated the characteristics of a doctrinaire trend.

Distribution of financial realization of investments (based on current prices, %)

Sectors	1981–1985
Sectors of raw materials	17.9
Processing industry	16.3
Construction	1.5
Food industry	16.6
Infrastructure	47.7

Source: Major processes of people's economy, 1979–1987. KSH Kiadványok, 1988. p. 34.

Supplies also decreased radically: by 21.4% annually over the same period. The data illustrate the fact well: indeed, *'the attics were swept clear'* in order that economic miracle, i.e. the emergence of export surplus could be achieved. The pace of the growth of exports declined (4.2%) as compared to the previous five-year plan period though – since the whole of the economy slowed down as well – that of the increase of imports (1.7%) was lagging behind the previous figures at a greater extent. (*Antalóczy K. – Botos K., 1990.*)

At the same time, several reform measures were continued to be introduced. The Central Committee approved the program of controlled market economy, based on mixed ownership in 1984. In 1980–1981 large companies of monopolistic state formerly were decentralized, external trade was liberalized, and the establishment of joint ventures with western capital was given an impetus and the manpower market was also liberalized. What became the most characteristic reform step of the 1980s was the legalized development of *the second economy.* Similarly to the appearance of the household farms in the 1960s, which cooperated with collectives, the profit-oriented economic working communities (the so-called 'gmk') and/or entrepreneurial working teams appeared and operated in the 1980s.

Since private capital was partly absent and, partly, it was a highly delicate question ideologically, here, too, the solution was that devices were provided, basically, by the state sector. The only thing 'that the undertaking communities had to do was to organize themselves and to perform the obligatory tasks in a self-exploiting way. Hungarian special literature has been concerned with the negative sides of the latter: with the employees who had their rest over official working hours and with the fact what consequences society had concomitant with the endless working hours. (Actually, the harmful effect of this can be seen in the mortality rate of male population by the turn of the millennium in which we rank first by world statistics.) Yet, the society regards it as a positive phenomenon that in the period of economic restrictions there were opportunities to increase personal incomes and the maintenance of the level of consumption. The entrepreneurial form of leasing ('gebin') became also spread where it depended only on the skills of the entrepreneur how much he was able to get from 'the tart of incomes'.

National Bank of Hungary in the two-tier banking system, 1987–1991

Although by the late 1980s the restriction determination of the power had already been moderated, and 'the reins had been loosened' again, it did not solve the crisis of the regime, just increased the problems of the balance of payments. Fortunately, the technocratic management saw this and did not give up the furtherance of reform steps. The 're-tailoring' of the financial system and its adjustment to market relations were started. In 1981 the first proposal on the introduction of bonds for financial investment was elaborated in the Research Institute of Finance, and then it was put under test, with local governments and councils. These were the so-called communal bonds – until that time by the concept of investment only real investments were meant. On the initiative of international institutions and with the active participation of the staff of the Research Institute of Finance the elaboration of the switchover to the two-tier banking system and a more modern tax system was launched. Reforms were not halted at all by the fact that *policy dissolved the Institute,* stating that certain representatives of the Institute urged the realization of political reforms which affected the basic problems of socialism, although it signalled that nothing had been decided yet. As in the party management reform forces were in majority, and in compliance with the principle 'preserving while terminating' the staff members necessary to carry on work were taken over to the apparatus where they could be easily disciplined and a great part of the intellectuals of the Research Institute of Finance as technocrats continued to work on the changes of great importance. There were some who landed in scientific institutions but there; too, the preparation of changes was under progress with full speed. E.g. in the Research Institute of Agricultural Economy the question of land that generated so

many debates was dealt with. Topics regarded taboos were discussed, namely: the great problems of cooperative farming, the environmental impacts and the issues of the competitiveness of private farms. And although the agrarian territory provided some shelter to the dissidents, this might not go on without the silent approval of the supreme organs. This demonstrated the hypocrisy of the system, i.e. the machinations with which the actual political changes were prepared under the veil of technocratic measures. At the same time, it showed on what international financial institutions and the influential forces behind them laid emphasis, i.e. *on the development of financial affairs.*

On 1st January, 1987 the two-tier banking system and on 1st January 1988 the tax reform that already resembled the West-European system came into force. What did not change essentially was the handling of the question of foreign exchange and/or the problem of debt management. It could be seen that restriction was only a symptomatic treatment. The solution would be the strengthening of capitalist-oriented exports. But this would not go on merely through restrictions. By the last third of the second decade of the reform production already consumed every import reserves and the foreign debt continued to grow. The budget turned 'to be red'. *For us even good was bad!* In the world market oil prices began to fall and so did the taxes of the budget, however, the demand on support remained. The forced surplus melted. Not only the capitalist exports but the whole of the turnover in relation to rouble became supported as the consequence of the balance of skimming and subsidies. Against the proclaimed development of the fields producing for convertible trade just a reverse effect could be experienced: Hungarian economy relied increasingly and more and more desperately on CMEA market. The company interestedness operated but, as the system of company covenants also remained, for the companies' not economic production but getting into the contingent became their interests – the rest was the trouble of the centre. Not market bargain but *regulatory bargain* prevailed in economy. Why would a Hungarian company orientate to other direction when socialist export was still the most favourable possibility for sales which could be supported by the investigations of profitability in different relations. (*Antalóczy K. – Botos K., 1990.)*

It can be stated that the Hungarian reform which was not pushed through the reform of ownership did not slacken or, from the aspect of power, did not jeopardize the CMEA ties to the slightest extent. We strengthened our intertwining with the region, based on the interests of our companies voluntarily and not for orders; what loosened this was the constraint of debt service.

It was mentioned more frequently that money lender's capital was not a solution. We would need the import of productive capital! All the arguments which were in favour of this form of capital inflow went on like this: 'This is an enduring capital injection; it need not be repaid, moreover, it brings technology and, probably, markets with itself.' Obviously, on the impact of this the so-called Bill on companies with mixed ownership which referred to the investments of foreigners into Hungary was enacted in December 1988 although there were opinions in which reforms would be jeopardized if those in power winning a breathing space due to foreign exchange inflow withdrew from taking further measures. The experts, who belonged to the emerging political organizations of the opposition in great numbers, hoped that this would not come off owing to publicity and the expected democratization of the political system. The Act on companies with mixed ownership contained guarantees for the security of investments, the compensation for probable expropriation, and the tax-free non-pecuniary contribution, the free disposal over paid-in foreign exchange and for the repatriation of profits since it was evident that *capital would flow in only if it*

may flow out. (*Antalóczy K. – Botos K., 1990.)* To attract investors the Act included tax allowances as well, what caused the accusation later that domestic investors were discriminated against.

However, preceding this provision of law the parliament enacted the *Bill on economic associations* which came into force from January 1989. This Act, too, assisted the inflow of foreign capital, partly, but it was of overall importance much more than that. The associations organized by the joint participation of domestic legal entities and natural persons, i.e. Hungarian citizens or by the participation of foreigners, too, as well as, probably, those established with 100% foreign ownership fell within the law. This increased the number of manpower employed by private persons to 500 and admitted the legality of capital revenues of private individuals as well. *Hanibal ante portas. Capitalism was knocking at the door…*

This Act laid the foundations of various domestic associations with the help of which the usable values of companies could be transferred into independent legal units while the debts of the former activities were left with the parent company. (It was more difficult to privatize parent companies after the change of regime because, with some exaggeration, the purchaser had to pay for them since their debt burden was high.)

Thus, practically, there was a revolutionary breakthrough. The former principles were shaken in their foundations; the sign of disintegration of the old regime became manifest. It is not by accident that western experts, including T.G. Ash called *refolutio* the Hungarian change[22] with the contraction of the words 'reform' and 'revolution' since *reform grew into the revolutionary change of regime,* together with its all advantages *and disadvantages.*

However, the domestic experts expounded clearly that capital import is only a necessary but not a sufficient condition of the solution of economic and, esp. foreign exchange problems. *If the strengthening of the direct capital inflow from the West occurred, indeed, we might think that it intended to get to the CMEA market which was much larger than the Hungarian one and that just would aggravate our existing difficulties,* therefore the inflow of working capital could not be the means but only an aid to the solution of debt crisis. *It may assist only if the necessary complex financial reform steps took place.* The inflow of venture capital cannot be expected either while forint is not convertible and the obligations of foreign exchange management have to be taken into account, the stock of banking instruments are poor and the capital and foreign exchange markets are underdeveloped. 'We can coexist with inflation and, thus, with currency uncertainties but *we need an advanced financial system* that will make the *coexistence smooth. (…) Its lack cannot be substituted nor can that of infrastructure be replaced by any tax allowances!*[23]

I think the financial management at the change of regime, which was able to rely on the ideas formulated in proper time in its field, cannot be blamed for the lack of experience and conception.

Were the economic processes of any importance, they would not have been enough to realize the *quiet transition* from planned economy to the market one. To this the revolutionary political ideas had to turn legitimate. In world economy there are examples for the operation of market economies under dictatorial political relations but the history of Hungary and that of Middle Europe do not speak about this. Desire for freedom was oppressed by the initial terror in our country and was made sleep by the successive 'gulash communism'. Even in the revolting Polish society 'the order' could not be kept by tanks for ever.

As soon as the weakening of the Soviet economy, which 'got out of breath' in the competition of military expenditure provoked by Reagan, could be felt and *'glasnost broke out*

in the East', the Hungarian political life also got an impetus. In 1989 the cautious new interpretation of the events of 1956, the reburial of Imre Nagy and his rehabilitation took place – as 'a grimace of the fate' the invalid great survivor, János Kádár pressed out of power earlier died on that very day. On the memorable day of 23rd October 1989 the 'people's republic' of proletarian dictatorship ceased to exist legally and the Republic of Hungary was proclaimed. The leaders of the two great world powers met in December 1989 and, presumably, they gave their blessing to the last days of Jalta.

In 1989 the majority of HSWP became members of the transformed party called Hungarian Socialist Party (HSP), and left relative autonomy for its technocratic government to manage the change of regime. However, the latter took some 'measures for the improvement of the general condition of people' that were not too lucky for the successors. They liberalized the use of foreign exchange and, as a result, the private savers enchanted by the Austrian abundance of goods set off to take purchasing trips in long rows. This shrank the country's foreign exchange reserves totally. In addition, the recognition of the fact that the Hungarian financial management informed international financial organizations not about the real state of affairs but had been sending them figures of 'face-lifting' for years could not be prolonged. The agony of the regime became more and more obvious.

Also, the political administration itself was ready to hand over power inevitably. The negotiations of the political and economic roundtable, in which the new parties, the HSP and the government and the so-called 'third side', the conglomerate of popular front of the organizations of business federations took part, were going on. The two leading forces of the new political scene became, on the one hand, the Alliance of Fee Democrats (Szabad Demokraták Szövetsége – SZDSZ) which attracted several technocratic and economic experts more open to world economy and controlled by neoliberal ideas and, on the other hand, MDF (Magyar Demokrata Fórum – Hungarian Democratic Forum) which attracted many experts of humanities and social sciences controlled by pro-people and pro-nation intelligentsia. Indeed, both trends had their own fans among socialists as well since 'the boys of Dimitrov Square' as the Németh government and his experts were called were brought up on the ideas of the same economic school as the élite of the Free Democrats. Then again, the question was whether the nation-oriented group, which was gathering, primarily under the flag of Imre Pozsgay, was of a decisive power within the Socialist Party, since they were inclined to cooperate with MDF. A certain cooperation of large coalition between the national wing and the new pro-people/pro-nation politicians seemed to be a real alternative, e.g. in the assurance of the position of the president of republic for Imre Pozsgay. However, this was torpedoed by the Free Democrats who had a sharp anticommunist propaganda and were clever politicians. In addition, they had considerable foreign support in the background. Free Democrats announced that those who entered into pact with the socialists did not want a real change of regime. A competition emerged who a real civilian democrat was; who separates himself from the one-time communists better. This made the people who had been in and bound to the old party undertake their past defiantly but pushed considerable number of radical supporters to the side of Free Democrats. In the last turn of elections the sympathy of society to MDF was strengthened somewhat, perhaps, due to the tone of the campaign and, thus, MDF became the strongest attraction in the new parliament. However, as the historic parties, first and foremost, the Small Holders' Party acquired certain support, so dividing the political 'palette'; the new government could be only a coalition. The question was if the two big parties of opposition would cooperate or the national-Christian conservatism would prove to be stronger. It should be noted that in

the background of both big parties there were expert groups: the Blue Ribbon and the Bridge Committee. In their assessment of the situation and economic proposals there were several common features and there was an overlapping in the structure of their staff. Merely on the basis of economic policy, cooperation could not be impossible since economy was on forced route after all. However, policy is always more than economy. In addition, the prospective social image was already different between the two formations. Against the Free Democrats who thought rather at global level MDF was linked closer to the model of social market economy of West-European roots.

József Antall, the candidate for Prime Minister of MDF chose the ideological coalition. Since MDF did not have sufficient majority to passing bills of two/thirds, it entered into a pact with Free Democrats. In May 1990 the new government was set up, with a prime minister of strong legal position but having political allies whose various interests had to be harmonized.

In the months preceding the change of regime it was entirely clear for everybody, including the economic politicians of MDF, that the establishment of a functioning financial system is one of the most urgent tasks. Yet, only in a short span of time of two years the relevant bills – the Act on the NBH and the Banking Law – were passed.

Several players of the Hungarian scientific and political life had emphasized the inevitability of political changes over several decades, yet *the change rushed upon us like a hurricane!* First of all, it was surprising how simultaneously the processes started in all former CMEA countries. The rapid disintegration of the Soviet Union was shocking. Nobody guessed what weak economic foundations of this military and political super power had. Studying the reports on Eastern Europe to the U.S. Congress, there were clear signals on the serious disorders of the operation of the system even in the late 1970s but it was not mentioned that it would collapse in a reasonable time by it. Even in the l980s the USA, the leading military power of the world, did not have an intent to interfere, e.g. with the Polish domestic events, i.e. the introduction of emergency and the military rule. Until 1989 the possibility of the change of status-quo was not even raised.

The fact that this had not been considered at all in the case of the Hungarian revolution in 1956 under the atmosphere of cold war and the conditions of military forces might be understandable. However, in the years of 1980s more and more hair-cracks of the system could be seen, yet the socialist fortress seemed to be unconquerable. Direct political interference would have been concomitant with too high military risk; the slow economic penetration seemed to be more viable through the growth of foreign trade and credit relations. From inside the reform-oriented intellectuals in the opposition could experience that criticism and constructive 'critique' might be stronger without existential consequences, e.g. without going to jail. And it may not be neglected that socialist leaders were ready to implement certain reforms not only in Hungary but in some other countries, too. It was of decisive importance that the line of Gorbachev came into power in the Soviet Union in the 1980s. By all means, the political and economic change of regime following the Polish events only some years later affected not only us unexpectedly but western societies as well.

By all means, it came as *deus ex machina for the European partners to solve their accumulating problems.* Out of the three centres of the world two struggled with the problem of recession in the late 1980s. In the economic competition of Europe with the USA Europe would have lagged behind more in the 1990s if it had not come to a new and large market with favourable conditions overnight. It is true that the unexpected opportunity to German

unification put serious burdens on German economy; too, therefore it was all the more important that its relations to other countries would be more beneficial to its own economy. (*Berend T. I., 1999).*

The requirement to join EU, actually, under fair conditions, was formulated almost at the change of regime by Middle European countries. As Dénes Csengey put it: 'Into Europe but all of us!' That is, they expressed the endeavour that all layers of society should benefit from the possibilities which would open up for them.

However, western countries did not urge formal expansion since it was evident for them that expansion would be concomitant with burdens. They considered Hungary's application to be early even in 1991. The establishment of institutional relation for EU was not urgent; for them the favourable terms of trade and investment possibilities were given after all. But as we would have liked to be part of Europe not only informally but formally as well, finally, EU made possible for us and some other countries to submit the application for accession. (How this took place and under what diplomatic and bureaucratic conditions, we may judge it only, based on the direct personal impressions of the participants who were there at the event. There were some who spoke about hurtful condescending tone and negligence. This already projected the shadow that we, the accessing countries from Eastern part of Europe would be just 'outsiders' when being 'inside'?)

It was also evident that the accessing countries had to meet several requirements. Some Hungarian experts directed attention to the fact that the process had lasted with the South-European countries for several decades, too. However, the changes accelerated by 1990s produced the illusion that accession might be successful earlier than that, moreover, for Hungary, perhaps, in a shorter time than for the other former CMEA countries. The source of optimism was just that reform had begun earlier.

Indeed, our partners rendered possible certain asymmetric advantage with opening up the market. This was considered the most important question, on Hungarian part, too. Undoubtedly, the expansion of market brought assets towards EU region what was of decisive importance from the aspect of solvency. At the same time, trade was advantageous for the West-European firms as well. As far as the closeness of economic relations is concerned, on Hungarian part, we stayed inside western integration well enough; we were built in the economy of West-European economy. Even by the late 1980s a significant proportion of the external trade of Middle European countries was managed with EU. In the case of Hungary the so-called convertible trade made up nearly 50% and our main partner was Germany. The share of EU continued to grow after 1990 in a way that the terms of trade altered *for the benefit of EU*, unambiguously. Thus, what EU countries lost in their imports owing to the successive oil explosions, they counterbalanced it through their trading with the acceding countries *(Botos J., 2001).* This is why the eastern market offered by the change of regime was of utmost importance for EU but, primarily, for German economy.

Beside favourable prices the possibilities of privatization were exploited by the entrepreneurs of EU member countries. Hungarian privatization chose the solution of so-called sale in cash, except for the possibility of using compensation papers. Of course, owners with domestic revenues had enough cash only sporadically, so privatization meant to attract foreign capital at the same time. On Hungarian part the appearance of foreign investors were also necessary because there was an urgent need to cover the deficit of the balance of payments. (*Árva L. – Katona K. – Ivicz M. – Schlett A., 2002)*

In the years after the change of regime the USA was the No 1 capital investor in Hungary. In the further part of the period (…) the multinationals from EU invested, among

them, primarily, Germany (…), the proportion of the Netherlands (…) increased significantly (…), at the same time, the investments of working capital from the USA decreased, in proportion, over the second half of the 1990s.[24] (By the turn of the millennium, half of the capital of joint ventures was owned by foreigners.)

At the beginning of the 1990s the greatest task was the solution of debt crisis. *In 1990 the stock of gross debt was 15.7 billion euro what made up 60% of GDP but import coverage was only for some months.* Short-term deposits were withdrawn from the country, thus, the critical situation of 1951–1952 was repeated. *The country escaped the political collapse that would have been the consequence of insolvency because the financial politicians of MDF to be expected to win at the election proclaimed definitely that the existing debts would be repaid.* Parallel to this, the government program set itself the target to stop foreign indebtedness. The program made it clear that with the nationalized properties – except the arable land – there was no way to restore the original state of ownership. The program defined privatization policy in general, stressing the importance of widening domestic property acquirement and the righteous nature of privatization (…) It was formulated as an important principle that the income from privatization had to be connected with the payment of state debt. The afore-running and successful IMF negotiations consolidated the state of Antall government over the year. But from this time, the path which could be followed by economic policy narrowed down.[25] Constraints had no alternatives. The government remained obstinate in that respect that it did not realize the necessary devaluation of forint which was justified by the state of the balance of payments, too. As a result, the Hungarian currency remained somewhat overvalued, and this did not favour external balance but, at least, it did not continue to raise inflation which had jumped to its record height.

Who were able to adjust to the new situation more rapidly? It was they who were in power previously. Sizing up the situation, with impressive rapidity, they understood that *everything should be changed in order to be unchanged*...

While in the first moments of political changes the members of the former administration seemed to lose their power, soon they regained their strength. They dug their toes in economy, and then in the mid-1990s they returned to the political life as well. But the new democratic forces coming to the fore had little practice in administration. On the one hand, despite all their high qualifications the new politicians had no concrete operative experiences in the organization of economy nor had several members of the government. Almost without exception they had been pushed onto the periphery before, at best, they acquired theoretical knowledge in research institutes, e.g. after the change of regime, the Czech Deputy-Minister of Finance, the Parliamentary Under-secretary of the Hungarian Ministry of Finance, later the Minister Responsible for Banking, the Minister of Hungarian External Relations and the President of the Bulgarian National Bank came from research institutes of the Academy, or financial research units. Their theoretical qualifications were unquestionable but they were not 'hardened' enough in the day-to-day political struggles and those for power. Also, the store of the instruments of financial policy to put theory into practice was absent, too. On the other hand, it was difficult for the new governments to fight with the attraction of illusions and the shadows of the past. After 1990 the citizens expected better days to come and they would not have guessed that their fate in the future might be worse than that in the past. They thought that, parallel to the political changes, the conditions, owing to which they were unable to reach the life standard of western democracies watched in TV and experienced during their tourist trip, in spite of all their diligent working, would cease overnight.

Out of the determinations the chronic capital shortage, technological backwardness, the lack of modern technological and organizational knowledge and skills, and the high foreign indebtedness in some countries – in Poland and, primarily, in Hungary, – were such a heritage which was not easy to overcome by companies and entrepreneurs, who found themselves under fierce market conditions all of a sudden, and not even by government organs responsible for economic policy. And the collapsing eastern markets caused the conditions to turn to be fierce at all fronts. The foreign advisers who 'supported' the government and represented the liberal market fundamentalism urged to call into being the conditions of real market competition. Because of the disintegration of CMEA the barter agreements having been guaranteed previously ceased and the producers in Hungary, too, had to redirect what was saleable at all to the competing western markets. And the government struggling with indebtedness and being badly in need of IMF assistance followed the 'guidelines' of IMF and the World Bank willy-nilly in order to avoid international insolvency which would have led to rapid fall of the government and drastic decline of the life standard. Incidentally, the advisers arriving with American government aids and assistance programs of Brussels had the same recommendations, namely: liberalization, holding back budgetary expenditure, cancellation of supports and the introduction of international standards in the practice of the state's regulation as soon as possible.

It can be said that in Hungary liberalization was continued by great momentum since initial steps had been taken before the change of regime.

Striking the balance of the budget had to be implemented – what was managed owing to the drastic recession and the strict measures taken by the late 1990s – and this was linked with liberalization closely. Liberalization of 75% of prices stripped the budget of the significant burden of price support, although there were still restrictions left as well.

Economy had gone through somewhat prolonged shock and there was also a recession. After a slowing down of decelerating pace lasting for several years the economy was over the worst. In that period the consolidation of the banking system had to be launched without which privatization and the development necessary to the operation of market economy would have been inconceivable.

Growth in Hungary

Year	Pace of growth of production (%)
1987	3.4
1988	0.1
1989	–*
1990	–3.5
1991	–11.9

* no data

Source: op.cit. Szakács S.: p.365.

It must be said that there was an interaction between the two things. The Banking Law elaborated by 1991 held a mirror to banks, and indirectly to economy, it showed what would be viable and what would be maintained out of the Hungarian economic structure. It is true that because of the rigidity of measures the proportion of the companies condemned to failure was probably higher than it was necessary, but under the given political and economic situation there was no better solution but to consolidate economy while losses were transferred to the banking sector.

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CHALLENGES IN THE CARPATHIAN BASIN AT THE BEGINNING OF THE 21ST CENTURY

By Katalin Botos

Countries located in the Carpathian Basin are all characterized by the fact that they went through a double change: once into socialist centrally planned economy, then back to a market economy. In this sense they were all 'ferry-countries' – going back and forth. After 1945 the region became the field of experimentation for the socialists' 'revolutionary changes'. Countries here became bumper states between the Soviets and the West. Only the policies of Yugoslavia that had a different relation with Soviet-Russia alter this picture, but not too much. The economies of Hungary, Czechoslovakia and Romania were forced to make a complete reorientation in their foreign trade. Earlier, before 1945 the Third Reich had the biggest influence on these countries, but after World War II the Union of Soviet Socialist Republics (USSR) became the most influential partner in trade. Countries in the Soviet hemisphere then soon became members of The Council for Mutual Economic Assistance (CMEA). The strength of this bond was of course influenced by the need for natural resources. Romania, for example, had a role to play, as it had large reserves of oil. Also the effects of Trianon and Paris – the two peace treaties after WW I and WW II – had their influence on the region, and this autarchy was not resolved by the creation of CMEA. The orientation still had a kind of star shape with the USSR in the centre. Countries of the Eastern Bloc did not trade with each other, and did not unite for mutual advantages, although these would have been reasonable steps to take. The intensity of trade among them remained relatively low until the end of the Soviet era. The Soviets were allergic to the idea of a so-called 'small CMEA', as that state of affairs was not in their best interest, even in the 1980s. (My colleague Mihály Patai and I were both attacked personally by Yuri Andropov himself, when Patai wrote an essay on the small CMEA, and I criticized the currency – the transferable rouble.)

The position of Hungary in this community was without doubt unique. Our homeland was 'stuck on the wrong side' at the end of the Second World War, with the mark of a 'guilty nation': patriotism was out of question (not to mention nationalism). In contrast, in Romania's politics nationalism was an ace. Even at the dawn of regime changes in the region playing the 'Hungarian card' was a liable way to distract the attention from real problems. (We just think of the bloody events at Marosvásárhely/Târgu Mures in 1990.) Basically there was no other country and we can count Poland here as well, that had such an anti-patriotic government after 1945 as ours. (Only Bulgaria and East Germany had a worse record, but they were frontier states from the Soviet point of view.)

After the trauma of 1956 the Kádár administration tried to coin the international (like the Moscow oriented) and more patriotic wings of the party into one. Stepping up for Hungarian interests, however, first and foremost meant keeping the workers' stomach from being empty. For this reason agriculture was supported and assisted more in Hungary than in any other country of the Carpathian Basin, or within the CMEA. To raise the standards of living even reforms – the so-called New Economic Mechanism (NEM) – were introduced, but soon, by 1972 these attempts were halted after the Soviets expressed their disapproval. Yet the Kádár regime was still focused on its own goals, but the price of those goals were high: a severe and rising indebtedness by and in the 1980s. The fact that no one can deny is that improvement in the distribution of food and the positive balance in the

trade of such goods were due to the creation of a unique system, where small, private farming and large-scale, state-owned farming existed side by side, without undermining the ideological background.

A concrete plan to put forward national interest, however, did not exist. What was generated by the methods of NEM, for instance to fight for better prices within the CMEA, as it was evidently a national interest, could be easily 'sold' by the bureaucrats and ministry officials with close ties to Moscow. In the 1970s, for example, a head of a price negotiation delegation to the Soviets argued that he accepted the Russian proposition because his stay in Moscow was 'too long' – as the author of these lines heard from the man himself.

Concerning the loosening of ties to the USSR that was mainly achieved by Romania, based on its oil reserves. Hungary also made a weak attempt by building the Adria pipeline at the end of the 1960s, trying to get access to oil from different sources, and so decreasing the dependency on Russian oil; but unfortunately the boom in the price of oil made the Arab oil too expensive. So we were left with the cheaper Russian source, which ultimately meant dependency on the Soviets. To make things worse we had to pay with goods – called 'solid products' – that could have been sold anywhere for solid foreign currencies, like the US dollar. Even in the 1980s it seemed undeniable that the USSR's lack of food could not be eased in a short period of time, so agricultural export, mainly the export of grain and meat meant hard products. This expressly agricultural orientation made us unique. Hungary became a net agricultural exporter long before the period, although Bácska and Bánát, the best soils/territories for agriculture were given to other nations by the treaties of Trianon and Paris. In all other CMEA countries, within the Carpathian Basin mainly in Romania, food shortages were always on the agenda. In contrast to Hungary they were all forced to import food from other countries.

In other fields, however, we were weak. We couldn't stay away from building pipelines, and so we couldn't stay away from paying the so called 'investment contributions' to the Soviets. The new pipelines were built in quite an inefficient and costly manner; they cost so much that only a short-sighted attitude foresaw them to be economical. (We of course have to note, that this construction had such irrationalities that affected all countries involved. Here, however, I refer basically to the facts that applied to Hungary.) Without doubt, building pipelines for Russian oil secured plenty of fossil energy for our economy, but the credit we needed to pay for the expenses (the contributions) – as Hungary could not afford such investments from his own pocket – directly and indirectly led to serious foreign indebtedness.

'Investment contribution' became one of the crucial factors of Hungary's indebtedness, which is far from being over. Although the Soviets paid for the credits with gas, it did not contribute to refinancing of our own foreign debt. Our industry was on the move, but the export of industrial goods – and so the income on selling goods for convertible foreign currency – did not rise too much. People in Hungary led a more comfortable life with gas based central heating, than previously with coal and wood, but the money invested in gas and pipelines was 'gone with the smoke'. Our national interest would have been investing our credit (foreign currency) into building new factories, producing goods that could be sold for convertible currencies. In this way, theoretically, these investments would have been ours '*ad graeacas calendas*' – till the end of time, producing valid profit and income to finance our economy growth and import.

Of course, I mean if our products would have really been of 'convertible' quality. And if we would have had our technology modernized and updated continuously, just as the

Japanese did after World War II. Most likely the volume of goods sold to our socialist trading partners – and not only to them – would have risen. As a consequence we could have had enough convertible currency to buy gas (and oil) for cash from Soviet-Russia. We could have bought enough fossil resources, and not more than necessary. (As a side effect of 'investment contributions' – that was returned in the volume of gas from Russia – Hungary introduced gas as a resource even where it was unnecessary, as other fossils, like coal could have been used. Yet, as there was plenty of gas, and in the beginning it was cheap too, it spread from households to industries.) It would have been smarter and cheaper to reinvest any foreign currency we had, and that could have meant a fine solution in the long run. But the *apparatcsiki*, the party bureaucrats feared for their status and position. They did not dare to go against the odds, while party leaders did not dare to confront the Soviets: they did not refuse to insure credit for them.[1]

One might say of course that our position cannot be compared to the position of the Japanese, who bought high-tech abroad and then even developed it to produce high-standard goods. Japanese industry sold products all over the world, and thus soon achieved a positive balance in its international trade, creating huge stocks of foreign currencies. One could also say that we fell under the restrictions of the Coordinating Committee for Multilateral Export Controls (COCOM), and that our party leaders had quite a pressure from the Soviets not to risk reforms that could have led to Moscow's wrath. The latter was a real threat as the opposition within the Hungarian Socialist Workers' Party (HSWP) had ties too close with Moscow. Yet, the views I had back then were justified by the regime change. In the early 1990s we literally pulled down all those factories that once represented socialist heavy industry, and even our light industry lost the race against the Asian challengers.

Investment contributions, as investments in the usual sense were profitable only for a very limited time and so made only a relative profit for the country. It did not serve the country's real interests in the long run, as the so badly needed structural changes, industrial upgrades and developments that would have meant a real alternative were cancelled. All developments that were realized in the 1970s preserved an outdated, extensive and energy consuming structure. We may find excuses for the decision makers of the era, but no one can deny that they knew there were problems. Many, among them the author of this paper, reminded those in power, but the bureaucrats and the political leaders did not want or couldn't understand the meaning of their arguments.[2]

A small surprise after the year 2004

Many expected that joining the European Union (EU) would bring about a rise in trade. But it is no wonder that the share of trade did not show a further rise. It had risen well enough in the previous nearly one and a half decade, as during the pre-accession phase the market of the EU was unilaterally opened. Of course a rise in the import could have been predicted.

In contrast, age old tensions among the countries of the Carpathian Basin melted slowly after the regime changes. It was even more complicated when Czechoslovakia and Yugoslavia collapsed, and when the war broke out in the Balkans. Although the commercial strategies of the Eastern European countries were reoriented into the same direction, it did not mean coherent cooperation in their trade policies. Of course it was the mutual aim of all Middle and Eastern European countries to join the EU as soon as possible (even if there

were voices against it in each country). All countries were eager to reset their targets, now to Brussels instead of Moscow. (As Árpád Gondos worded it was 'the Hungarian yo-yo'. In fact it was rather the swing of all Eastern European countries.)

All countries negotiated their own accession individually – Brussels was keen on not having a united stand. The efforts for cooperation among the Visegrad Four (V4 – also known as the Visegrad Group) countries could not create a real valid unity – mainly after József Antall, the PM of Hungary had died. These countries were faced with the problems of the political and social transformation/transition: privatization, bank consolidation, introducing a modern two level banking system, establishing control over it as well; liberalization and taking on the *aquis communitaire.* One could say: they were all minding their own business. To tell the truth, before joining the European Union in 2004, the EU itself did not care about them too much. Although in 2002 it was confronted with the fact the 15 countries already in the Union did not have enough incentives for further cooperation and growth, so the decision makers made up their minds to *introduce a new paradigm*: enlarging the EU not in depth, but in width; enlarging the Union with as many countries as possible and as soon as possible.

The nine ex-socialist Eastern European countries fell into three subgroups. In the first place there were the V4 countries, in the second place there were the Baltic states (becoming EU members in 2004, as a consequence of the new paradigm); and in a third place were Romania and Bulgaria that were given a later date of accession. Between 1999 and 2006 for all nine countries the most important trading partner was the 'old' EU. In this period the 60% of the all exports of the nine countries went to the 15 states of the EU. If we take a look at the same data in respect to 27 countries of the EU, the export was 80%.

The surprise is that *the share of the EU 15 did not increase after the enlargement, but it definitely decreased*. In 2003 their share was 67.7%, but by 2006 it decreased to 60.5%. Meanwhile the trade among the new nine states was rising, from 13.7% to 17.9%. It is true, that the Baltic states' 'internal' trade rose more dynamically than the V4's, yet it is still major (23.4% and 11.2%). One could sigh with relief: 'The Trianon trauma is over!' But it would be too early to say that the ethnical/national conflicts are over, and that all wounds are healed. Anti-Hungarian propaganda still has a role to play in the Carpathian Basin, and it is often on the agenda in the surrounding countries.

It seems, however, that economical rationality can overcome the bad feelings of politicians, as in all ex-CMEA economies the share of multinational capital and investment became pretty major. And for them one market is like the other. Their purely economical calculations are not burdened with aversions or prejudice. They rely on geographical advantages, and if they can break into each other's market, they simply do so. In this respect the Eastern neighbours, Russia and Ukraine became important as well. Between 2003 and 2006 the trade of the nine Eastern European countries with these two countries rose from 3.4% to 5.3%, while – as we have already noted it – the trade with EU 15 decreased in the same period. Even export to the Asian countries rose somewhat, which must be due to the rising imports from there.

Hungary is a little different

If we take a look at the V4 countries in the OECD's latest forecast, it becomes quite clear that Hungary is following a different path to the others. In a previous study of mine[3]

I made an analysis on the reasons for Hungary's success at the regime change, and fall after the millennium. Now let's take a look at the statistics, compared to the other V4 countries, in the years following the accession. The OECD looks even further – makes predictions, but in connection with Hungary they shouldn't be taken too seriously. OECD works with official data released by the Hungarian government, and unfortunately there is evidence that this data often reflects only the optimism of Hungarian officials. This is one of the most important reasons why we lost credit. If we assume that first and foremost the tendencies in the GDP, or even more so the tendencies in private consumption are the key issues, and everything is important only from the perspective modifying these two, then we should start with the real data.

Taking the year 2000 as a base, the Czech GDP growth was around 6.0–6.5% in three consecutive years after the accession, and that dropped only 1% even in 2008. The Polish started on 3.6% and ended up at 6.2–6.5%; their estimation for 2008 is 6.6%. Slovakia started with 6.0% and reached 8.3–9.1% in two consecutive years. It is predicted to slow down to 7.3% in 2008. In contrast with these, our country had a 4% GDP growth in 2005, and 'fought its way down' to reach 1.8%. The forecast for 2008 – before the recession started – had been 2–5%. If we take the changes in private consumption (at the price levels of 2000) the picture becomes even more depressing. It is true that we were the second to follow Slovakia, with a 3.4% increase in private consumption (the Slovaks had more than double this), but then these percentages began to diminish. In 2007 the data shows negative growth, so in an absolute sense private consumption fell.

So while the citizens of Slovakia could keep their consumption – the growth – above 6%, and V4 nations like the Czech and Polish could raise the percentage of private consumption, Hungarian citizens had to accept a slowing growth, even more, had to come terms with a decrease in budget spending in 2007. Parallel with these facts, public consumption decreased radically as well. We cannot state that other Eastern European economies did not enter a new era of moderate growth in public consumption, *but no other country had to suffer such drastic measures, as ours*. In 2005 the growth in public consumption was some 2.5%, and that increased to 4.7% – surprise-surprise: it was an election year in 2006. These lovely figures were then followed by awkward values: –4.5 and –3.3%. Our gross investment was time and time under the level of other Visegrad countries, which does not suggest a bright future for creating new jobs. In fact unemployment is moderate – it has been around 7% since 2005. (From the outside it looks good. The official unemployment rate in Hungary is always lower than in the EU, or even in such 'newcomers' as Romania or Bulgaria. The reason behind it is quite simple: many people become private entrepreneurs involuntarily. They are now attacked for evading taxes; yet, if the latest campaign of the government succeeds, there will be a rise in unemployment.)

There is one other data where we are not holding the worst position, but second after the Czechs and this is the *current account deficit*. Here the figures – measured in the percentage of GDP – decrease slowly, from the rather high value of 7%. Seemingly we are in a position that could be consolidated. If we take a broader view it becomes evident that Slovakia and the Baltic states have a pretty negative account too. But there is a problem. The imbalance of payment in Hungary originates from income flow. Correctly: from the outflow of income… As in any other passive country the balance of trade is also negative. This deficit, however, is bitterly worsened by the inflow and outflow of income. This is the crucial difference between Hungary's and the other countries' deficit. And so here we can stop for a closer look.

First of all we have to see that in the case of other countries' current account it is the deficit in the balance of trade that we are talking about. It means that goods are shipped into the countries that have to be paid, but if the import exceeds the export you need other sources to finance it. One method to resolve this is an extra capital import that can be debt generating, or non-debt generating. Credits have to be paid with their interests, on *capital stock* dividends are to be paid (unless the profit is reinvested). A surplus in exported goods may serve consumption or investment goals; taking the latter possibility into account that can be a base for a surplus in the export in the future.

Anyway, people of a given country do not perceive negative consequences of the current account deficit, but on the contrary they perceive the advantages – a surplus in consumption. It is because of profit repatriation, reinvestments and profit reinvestments that they don't feel the deficit. What we perceive is that the profit made here is taken out of the country. (And even when it is reinvested is just a correction of previous undercapitalization. Foreign companies often worked the privatized Hungarian firms with a very small amount of registered capital; and they secured capital from credit financing, usually from their mother companies. Reinvesting some of their profit could be used to secure their own financial position.) So we do not meet any surplus in goods or services. To put it cynically: *we have already received them*. Well, that was not much, as the credit to finance welfare – based on imported goods – became quite expensive in the 1970s and 1980s. Our old debts were repaid from our own national wealth. So we were deprived of the chance to use this wealth to finance the consolidation of our economy, banking system, modernization; or to readjust our social and health expenditures. These all created further needs for credit. The sole chance left for us – to modernize and restructure our economy – was capital import; but capital comes and goes, its only aim is to create profit for its investor, a profit that can be distracted anytime. By the millennium half of the registered credit of companies already belonged to foreign corporations.

So nowadays the deficit in Hungary's balance of payment rises, from the people's perspective for nearly nothing. Of course, I am exaggerating here, as in the growth of our foreign debt the rise of the foreign debts of the private sector has quite a role to play. They buy houses and real estates – burdening themselves and the balance of payment at the same time. Thanks to the excessive borrowing in foreign currency (and so moving interest rates) they also risk losing their mortgage burdened properties. So at this stage of affairs there is not the slightest possibility of getting rid of foreign debts; it could only happen if debts were created by the import of reasonable assets. As the lack of credit generates demand for financing, our dependency on foreign lenders continues to grow.

Hungary's public spending and maturity for the euro zone

One of the latest surveys of the National Bank of Hungary (NBH) re-evaluates a previous analysis of the central bank (made in 2002), that was focused on numbers concerning the pros and cons of joining the euro zone.[4] It is all the more important, as our northern neighbour Slovakia will soon introduce the currency of the EU, why we could not even name a possible date for it – a date that seems to be pushed further and further into the future. Slovakia's successful tax reform, high rate of GDP growth and achievements in reducing inflation are envied in the region. They kept their budget deficit and debts under control. While the rate of inflation and their current account deficit are both high, but they are not part of the Maastricht criteria.

The analysis, half a decade later than the previous one, suggests that the benefits of the common currency would be still significant for Hungary. There are good reasons to join the euro zone as soon as possible. While calculations show that introducing the euro would not trigger such growth in the foreign trade as was previously forecasted, but it surely would create surplus and positive effects. In many respects we correspond the criteria of the optimal currency and others are also a given, like our integration is already strong, and we even move in parallel with the business cycle. Although this latter one reflects the years before 2000, since the millennium this synchronization has weakened.

In respect to openness in foreign trade Hungary is the third country in Europe. The fact – mentioned earlier – that trade with our neighbours grew faster than the trade with the EU 15 did not mean a loosening in the ties to the countries of euro zone. Integrity is tight; the trade volume was bigger than the average of the euro zone, and was above the index of the newcomers. Following the regime change Hungary's export sector moved towards the trade of high-tech – premium and medium quality – products. Its share within the export is higher than the average of the euro zone or the average of the countries entering the EU in 2004. The study, however, points out that although Hungary made progress by entering new markets in recent years, it happened by decreasing prices. This obviously did not have a good effect on Hungary's trade balance. It is also undeniable that the percentage of mediocre products in the export grew at the expense of the high tech industry. Let's add to this that Hungary's export is highly concentrated, even measured to any other European country. That makes our positions vulnerable, and so quite sensitive to shocks from the outside, may be after entering the euro zone too.

The structure of the Hungarian economy is so close to the average of the countries already in euro zone that the asymmetry of its 16 layers are the slightest of all countries still outside that. It does not mean that countries of the euro zone are not vulnerable from those respects already mentioned. On the contrary, their last resort is already fiscal policy (intervention) to eliminate possible shocks. In Hungary's processing industry the ratio of the number of employees and the volume of added value work in diverse directions. It shows that our companies – mostly foreign owned – upgrade their profits via raising productivity, so employment is left for the other fields. Of course, in some work intensive layers the demand creating effect of fiscal expansion was also involved in this.

So from one perspective we have close ties with the euro zone, and so from our *de facto* relations we would be suitable to introduce the euro; but from another perspective we are still quite vulnerable. The changes in foreign markets, the more and more expensive resources of the energy sector, even trends in the market have an effect on our export capabilities. And as it has a leading role, it has an effect on our economy as a whole. Yet, after introducing the euro, in relieving shocks, monetary policies will have no role to play and so fiscal policy would be our last resort. That is why the Hungarian government tried – at least on the level of public declarations – to bring the budget's deficit to 0.5% in its convergence programme. Not to mention: we are light years away from it. This way the field of operations for fiscal policy, that needed to resist shocks after joining the euro zone *could not be established*.

What is also unfavourable: aiming at its target the government chose such methods in its programme that are not good for creating a higher value added production. Yet this latter factor was seen as an advantage in the respect of our vulnerability in the post-accession period by the analyst team of the central bank. As the study of the NBH suggests decreasing the budget is one of the goals, but a cut in education and healthcare spending goes against the aims of human capital development.

Excessive borrowing of Hungarian individuals seems to be fairly problematic in the eyes of many, mainly in connection with entering the euro zone. The NBH's analysis suggests, however, that it is a problem in those countries – waiting to join the monetary union – where the credit boom created a bubble in the prices of real estates. In our country credit to GDP percentage is still in the reasonable sphere. Introducing the euro would most likely decrease the risk of a credit boom and would narrow the path of interventions by economic policies. It would not exclude the exchange rate risk, due to the excessive borrowing in Swiss franc (CHF), but there have not been drastic changes in the exchange rates of the two currencies.

Summary

Hungary's economy entered a new path after the millennium in contrast with other Eastern European countries. It fell behind in growth; the mostly compulsory budget cuts, and the economic policies that do not offer alternatives for Hungarian ventures (firms, companies, etc.), created a sense of general dissatisfaction. The profit created by foreign investments is used in a manner that burdens the current account and thus the external debts are rising. The budget – due to severe taxation and because of the improvising changes in state expenses – is faced with quite a deficit. *This way it cannot secure the field for those manoeuvres that would be needed in our economy to relieve shocks after joining the euro zone.* Well, not as if it was round the corner. From the 'happiest barrack' of the era before the regime change we became the most dispirited republic after it. How to stop our economy from dropping behind the trends of other Eastern European countries development is a big question.

Changes in the volume of privet consumption in percentage
(at price level 2000)

Changes in the volume of public consumption
(at price level 2000)

Country	2005	2006	2007	2008	2009
Czech Republic	2,5	4,4	6,7	4,0	4,1
Poland	5,2	5,8	1,5	1,9	2,0
Slovakia	–0,6	4,1	2,8	2,2	2,0
Hungary	2,5	4,7	–4,5	–3,3	0,2
Source: OECD Economic Outlook Preliminary Edition					

Net export surplus/deficit influence on the GDP

Country	2005	2006	2007	2008	2009
Czech Republic	4,8	1,1	–0,1	0,7	1,0
Poland	1,2	–1,1	–2,0	–2,0	–1,6
Slovakia	–2,8	1,7	3,6	2,2	1,2
Hungary	2,8	2,8	2,0	1,7	0,9
Source: OECD, Economic Outlook Preliminary Edition					

Deficit of budget in the percentage of GDP
(without pension funds)

Country	2005	2006	2007	2008	2009
Czech Republic	–3,5	–2,9	–3,7	–3,1	–2,5
Poland	–4,3	–3,8	–2,8	–3,2	–3,0
Slovakia	–2,8	–3,7	2,6	–2,3	–1,8
Hungary	–6,8	–6,5	–4,6	–3,8	–3,5
Source: OECD Economic Outlook Preliminary Edition					

Rate of unemployment
(at price level 2000)

Country	2005	2006	2007	2008	2009
Czech Republic	8,0	7,2	5,4	5,0	4,7
Poland	17,7	13,8	9,7	8,4	7,7
Slovakia	16,2	13,3	11,0	10,1	9,4
Hungary	7,3	7,5	7,3	7,2	7,1
Source: OECD Economic Outlook Preliminary Edition					

Gross capital investment - volume changes in percentage

Country	2005	2006	2007	2008	2009
Czech Republic	2,9	7,6	4,2	7,8	7,7
Poland	6,5	15,6	21,5	15,5	11,6
Slovakia	17,5	7,3	7,4	7,4	7,8
Hungary	5,3	–2,1	1,1	4,1	6,8
Source: OECD Economic Outlook Preliminary Edition					

NOTES

[1] Before charging the author of these lines with all too late wisdom, I have to say, that in those days I was working with those who were in charge of Hungary's economy. I was working at the Ministry of Finance when a dissertation of mine was classified, and my essay on the subject above was black listed. It was Yuri Andropov himself (!) – that time the head of the KGB – who reminded Hungarian party leaders to take control of and censor my publications. I have this information from István Hagelmayer, my late boss and fellow-professor, who – by order of the Minister of Finance – did not let me publish on the CMEA until approved by the deputy minister. And that approval never came while Andropov was alive.

[2] As for me, it was not without risks. During the 1980s it was my own boss István Hagelmayer who protected me against inquires of the Ministry of Interior. For his brave bearing and support I will always be grateful. From the political leadership it was Rezső Nyers, once the 'father' of NEM, who was later moved aside, in those days head of the Hungarian Academy of Sciences' Institute of Economics, who helped me from the background. I owe him the fact that I could publish papers on the CMEA in the 1970s. Last but not least, I have to thank Péter Szőnyi, brother of the executed Tibor Szőnyi, for his help at the Department of International Economical Relations (Nemzetközi Gazdasági Kapcsolatok Titkársága). He helped me with my studies on the prices and rates of the CMEA.

[3] Közép-Európai Közlemények, 2008/1

[4] Released by the NBH in March 2008.
http://www.mnb.hu/Engine.aspx?page=mnbhu_konvergenciajelentes&ContentID=10822

THE OIL PRICE EXPLOSION AND ITS EFFECTS ON HUNGARY

By Csaba Nagy

The Emergence of the Problem

The shocking changes in the world economy in 1973, the explosion of the oil prices had a serious impact on Hungary as well. Oil prices have quadrupled from the initial 25 dollars to higher than 100 dollars in a short period of time. This drastic price increase pulled the prices of other raw materials as well.

Hungary, with its small and open economy, was severely hurt by the price explosion. The value of its foreign trade balance was the same as that of India, which at that time had a population of 650 million. 60% of its total volume was COMECON-oriented, and the changes affected this part later and to a lesser degree, in contrast to the 'non rouble-based' commerce, where the country suffered a substantial, 20% swap ratio devaluation as early as 1974–1975. By 1975 it was apparent that the prices in the COMECON-commerce would follow the changes in the world economy. As Berend T. Iván, rector of the Karl Marx University of Economic Sciences at that time put it (on the 1975 meeting of the Central Committee): Hungary hit the wall when she suffered the first blow, but the second hit would be given by the wall itself.

Preparatory work for the 5th five-year plan began as early as 1974. During it, the negative changes on the international markets should have been accounted for, however, this had not been accomplished yet in the first part of the year. In April the same year, the National Planning Office and the Ministry of Finance prepared a common presentation, with the title 'The Possibilities and Conditions of Foreign Resources Involvement in the 1976-80 period', in which they did not truly account for the changes which had happened in the world economy. Since the aggregate performance of several years was inspected, they drew the conclusion that the foreign trade related and external financing position of the country had become more favourable, since the dynamics of our exports was high, and the structure of our external financing was skewed more toward the long-term debts. They did not see a problem in the increased imbalance that was present between the value of our external debt and the performance of the country. In the view of those who prepared the presentation, the problem was that these debts were not used efficiently enough in investment financing. Their remark is correct when they say that foreign debt is only justified if investment activities are financed, especially the ones that increase the gross national product, because these investments create the conditions which are needed to repay the debts.

By the middle of the year it was evident that the negative trend on the international markets was going to be of longer duration than previously expected. Despite this, the majority of the leaders did not sense the danger, and if they did, they still stuck to the "no need for change" policy. The members of the economic policy leadership who could see the degree and the possible consequences of the problem relatively early, emphasized, back in 1974, the importance of beginning to look for new solutions and ways out in the economic policy.

Mátyás Tímár, the vice president of the cabinet council, in the 1974 meeting of the Central Committee talked about the fact that the Hungarian economy did not react to the economic changes in the world, and the acclimatization process did not start. As an example he mentioned Japan, which was highly dependent on the export of raw materials, as was

Hungary. In Japan the government reached an agreement with the important players in the economy that production of certain raw material-intensive products had to be reduced, and the expansion of certain industries and branches had to be pulled back.

Tímár proposed a different therapy at home: according to him, the changes in the international prices had to be 'unleashed' on the Hungarian market, namely, production and consumer prices had to be increased. In his justification, he analyzed the international effects of the price explosion. He highlighted that while oil producing countries had accumulated an enormous, 70 trillion dollars additional revenue, in the majority of countries that rely on the export of raw material, and especially in the developing countries, severe current account problems occurred, which led to general economic and political problems, and, in some cases, to government crises. He emphasized that socialist countries could not avoid the effects of the price changes, since the economies of the two blocks were intertwined. He mentioned concretely that the price changes would affect negatively the Hungarian current account.

Since the elaboration of the 5th five-year plan was in process, Tímár implicitly mentioned through the Japanese example that the changed external conditions surrounding the Hungarian economy needed to be considered in case of the investment plans as well. In Japan, the government and industry representatives compiled a positive and a negative list about industry development. Other countries were rethinking their investment activities, and Hungary should do likewise, according to him. It was needed for Hungary, a country lacking raw material resources, to consider this in the process of creating the 5th five-year plan, and the problem of material saving should also be dealt with care.

Furthermore, he stressed the importance of informing the public opinion, so that the measures to be introduced would be better received by society.

The first, not too bold pace leading to a more cautious and elaborated money borrowing policy proposed by Tímár was the proposal elaborated by the NC and the Economic Policy Department of the CC for the Political Consultative Committee. Resulting from it, the PC approved only a 2.5 billion dollars loan instead of the originally planned 3.6 billion dollars for the period of the 5th five-year plan. In addition, they made a decision about limiting the capital export to the Soviet Union as well. The fact that they decided to lift the accepted money borrowing limitations in case of an economic boom shows that their perception of reality at that time was erroneous.

The first, vague experiments to handle the deteriorating external position

For the leadership of the party, as well as for the wider party elite, the first station of facing the situation was the December 1974 meeting of the CC. Károly Németh, who followed Rezső Nyers in the position of President of the CC in economic policy matters that year, gave a long speech on the plans for the people's economy and budget for 1975, and about the leading principles of the 5th five-year plan. It is an important and interesting element that the leadership of the party realized and admitted that in the world economy there had been such negative tendencies that pushed Hungary to draw certain consequences. The package of economic policy measures accepted by the CC, despite the fact that it was inconsistent, fact to which we will draw further attention in the future, could have helped in preventing extreme debts, however, it did not come true. Contrary to the resolution, there was no development in changing the economic policy trends. Had there been any, Hungary could have prevented or decreased the impact of these negative tendencies.

Károly Németh asserts already in his introduction: 'When we elaborated the plan and budget for the next year, as well as when we came up with the principles of the 5th five-year plan, we needed to consider some economic conditions that are very different from the ones in the past.'[1] He shares that although the development corresponds with the requirements set forth in the 10th Congress of the HSWP, the balance of the economy was worse than previously planned. He admits that there had been problems in the continuous provision of the country with raw materials and energy providers, and that their higher prices appeared in the production costs as well.

The continuous provision of certain important materials couldn't be assured, which led to the temporary limitation, or cancellation in cases, of the production processes. It is not revealed what kinds of factories were forced to introduce limitations, or cancel their activities, but the degree of the problem can be felt even without mentioning their names. He reveals that the reason behind the forced production stops is that the socialist partners did not fulfil their transportation quotas in some cases, and, as Németh puts it, 'there had been difficulties for our partners as well'. This way of expression is extremely 'sophisticated'. The smaller socialist countries after the oil price shock suffered a serious swap ratio deterioration, like Hungary did, and they tried to make up for this by selling raw materials and other products on the capitalist markets, sometimes even neglecting their COMECON obligations. This meant that Hungary could fulfil its needs primarily by increasing its capitalist imports and decreasing its export targets, like many other socialist countries did. So, raw materials needed to be acquired for convertible currencies from the capitalist markets, and at much higher prices than on the COMECON territory.

Despite all this, our internal consumption increased substantially, and the CC secretary takes pride in this. In 1974, there was a substantial, 6% increase in real incomes, most importantly, retirements and family support were increased, and other socio-political measures were taken. The monthly financial payment of soldiers was also increased by 100%. The investment dynamics was also substantially increased, by 7% in comparison to the previous year.

The population could sense only from the increase of the heating material prices in September that something was wrong. The leadership did everything to hide the worsening economic situation from the population, and not only on the incomes side. Because of this, the volume of endowments in the budget was increased relative to what had been planned, both in case of individual and industrial consumption, by a value of 30 billion forints altogether.

The description of the situation ends with an analysis of the worsening external trade position. Németh explains that considering capital, the economic policy leadership calculated with an overall balanced position in 1974. They had assumed that the swap ratios would decrease by 2–3%. Because of the increase in the prices of raw materials, this decrease was a lot bigger[2].

While in imports the prices of crude oil, and those of industrial and chemical raw materials, which present an important item, increased fast, only the prices of the iron and steel market increased more rapidly considering the Hungarian export products. In case of our most important export products to capitalist countries, like live animals and meat, there was a price decrease in 1974, which was further worsened by the export limitations imposed by the Common Market.

Because of the worsening swap ratio, the gross national product fell short of the plan. In the plan, they accounted for a smaller internal consumption than the degree of econom-

ic growth. In reality, exactly the opposite happened. The difference between production and consumption was equalized by the increase in the accumulated capital debt.

Based on the above, he draws the conclusion: 'The external economic background is different qualitatively from the previous period, and we need to account for this not only next year, but in coming years as well. The equilibrium deficit is greater than in previous years, and resulting from this, we can only restore the balance of our economy during a longer period of time, and with greater efforts. It would be a great mistake not to account for the changes of the capital markets, and for the fact that the prices in the COMECON socialist contracts had been changed for a reason, but likewise, it would be erroneous to disregard the internal problems of our economy, and the shortcomings of our work'.

After the situation analysis, the CC approved an economic policy provision package, the most important elements of which were the following:

In production there need to be introduced structural changes, which increase energy and material efficiency. The changes need to facilitate the production of export products going to capitalist countries, and the replacement of imports coming from capitalist countries.

1. The efficiency of investment activities needs to be increased, and the investments planned for 1975–1977 need to be finalized earlier.

2. A concrete program needs to be elaborated in order to unfold the internal reserves of the people's economy, and to fulfil the efficient use of human resources. The rate of increase of stocks needs to be decreased substantially.

3. The quality of economic management and leadership activities needs to be improved.

4. Although in the policy for assuring the standard of living the principles applied hitherto need to be assured, the rate of development needs to be less than so far.

The CC resolution determined the GNP growth of the country to be 5.5%. In order to assure the balance of the economy, it was determined that the dynamics of internal consumption couldn't be greater than the growth of the GNP, which meant a 4% consumption and a 5–6% investment growth.

By inspecting the individual elements of the provision package it can be stated that these dispositions were inconsistent with the economic condition system of the country, furthermore, there was inconsistency between the provisions and the goals (economic balance).

Reaching the 5–5.5% growth was impossible when both the internal and the external market opportunities were becoming less attractive. Of the components of the growth, exports and internal consumption decrease, and the supply stock diminishes. The intent of speeding up the process can only be seen in investments, which is not enough to reach the planned GNP increase.

Between 1974 and 1978, the (manifested) economic policy assumed permanently that the balance of the economy could be created by maintaining growth and increasing, parallel, the standards of living. The leaders who created Hungary's economic policy identified, by the end of 1974, correctly (in general) the problem, however, the proposed therapy was not enough for handling the changed conditions. However, it could have made the external position of the country somewhat better. In order to achieve this, it should have been realized.

The Orthodox Change and the 11th Congress

However, the conditions were not right for such a demand-narrowing economic policy at the turn between 1974 and 1975. It would have been wrong from the economic point of

view anyway. The so-called worker opposition, which sat in the party leadership, the 'hard-core communists' had just attacked the new economic mechanism, and were just preparing to change the government and the party leaders, who they considered 'too reformist'.

The substance of their attack was that in the economic leadership, the 'worker policy' was not represented enough. They demonstrated this by saying that big factories were in trouble, the living standard of farmers was increasing more rapidly than that of the workers', and the prices were continuously increasing.

The attacks brought the desired results. At the beginning of 1974, Rezső Nyers, the president of the CC concerning economic policy matters was changed, and Lajos Fehér likewise. On the 11th Congress held the following year, Prime Minister Jenő Fock resigned from the presidency of the government, after a dramatic speech he gave in the Congress, while Mátyás Tímár was relocated to the HNB, as president, a position which had been occupied by Andor László, who retired.

The leading positions in economic policy formulation were taken by new people both in the party and in the government. György Lázár, the former president of the National Planning Office became the prime minister, while the secretary in charge of the economic policy position was assigned to György Lázár, first secretary of Komárom County.

The new economic policy leaders were not coming mainly from the candidates of the worker opposition, but instead, this leader group was made up of people who did not participate in formulating the reforms meant to direct the economy, or were less exposed to this work.

The activity of the 'hard-core' people is an important moment, since without them, an adaptation process could have been started right then, which could have prevented the huge future debts of the country by restraining the industrial and individual buyer consumption, and by preferring the more competitive investments.

This way however, the 5th five-year plan did not give any rational economic answer to the ever worsening external balance position of the country. It did not refrain from the internal consumption of the country, it did not make a selection between investments, and by maintaining subventions and endowments, and it did not foster the structural reforms.

On the 11th Congress, there was a step back concerning the necessity of demand narrowing in comparison to the CC resolution of 1974. Kádár in his report unanimously confessed his calling to provide growth and a higher standard of living. '… despite the external difficulties it can be reached for our country to have an economic growth that comes close to previous years, and for the standard of living to increase further'[3].

Practically, on the congress the equilibrium of the economy was not mentioned. Even Károly Németh, who in the previous year dealt with the restored balance as an economic policy priority, said that there was no need to change the proven economic principles.

Overall, we can say that during the course of elaborating the fifth five-year plan, despite the changed situation, which required special management, political interests were dominating opposite the needed economic steps. The political leaders did not admit that things could not be continued in the old ways, and there were societal sacrifices needed. The sacred cow of the system, the continuous improvement of the standard of living, which by the way also assured the legitimating base of the system, could not be touched.

However, it seems possible that if the leaders who formulated the economic policy, and stood on the basis of reforms, would have stayed in their place, things would have turned out differently.

Towards 1978

The fact that those who opposed the harsher provisions won, did not mean that adjustments were completely taken off the agenda. They couldn't be, since the situation was worse and worse. In 1975, on the December meeting of the CC, Mátyás Tímár brought up the issue again, already as the president of the HNB.

As he had voiced previously, he ascertained again that the Hungarian economy was not independent from the tendencies of the world economy, which influenced it a lot. Nowadays it might seem unusual that Tímár talked about this well-known issue again, but back then, this issue wasn't this unambiguous, except for the people who were knowledgeable about it.

According to the official ideology, the world economy cannot be treated as a unit, and even though the capitalist and socialist countries have intensive and various economic relationships, they form two different, separate economic systems.

It is because of this that the worldwide economic prospects were not entirely convenient. It seemed that the year 1976 wasn't going to be a bad one considering the export opportunities, since there were elections in the GFR, Hungary's most important commercial partner, and in the USA as well, which usually entails an invigorated demand through fiscal tools. In the medium term, however, there was no possibility of coming out of the recession. The chances of eliminating stagflation (low GDP growth, together with inflation), unemployment, and the severe current account deficit, seemed to be miniscule.

These were the external conditions of the running five-year plan. The plan accounted for a substantial increase of the capital debt of the country, especially in 1976 and 1977. The planned net value of the debt capital by the end of the planning period would have been close to 4.5 billion dollars. This debt amount would have caused a difficult situation for the country, but unfortunately, this later reached an even higher value.

The president of the HNB distinguished between two big problem areas, when he presented in front of the CC. On the one hand, special attention needed to be paid to the interest and principal payments of the debt. This applied in spite of the fact that in the middle of the 70's, it was relatively easy to receive loans on the international money markets. The financial commitments coming with the loans pushed the leadership to spend the money on developing the convertible product bases, instead of on expanding the consumption rate. This would assure export to capitalist countries, which creates the currency sources needed to pay back the loans.

With this, we have arrived to the second type of problem, the more elaborated implementation of the investments. It was important to allocate the agricultural investment resources in a more thoughtful way than before, and to change the machinery industry so that it would be capable of producing more selective products that could better satisfy the expectations of Western markets. As Tímár put it: 'We should be brave enough to say "no" to certain territories, and where we are competitive, we need to provide the necessary tools.'[4]

It seemed that export crediting and export subsidies needed to increase as well. The fifth five-year plan assigned 850 billion forints to investments in total, of which the majority went to financing the energy investments and the real estate area. There were a couple of hundred-billion forints, where there was still place to move. This is from where Tímár proposed to spend more than the planned 45 billion on export subsidies.

The issue of economic policy changes had surfaced again. Not long after the new mechanism was left without resources, it seemed daring that the president of the HNB talked

about reforming the regulatory, primarily the price system. 'A better price system makes the role of profit as an efficiency expressing means better, and this way, stakes can be better validated than before. I think it is important that firm independence and initiative does not suffer. The big tasks ahead of us call for us to listen to the ideas and thoughts of several thousand company leaders.'[5]

Between 1976 and 1978, it was apparent that the economic situation remained below the not too optimistic expectations of the plan, especially considering the current accounts balance and Hungary's debt to the capitalist countries. The deficit was greater year by year, and considering the total planning period, it was bigger by 2.5 billion dollars or by 50% than the planned amount.

The problems at this time were already present in the COMECON relationships. The swap ratio with the Soviet Union suffered substantial losses, while in total, we had accumulated surplus here and in other socialist countries as well, which were also covered by the convertible loans. In case of the big companies, the endeavour to strive to reach export surpluses, which was a characteristic of socialism, was still there, and they were helped by the budgetary subventions. In many cases, however, imports from the West were easier, faster to receive, and of higher quality. Such products were the fertilizers and pesticides, protein forages, machines and machine parts, and coffee as a consumer product. There was a year when we spent 200 billion dollars for the import of this latter product alone.

The macro-level resource flow catalyzed by the dual external commerce presented the following image: we procured the high added value, or expensive products from our capitalist commercial partners for convertible resources, while our export opportunities in this direction were relatively limited, since the quality of Hungarian products in general did not reach the expectations of the exigent Western consumers. The only exceptions were the agricultural and food products. This brought an ever worsening external balance and an increasing debt in convertible currencies.

The other side of the coin is that the majority of the products and parts acquired for convertible currencies were swallowed by the COMECON exports of the country. The capitalist import proportion of our socialist exports and our socialist assets was ever higher. In practice, we can assert that in Hungary's debt a huge role was played by the socialist export of the country, and we covered the domestic consumption of socialist countries by loans in convertible currencies.

The surmounting problems had passed the stimulus threshold of the party leaders by 1977. By the middle of the year it was entirely evident that the specifications of the 5th five-year plan could not be held, and the negative effects of the world economic crisis were more severe on the Hungarian people's economy than expected. In this context did the July 12, 1977 PC meeting inspect the equilibrium situation of the country, paying special attention to the specifics of the Hungarian–Soviet economic relationship. The committee's opinion was that taking into consideration the difficult situation of the world economy, Hungary should ask for the help of the Soviet Union. The basis of the request was a letter from Brezhnev, dated February 3, 1975, in which the Soviet first secretary promised to offer a one billion roubles loan for Hungary. Based on this, the PC decided to ask the Soviets to offer a three-year loan in order to cover the loans accumulated in the bilateral relationship by the end of 1975. In case a shortage would be accumulated in the period of the 5th five-year plan, which would be covered by a Soviet loan with a running period of ten years.

According to the resolution of the PC, the loans should be amended by top level negotiations in order to achieve that the Soviet Union increases its Hungarian exports, by a value

of approximately 350–400 million roubles. As the presenter of the point in the agenda, István Huszár said: 'We should call for additional imports, say 400 millions, but we should consider its real value as 200 millions. This is what we consider as appropriate in the present situation of the people's economy. We have inspected the relationship of the 350–400 million additional exports with the Hungarian production opportunities, and their effect on the capital balance.

We have come to the conclusion that we can now assume this in reality, not excluding the possibility of a bigger enlargement later.'[6]

Kádár, in his contribution, shows a relatively pessimistic attitude. He asserts that Brezhnev's letter from 1975 and its content belongs to the past.

The leader of the SCP changed his attitude from the previous year. 'According to him, the equilibrium of the Hungarian people's economy is not as bad as we explain, and cannot pay back a loan of one billiard, but they are ready to discuss and give a credit for the amount of the yearly deficit.'[7]

At the background are, in his opinion, the problems of the Soviet economy. Because of this, we should try to have discussions with the Soviets, but 'we shouldn't have any illusions'. Because of the above, Kádár proposes to include in the resolution of the PC that in order to handle the situation and acquire the necessary resources, there needs to be measures taken in the capital area, meaning that investment loans need to be acquired.

György Lázár, the prime minister, formulates his opinion even more unequivocally, and asides the investment loans propose another area of thought to the PC. 'It is well know by the respected Political Committee – and the causes why we keep the question in our drawer is well known as well – that this is the question of arranging our relationship with the World Bank. This is another opportunity which is not a quick solution and doesn't solve all of our problems, but we could enlarge our loaning opportunities by it and it would make possible to solve our equilibrium problems...'[8] Lázár proposes that during the crediting negotiations with the Soviets it would be advised to renew the consultations about entering the international financial organizations by Hungary.

After 1973 the question of Hungary's joining the Bretton Woods financial institutions surfaced again. Although the prime minister's proposal wasn't incorporated into the resolution of the PC, it was still important because from this time until we joined them, the topic was 'in the air' and in the head of the party leaders.

According to the decision of the PC, the CC addressed a letter to the Central Committee of the SCP, in which it bought up the question of the above mentioned loans and the one concerning the enlargement of exports. The requests contained in the letter were repeated by Kádár on the usual Crimean meeting with Brezhnev, on July 26. The meeting surpassed expectations considering its outcomes. The Soviet Union agreed to:

– offer a three-year loan in order to counterbalance the Hungarian deficit accumulated by the end of 1975 in the Hungarian–Soviet foreign trade.

– it would cover the whole amount of the expected Hungarian deficit between 1976–1980 with a ten-year loan, whose volume would be 800 million roubles, according to Hungarian calculations.

– the Soviet Union is ready to negotiate the enlargement of the product commerce which should be higher than the one prescribed by the five-year plan.

– they are ready to have separate negotiations about the energy carriers.[9]

When Kádár presents an oral summary of the meeting to the PC, he shares that the fulfilment of the Hungarian requests should be appreciated, on the one hand, in a context when

the Soviets themselves are in a difficult situation, and on the other hand: "…not only the Hungarian party stays lined up in a queue with their problems, there are others as well, like the GDR, the Poles, and many others. The situation now is that they have pulled us out of the queue and have decided to give this to us."[10]

Brezhnev does not elaborate on why the Soviet Union helped Hungary, however, in connection with the question he brings up an issue which could explain the background of their decision. This issue is the question of dependence on the West. According to Brezhnev, the cause of the economic problems in the communist countries is the extreme degree of worldwide economic integration. About this, he shares: "we could have saved a lot of Western debt had we relied more on socialist integration. …this kind of dependence, economic dependence from the West, which has political consequences when it surpasses some limits, cannot be increased."[11]

The Soviets probably knew that Hungary had not given up the idea of joining the Bretton Woods institutions[12], however, they also had to know that a deteriorating debt position would push Hungarians toward that direction. Since the period of the detente was about to end, it was impossible for the Soviet Union to accept the idea that the block would fall apart. In order to prevent Hungary from following Romania on the road to join the Western financial institutions, the Soviets were ready to offer help, which was not justified by their financial position.

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MOL 288. chapter 4/131.
MOL 288. chapter 5/722.
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NOTES

[1] MOL chapter 288. 4/131
[2] Károly Németh in his speech does not give numbers. According to the calculations of IMF later, in 1974 Hungary suffered aproximately 10% deterioration of its swap ratio.
[3] The minutes of the 11th Congress of the HSWP, Budapest, 1975.
[4] Mátyás Tímár: Grey money-matters, Magvető Publisher, 1989.
[5] The same
[6] Mol chapter 288, 5/722
[7] The same
[8] The same
[9] Mol chapter 288, 5/723.
[10] The same
[11] The same
[12] In the period 1975–1977, several professional materials were compiled in the subject, of which the KGB might have known.

CHALLENGES AND ANSWERS IN ENERGY POLICY

By József Botos – Katalin Botos

Introduction

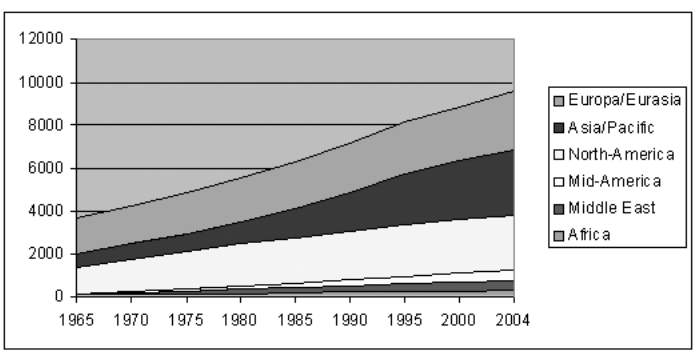
No question that the economic history of recent times can not be interpreted without exploring energy issues.

According to Angus Maddison[1], the acceleration of the development of western economies started in 1820, when the use of fossil fuels in the economy became extensive. Infrastructural development triggered by the spread of steam engines induced an upswing in the industry, resulting in an increase of the population and growth of economy. World economy which as a consequence of a low level of energy input had grown slowly until this time, started to boom and although showing huge fluctuations both in time and across regions, it demonstrated an enormous development. As people now live longer, they also consume more. GDP per capita grows, thus the theory of Malthus is not justified. The next technological boom in the 20th century was also connected to the use of fossil fuels by the spread of internal combustion engines. The main goal of world policy became the fight for new oil fields.

The present situation

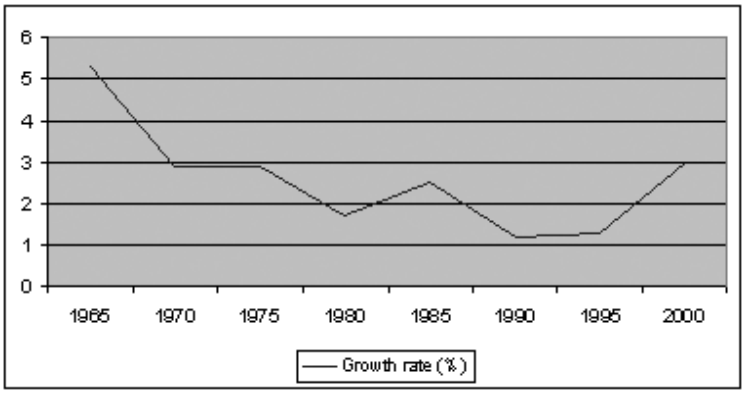
Global use of energy has grown dynamically the last 40 years but this trend has been moderated by the oil crises of the 1970s. Although the dark perspective of the Club of Rome about the fast exhaustion of energy sources did not come true, it is sure we will run out of fossil resources one day. New oil and gas fields will further enable us to base the growth of world economy on current technologies. As more and more countries need the blessings of motorization, more and more production areas are born that require high levels of energy input. The extensive development of Asian countries in the 1990s and especially after 2000 has increased global energy utilization again.

Figure 1.a.: Development of global energy consumption across regions (1 million ton)



Source:http://www.deutschebp.de/browsebytheme.do?categoryId=2010147&contentId=2000077 Own calculation

Figure 1.b.: Percentage development of global energy consumption (Total=100%).



Source:http://www.deutschebp.de/browsebytheme.do?categoryId=2010147&contentId=2000077 Own calculation

Figure 2.: Natural gas as the main energy source of Europe and Eurasia

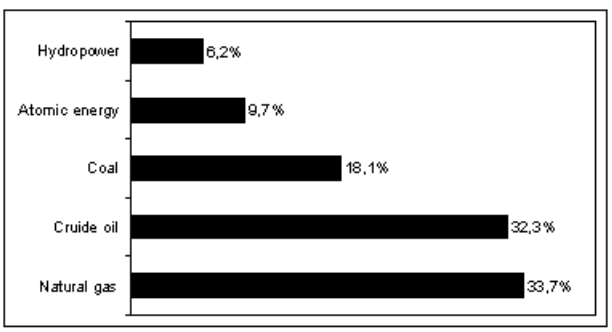


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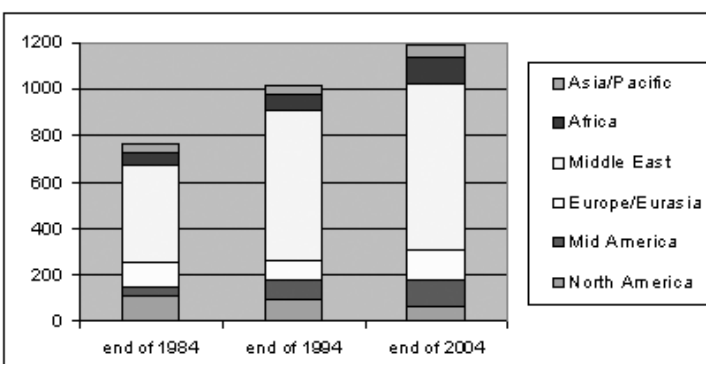
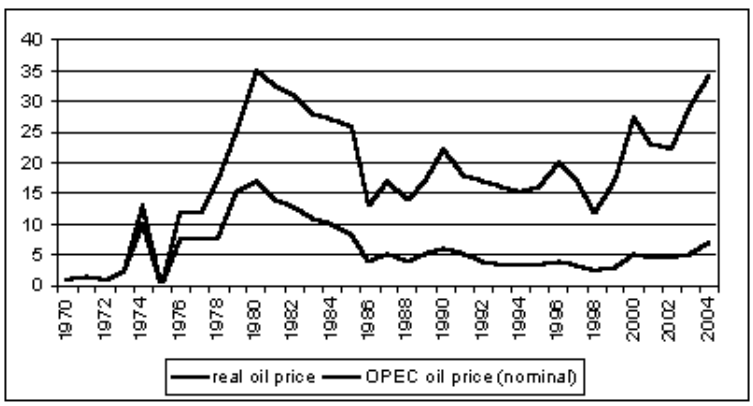
Figure 3: Changes in real oil reserves (billion barrel)



Source:
http://www.deutschebp.de/browsebytheme.do?categoryId=2010147&contentId=2000077

Many experts have pointed out that the rise of oil prices had an enormous effect on world economy. Changes in the international financial system were also forced by the boosts of oil dollars. International inflation heated by euro-dollar markets disrupted the fixed exchange rate system of Bretton Woods. Although the international financial system remained operable, it had to suffer severe crises from time to time. Foreign currency deposits of oil exporting countries also contribute to the current imbalances of international financial markets, although it has many other reasons as well.
It is worth studying the real prices of oil during the last 25 years as a huge inflationary wave penetrated the world economy in the 1970s and in the Eastern-European countries in the early 1990s as well. Thus, it is important to study the prices of oil cleared from inflation.

Figure 4: Inflation-free oil prices have not risen since the 1980s (US dollar/barrel)



Source:
http://www.deutschebp.de/browsebytheme.do?categoryId=2010147&contentId=2000077
Own calculation

It may seem astonishing but the real price of oil did not rise in the last 20–25 years, indeed. It remained under the level of the second oil crises of 1979 and started to rise only moderately in the recent years, probably due to the higher consumption by the Asian countries. Oil exporting countries could enjoy real price advantages for a short period of time only, because as soon as these countries wanted to spend their profits, developed countries sold them goods and services for higher prices.

Which factors influence nominal prices indeed? First of all, the boom of the world economy which was, however, held back temporarily by sudden increases in oil prices. Second, the amount of goods demanded and supplied in the market. OPEC countries strictly coordinate the amount of oil and gas produced and sold abroad, otherwise some countries would decrease prices to get extra foreign currency. However, real prices are influenced by international inflation. It seems strange, but it is the huge foreign currency surplus that enabled the decrease of real values of reserves: oil-dollars deposited in banks worldwide sought investment possibilities, thus financed government deficits – avoiding severe economic recessions – and realized investments that sufficed less energy consumption. Per capita energy consumption decreased global energy demand, and finally, high oil prices were moderated by the demand for fossil fuels. This process was, however, also forced by the decrease of economic growth stipulated by many other reasons (consider the economic

stagnation of the 1980s from which European countries and also Japan could hardly revive). Only the USA managed to produce a significant economic boom but he was not forced by the international markets. According to experts, this fact pushed the third oil crises far in time[2]. The third crises were supposed by the fact that foreign currency deposits decreased in real term after the first and second oil rise due to inflation. This, however, required a certain level of demand for oil and gas which was responsible for the first oil rise as well. We argue that synchronizing the American and the European business cycles produced a market environment where the oil prices could have been increased. The American diplomacy promoted the widespread use of dollar in the international commercial contracts. Thus, oil exporting countries demanded dollar which suffered from weaknesses that time.[3]

The evolution of terms of trade

Prices in the world economy are best characterized by the ratio of prices of raw materials and energy sources to finished products. The most important factor of term of trade is the price of energy. We have seen that developed countries managed to substitute losses of income due to higher oil prices. Studying term of trade between 1963 and 2000, we can establish which countries were capable for it[4].

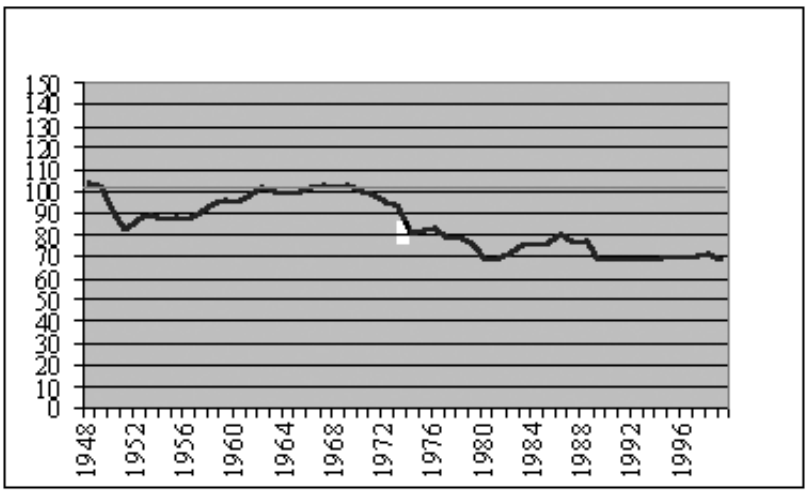
The basic year of our investigation is 1963 because in this year – falling between the Korean and the Vietnamese wars – world prices remained stable. As wars and military conflicts always have a price-increasing effect on energy markets, stagnating prices of the 1960s started to increase in 1973 when the US dollar was depreciated the second time. Export competitiveness deteriorated in countries where currencies appreciated against the dollar. It had two reasons: energy prices increased and export income nominated in national currencies decreased. These two reasons led to a significant worsening of profitability that could be moderated by increasing export foreign currency prices.

Countries made price increasing decisions according to their treaty positions on their export markets. Corporate producing up-to-date finished products by using developed technologies were able to increase foreign currency prices because their customers could not supply these goods at lower prices. Corporate exporting agricultural products were not in such a lucky situation.

Term of trade is a – not complex – signal of competitiveness. This has to be pinned down because many people doubt the ability of term of trade to describe competitiveness. Some researchers reject measuring competitiveness of countries as well. Should an area underlie a currency area, competitiveness of market entities is rather influenced by prevailing economic policy. Once the commercial account of a country has been in a deficit for a long period of time, it is worth investigating why merchants selling goods to these countries are highly competitive. Chronic commercial deficit still bears losses in competitiveness even if it is hard to be financed or the technological advantage of the country is significant.

These facts are typical for the USA but it would be inappropriate to declare it „uncompetitive". According to data, however, term of trade of the USA has worsened since the 1970s.

Figure 5.: Term of trade of the USA (1963=100)

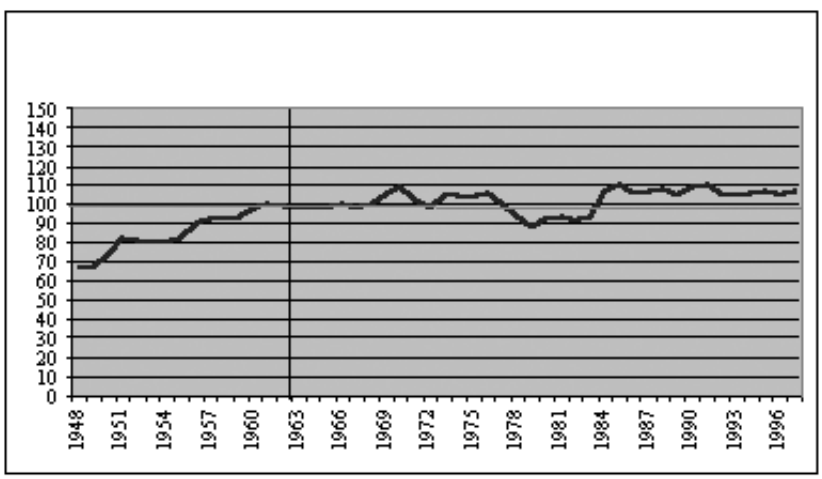


Source: Monthly Bulletin of Statistics, 1977, 1981, 1998. Own calculation

The USA seems not to want to or not be able to increase its export prices as much as his import prices have increased. Thus, the share of USA in international trade is constantly stable at 12% (the share was above 20% after World War II). However, it is clear that the government of the USA gives a share from income to its exporting firms or these firms force subsidy from the government. The term of trade never reached the level of 1963 again.

We see a different situation with German prices. Looking at term of trade, we see that oil prices had pushed the German term of trade only temporarily under the level of 1963.

Figure 6.: Term of trade of Germany (1963=100)

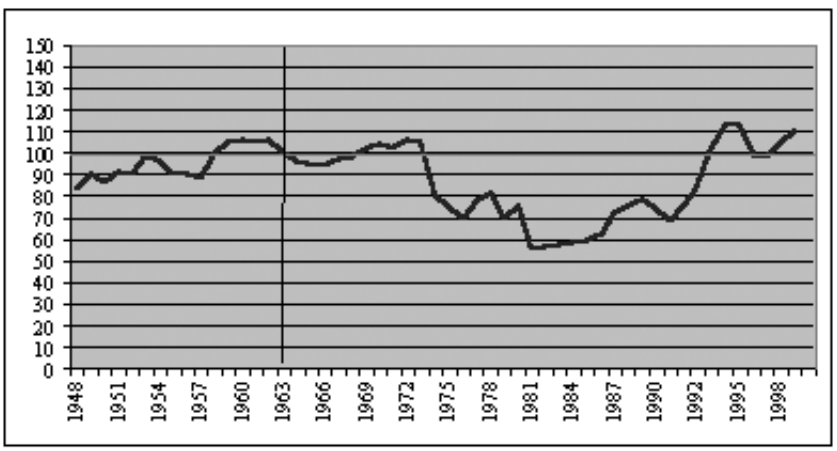


Source: Monthly Bulletin of Statistics, 1977, 1981, 1998. Own calculation

Term of trade has been positive since the beginning of the 1980s so German market entities were able to revive from cost drawbacks caused by the increase of import prices. Studying price trends in the statistical report of the Federal Bureau of Statistics of Germany („Preise, Löhen, Wirtschaftsrechnungen"), we can establish a change in German price policy since the middle of the 1970s. During the 25-year-period after World War II, the level of export prices remained usually under that of import prices as the German mark was rather devaluated to purchasing power parity and firms burdened their operational costs mainly on the domestic market. During the next 20 years, companies successfully tried to compensate for the intensively increased import costs by raising foreign currency prices. We have to admit that continuous appreciation of the German mark forced them to raise the foreign currency prices. Appreciation compensated for the rise of foreign currency import prices but it also decreased the value of incomes realized in dollar but converted into German mark. In Germany, rising of foreign currency prices was a general constraint. But how was this possible in a strong international competition? The only possible solution is that products on international markets were cheaper but at the same technological level that remained attractive also after price-rises as opposed to other possibilities.

Japan, requiring a significant energy input had suffered severely from oil price rises.

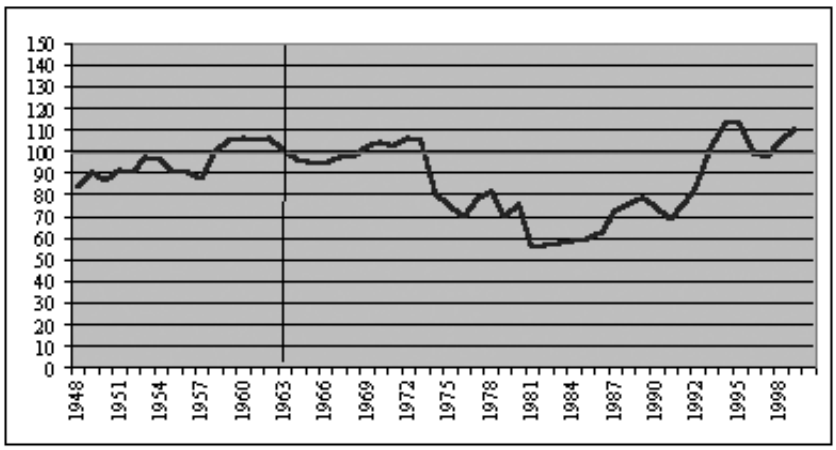
Figure 7.: Term of trade of Japan (1963=100)



Source: Monthly Bulletin of Statistics, 1977, 1981, 1998. Own calculation

Japanese export prices were rather low. Japan did not risk this price level so prices remained under 100% from the 1970s to the middle of 1990s. His term of trade improved only for a short period of time. As opposed to Japan, Switzerland had a positive term of trade. Despite oil price increases, the country produced export surplus and also gained on export prices.

Figure 8.: Term of trade of Switzerland



Source: Monthly Bulletin of Statistics, 1977, 1981, 1998. Own calculation

Comparing term of trade to GDP, we can establish that a country gains and loses incomes during business cycles based on external foreign currency price changing. According to the calculation of József Botos, Switzerland may gain a whole annual income in every 11 year if his international commercial prices are favourable[5]. In the annex, we present the graphs about the external competitiveness of Norway, Italy and Spain. Term of trade of Spain have not revived since the 1970s, Norway gained profit from national oil fields. Italy was affected by oil price rises but managed to alter his term of trade in the 1990s.

The case of Hungary in historical aspect

Hungarian term of trade shows huge losses on term of trade. Hungary's international commercial prices did not enable the country to revive from the shock. This is due to the fact that our export to the Soviet Union was dominated by agricultural goods. During the change of the political system, the share of agriculture from export was about 20%. We could sell agricultural goods in barter just like the Soviet Union sold us energy. During the 1980s, meat and cereal exports were contrasted with oil imports in barter agreements. It is also known that prices nominated in rouble followed international price changes with a slight delay within the socialist commercial frame. These prices were defined well for stock market products but were rather low for agricultural products. The Hungarian agriculture could not compensate in its export the losses on import price increases: the prices of most homogenous products could not be raised. The fact, that the Hungarian economic policy wished to stop twisting of the inflation by appreciating the currency, encouraged the rise of foreign currency prices. Its success depended, however, on the product-structure. We can observe that capitalist's international trade developed slightly on price-work that was perceptible also in term of trade. Altogether, Hungary's economy suffered losses on the changes of term of trade. According to the calculation of Jozsef Botos, Hungary lost its annual GDP on the prices every 7 years. This confronts to the data in Switzerland. This cal-

culation was supposed to emphasize that the structure of export and import can significantly influence the GDP of a country. If national products are demanded on international markets, exporting firms are able to increase prices and compensate the losses on import prices. Eventually, the country shall not suffer from income losses from international price changes but market entities will definitely face market changes.

This process did not come true in Hungary. But how is term of trade of capital referring to oil price rises if most of our energy inputs originated from the Soviet Union? The deterioration of term of trade of the Soviet Union can be understood but why does it reflect in the trade relation with Western economies?

Hungary experimented to moderate the dependence on soviet-import by the Adriatic oil pipeline. This cost a lot of money and achieved no success. We wished to diversify our input but as the pipeline was completed in the 1970s, oil export from Arabian countries would have been more expensive than from the Soviet Union.

Soviet oil prices were set into trade agreements at a crawling price base, so prices remained under potential prices. The pipeline became one of the many investments of the socialist era that have never brought any profits. We have to admit that the aim of the economic policy was right since dependence on oil has led directly to political dependence[6].

We can not state that the only means to keep a country in dependence was the oil but it was definitely an important tool.

An important element of political dependence was the fear that possible domestic political disturbances will lead to external interventions. The prevailing political forces were highly interested in maintaining political stability. This political dominance acquired by alien weapons could only be maintained if direct external interventions are successfully averted. The country could, however, have carried out reforms to maintain relative well-being if there had been no disturbances from dissatisfaction. This was a double trap! Reforms enabling better achievements of the economy required peace in the society but these reforms could only be realized in peace. Without this, economic policy is shepherded back to administrative means used during the era of planned economy which would have caused poverty and dissatisfaction. Thus, people had to be persuaded to legitimate the system quietly.

Oil price rises affected Hungary severely from this aspect. As energy prices rise in the country people are interested in their standard of living and neglect the fact that energy prices on international markets could have risen even higher. Economic policy was thus responsible for hindering energy price rise penetration and social dissatisfaction in the 1970s. This role confronted with planned reforms since it distorted the inspiring role of prices. Neither corporate, nor people had been interested in energy savings that would have been the only sensible reaction, however. Economic policy introduced active exchange rate policy as a general tool, appreciating the forint and fixed prices needing government subsidies later[7]. Price and export subsidies created by the appreciated exchange rate meant a huge burden for the state budget. As Hungary did not dispose of enough domestic savings, forint surpluses could only be financed from foreign credits. External financing was easily justified by the fact that the dollar – becoming artificially cheaper after appreciation – boosted the import which required more foreign currency reserves. Then has the so-called „twin deficit" developed but it has also been typical ever since. The contemporary state accounting boards, however, tried to obscure this and present deficit financing credits as other revenues.

But why did not Hungary have domestic resources to finance the budget deficit? The reason is that wages had been relatively low and possible savings from the society were

spent on housing credits. There have been no other resources but external financing which was furthermore comfortable for the country. So, temporary domestic problems had been solved by increasing the level of indebtedness. We do not know for sure why economic policy decision makers believed that indebtedness can be overcome later on. They certainly did not count with two things: first, that deficit will not be a single phenomenon since the economy can not adjust to changed circumstances in the world economy due to the distorted mechanisms, and second, that international interest rate conditions will change dramatically. It was rather cheap to apply for foreign loans due to excessive liquidity but it became expensive after the deficit boom of the USA increased the interest rates worldwide.

This has increased interest service that could not be financed from the capital account suffering constantly from a deficit. So, debt had been accumulated by a snowball-effect.

As a consequence, international inflation could not be kept outside the country by appreciating the currency but it could be converted into a current account deficit.

It should be emphasized that the odd Hungarian economic reforms which were started but stopped later affected the external relations. Western import becoming cheaper after depreciation was incorporated in Eastern exports boosting indebtedness. Western countries produced a surplus as opposed to Eastern countries where the level of indebtedness increased. As Hungary could not take up any more loans from abroad the country came close to insolvency, like Poland. In order to manage debts, Hungary joined the IMF in 1982 and was forced to carry out tightening actions. However, setting the country on a dynamic growth pathway was not feasible in the 1980s (statistics show only 1% growth of GDP p.a.). This has increased dissatisfaction and led – together with foreign problems – to the collapse of the system in 1990.

Returning to our first question: why did Hungary suffer from a term of trade deterioration in international capital relations beside the oil import that burdened all socialist countries?

The reason is that our western partners increased their prices what could be seen on the graphs. This period, Hungary performed about half of his foreign trade with countries out of the CMEA territories, especially with EU countries. Our most important foreign trade partner was Germany but Italy played a significant role too. We have seen that these countries made enormous efforts to diminish their losses on prices. These countries raised their export prices and we could not do anything else than get used to it as developed Western technologies assisted to produce and sell competitive processed goods to Eastern countries. Most firms considered trading with socialist countries to be beneficial. The business was remunerative in national currency!

So, Hungarian foreign trade had suffered from oil price rises by two factors: directly in soviet relations and indirectly in foreign trade relations with Western countries. All responsibility, however, shall not be drifted to external circumstances – Hungarian economic policy had also a big role in the severity of the consequences.

Challenges and answers in energy policy

It is worth evaluating the answers of the energy policy besides analysing economic policy. Studying analysis of former UN officials, we can establish that developed countries did not react to energy price rises by developing the domestic energy sectors[8]. The exploitation of fossil resources in Europe cost lots of money since reserves shall be exploited from deep

and exploitation from the North-sea requires expensive technologies under the current physical conditions. These fields were not utilized until oil prices skyrocketed again after the second crisis. At this time, exploitation seemed to be economical, so it became a real alternative for Norway and Great-Britain. We remember, however, the strong commitment of the Thatcher-government to close down non-viable mines requiring state support in spite of long lasting strikes.

Energy policy followed a special path in France where nuclear program became the cornerstone of energy policy. A significant part of France's energy demand is provided by nuclear power stations.

Most countries in Europe, however, had bought energy from abroad. These countries did not even aspire to make foreign investments. On the one hand, this was due to the fact that oil exporting countries have realized the importance of their natural resources and on the other hand, foreign investments were risky due to the international political turbulences.

The only possibility was traditional trade in which developed countries tried to compensate losses of income by raising export prices.

As far as domestic investment policy is concerned, the spread of energy saving technologies had been typical. Per capita energy consumption decreased everywhere. It is an interesting fact that since domestic energy price rises in the USA had been smaller than in other countries in the 1970s, the country had a time-lag to European countries in using energy saving technologies[9].

In Eastern-Europe, however, we experience strengthening of self-sufficiency in the countries of the Council for Mutual Economic Assistance (CMEA). It was not only because better prices supported internal trade but also because price changes had been favourable to the Soviet Union. It is common said that providing CMEA countries with energy was a burden for the Soviet Union, the situation eased as prices became more advantageous. Price differences enabled to import products to the Soviet Union suffering from constant current account deficit. Since energy transportation from long distances in the East requires capital investment, the soviet economic policy had to overcome the problem.

Investment contributions and credits of the International Investment Bank[10] had served this purpose. Former conditions are reflected well in the fact that the scientific thesis of the author was classified, although neither secret information had been included nor the critics of the CMEA system had reached further than the work of Alexander Ausch („Situation, mechanisms and prospects of the CMEA system") published by the publishing house of the Hungarian Academy of Sciences in 1969. However, the era between 1969 and 1972 had brought a tenser viewpoint of the Soviet Union as opposed to the previous liberal, reform-oriented manner. The thoughts seemed too „revolutionary"[11]. Ausch rejected previously the official viewpoint many times. He was not invited to conferences and became embittered. His teaching work at the University of Economics was taken by the author of this article later.

The International Investment Bank was established in 1971 similar to the European Investment Bank to finance common developments. During the first period, Hungary tried to get support also for developing the processing industry but these efforts had not been successful. The bank that will be dissolved soon used most of its tools to finance the building of the Soviet pipeline in the 1970s[12].

As we can conclude from a former study[13], investments financed also by the International Investment Bank served mainly the interests of the Soviet Union and lacked of any kind of rationality. The building of the pipeline of Orenburg was divided among the inter-

ested countries. Every country had to perform their own works; payment was settled according to soviet building norms. The pipes had been imported from Western countries, thus, countries applied for foreign currency loans. The pipeline, however, became the property of the Soviet Union. The foreign currency and transferable rouble loans to build the pipeline had been given to the Soviet Union in two-sided agreements. The loans were installed but loan conditions were rather unfavourable. The several billion dollar debt burdened the external debt of Hungary and so contributed to the snowball-effect. This served the purpose of transporting gas with fixed long-term conditions. But gas received as an exchange for loan instalments had to be accepted. Thus, Hungary became a leading country in using gas-operated systems. The technology spreading also in rural areas diminished traditional methods of household utilization. Using gas was more comfortable for households and more advantageous to protect the environment as opposed to coal. The indirect effect from eliminating traditional agricultural wastes stemmed evanescent but may seem regrettable today.

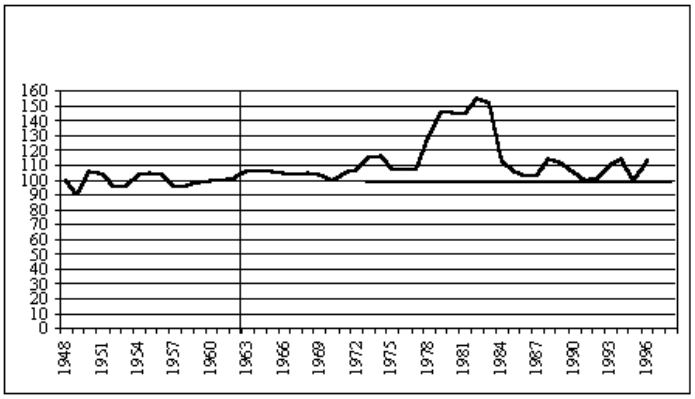
Today, Hungary depends more on gas import than it would be acceptable. It is easy to get used to good things, so households use gas heating more widely than it would be acceptable. As gas prices rise the population is also about to save energy by heating only designated places of flats. However, consumption remains high in Hungary. This fact – as we have experienced during the winter of 2005/2006 – exposes the country to severe risks in economic policy.

Summary

Hungary reacted to international oil price rises in a no sensible way in the 1970s. As opposed to international practices, the country did not pay enough attention to develop processing industry by energy saving technologies and encourage the sensible consumption of households but invested in extensive solutions. The country was partly responsible for this step but the pressure from Moscow also forced us. Autarchy at the level of CMEA in the form of investment contributions and unreasonable economic and organizational solutions became a costly way of energy supply. Financial policy serving the wishes of the power held in the emergence of price effects on internal markets hurting the country severely on the long run. The most absurd thing in this situation was that these negative effects had been intensified as a result of Hungarian economic mechanisms. Everyone was interested in forint profits. This fact resulting in the increase of dollar import and appreciation of the exchange rate became a serious factor of indebtedness. As profits were measured in forint, we transformed convertible dollar receivables to inconvertible transferable rouble. So, debt taken up from capitalist countries had not been even partly moderated by claims from socialist countries. Actually, both meant a burden for the country. The term of trade of the country deteriorated constantly and we could not reverse it by developments in the processing industry. But how would it have been possible if capital required for modernization had been absorbed by autarchic energy policy and reforms aiming to serve a sensible economy had been realized only partly until the collapse of the system[14].

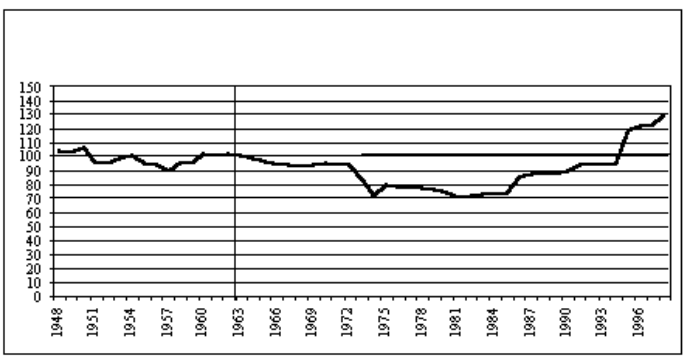
ANNEX

Figure 1: Term of trade of Norway (1963=100)



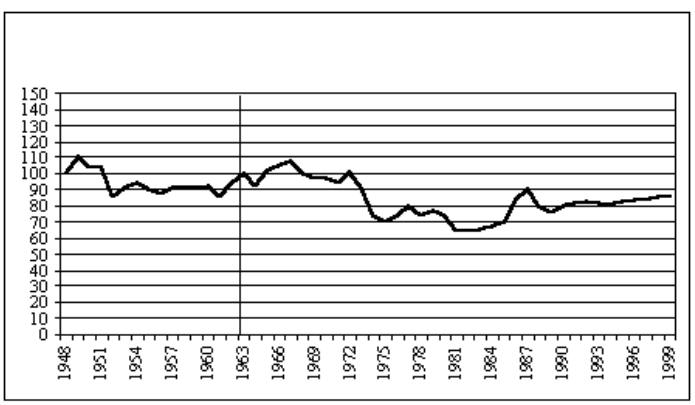
Source: Monthly Bulletin of Statistics, 1977, 1981, 1998

Figure 2: Term of trade of Italy (1963=100)



Source: Monthly Bulletin of Statistics, 1977, 1981, 1998

Figure 3: Term of trade of Spain (1963=100)



Source: Monthly Bulletin of Statistics, 1977, 1981, 1998

NOTES

[1] The World Economy: a Millennial Perspective OECD Publications, 2004
[2] József Botos: Nemzetközi versenyképesség és árforradalom KJK, Budapest 1981.
[3] József Botos i. m. 1981
[4] József Botos: Versenyképesség – Nemzetközi versenyképesség PhD-értekezés, SZTE, 2001
[5] József Botos: i. m. 2001
[6] It is no coincidence that Romania who disposes of more oil reserves could shape his foreign relations freer in the 1970s than any member country of the Council for Mutual Economic Assistance. This fact has become a subject to jokes. The Mikroszkop Theater led by Janos Komlos presented once a cabaret show in which artists dressed in folk representing the countries of the Council for Mutual Economic Assistance. The artist representing Romania had two musical instrument in his mouth: he blew a pipe and a saxophone.
[7] Botos – Szalkai – Patai: Pénzügyek és nemzetközi gazdasági kapcsolataink. KJK, 1981
[8] Konjunktúra-és Piackutató Intézet: A fejlett tőkés országok beruházás-és fejlesztéspolitikájának hosszú távú alkalmazkodása a megváltozott világgazdasági helyzethez. Discussion Paper, manuscript, 1980.
[9] Katalin Botos: Energiapolitika külgazdasági szemszögből In: Pénzügykutató Intézet Tanulmányai, 1980.
[10] Katalin Botos: A szocialista integráció nemzetközi beruházáspolitikája Kandidátusi értekezés, 1972
[11] Alexander Ausch died unexpectedly in 1971, two years after publishing his book. The cause of his death has never been clarified.
[12] A study of the author dealing with investment contributions of the 1970s had not been approved for publishing. The prestigious director of the Finance Research Institute, Istvan Hagelmayer justified this decision by the fact that Andropov, former head of the KGB (later secretary general) visited Hungary that time and asked the leaders of the Party to stop the publishing of the article judging the rouble settlement system. Censorship had only been eased after the death of Andropov.
[13] Katalin Botos i. m. 1972
[14] Katalin Botos: Lesz-e konvertibilis a magyar forint? KJK, 1990

REFORM IN AGRICULTURAL PRODUCTION IN HUNGARY THE ROLE OF PRODUCTION SYSTEMS IN THE EVOLUTION OF THE AGRICULTURE BETWEEN 1960 AND 1990

BY SCHLETT ANDRÁS

Hungarian agriculture expanded its emission fast in the sixties and seventies. Between 1961 and 1978 Hungary was surpassed in the increase of gross agricultural production value only by the Netherlands. Moreover Hungary took the first place in agricultural production value per head.[1] Agricultural development speeded up especially after 1967. The agricultural production value between 1960/62 and 1983/85 nearly doubled. In case of cereal production per head Hungary was on a par with the USA, and it was only passed by Canada and Denmark, while in case of meat production per head Hungary stood second in the world after the Netherlands. On the other hand, however, because of the growth of capital intensity net production of the agriculture at the same time increased only by 20 per cent in relative comparative prices of 1981.[2] (ROMÁNY, 1998.)

The potential of Hungarian agricultural production was also significant in international relations. The average production of wheat and corn matched the French, the Danish, the American or Canadian outcome, and meat production was also among the best in the world (KSH, 1985).

The aim of the essay is to demonstrate the characteristics of industrial like productive systems gaining ground in the Hungarian agriculture from the beginning of the sixties. In course of this the article concentrates upon the emphasis and analysis of those factors which determined the offset and development of the new production organising form in special way. It presents what role industrialising played in the evolution, successes and failures of the given development models, and what agent role it played in the enterprise system established in the sixties and seventies and in the organization of different integration forms. In the end the history of industry like agriculture, – as an outbreak attempt – can partly give an answer to the deeper correspondences of the operational problems of the socialist economic system.

The main aim is to demonstrate the specific and dominant elements of the mechanical development of social agriculture, such as:

– The spreading of mechanical energy and mechanical machines
– The development of plant improvement (first of all hybridization)
– Artificial fertilization, cross-breeding in live-stock farming
– More perfect soil-ameliorating improvements
– Introduction of constructional improvements

In agriculture beside the policy aiming the improvement of the standard of living and the effectiveness of the production, the second aim closely related to the former was to justify the legitimacy of the big farms, its more developed state. Till the beginning of the sixties as a consequence of collectivization agricultural production reduced with 10 per cent at the same time. It was obvious that considerable development, the provision of the supply, the growth of the standard of living among new conditions could be carried out only by total technological reconstruction.

Live-stock farming

Socialist ideology tried to change the producing proportions, push forward the segments having higher efficiency, and raise the output rapidly in agriculture. Before the poultry-farming programme Hungarian agrarian experts were informed by international data and foreign literature about the rapid industrialisation of the poultry meat and egg production in the developed countries, in consequence of which this sector guaranteed the largest crowd, most equal quality and cheapest meat production within the briefest period. As a consequence of the great prolificacy of the poultries the rotation of the production is also quick, so it was appropriate for producing great mass of meat year by year. Its adaptation ability was remarkably wide and coped with every phase of the professional production. So in case of poultry meat and egg production the economic and political profile became compatible with each other.

The opening to the West of the Hungarian agriculture was also connected to this sector. Egg production started in 1962 with Lohmann-type poultries imported from West-Germany. Then they organized the building of poultry stables within the farm, which were built in construction appropriate for the close production system. With the cut off of the elements of natural environment and with the industrial type portioning it became possible to measure and regulate all producing factors in all time. They created strict harmony among farming, propagation, incubation, raising, settling and slaughtering. The activities of all factories was organized according to a closely connected programme.

As a consequence of the significant domestic supply and the relatively cheap price domestic poultry meat and egg consumption sky-rocketed, and in 1985 Hungary was ranked among the first five countries in the world screened per head. The production made a significant export possible. The most progressive role was played by poultry-farming in the Hungarian large-scale live-stock farming till the end of the examined period, and in its level it became the closest to the leading countries in production.

In the field of large-scale pig breeding they wanted to reach competitiveness with creating large-scale conditions similar to the poultry. In the beginning of the programme pig farms operating on the closed technological principle already existed in the developed capital countries, but their proportion was smaller than the capacity of the farms built in Hungary (with an issue of generally 600–700 sows, 9–12 thousand porkers). The production with a new method – although this started on wide research-developing and producing base and by which they used numerous foreign experience and innovating results – remained problematic till the end. In course of the planned investments they often overdrew the financial budget with 40–60 per cent. The buildings and the new farming technology did not fit to the nature of the animals. The production proved to be more material- and energy-demanding than the planned that is why most farms could not realize the nominal emission.

By introducing the system the main fault was that during the carry out they copied the poultry-farming programme mechanically. It turned out that they cannot take over everything from the poultry-farming, because the most difficult part of the process, the incubation was good to solve by poultries, but at the same time the early phase caused numerous further problems by pigs.

The failure of the programme is shown by the fact that we could not manage to join forces with the international leading group with the farming and the producing results, and meat quality also fell behind eg. the Danish and Dutch standards. The losses caused by death and the so-called technological rejects were remarkably high (from 100 only 68–71

reached the slaughterhouse). National spread of the professional farming and stabilization of the results on internationally week middle level resulted in the most potential loss of Hungarian agriculture.

The industrialisation of the sheep-farm ended with a spectacular failure, as it was less compatible with the biological capacities of the animals. By industrialising the production the farming on closed tread grating caused foot problems and get lame within a short time, so the animals were later fattened within traditional circumstances but with intensive fodder supplement.

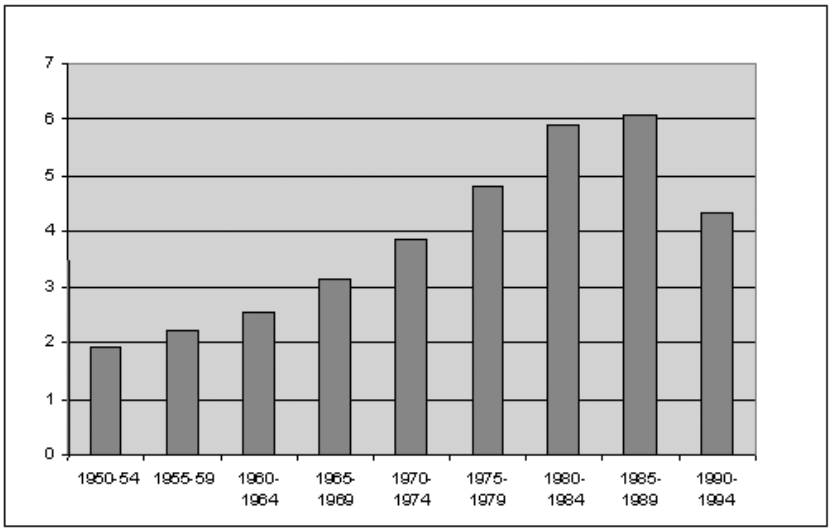
Cultivation of plants

The closed system of the professional commodity production was firstly developed in the production of poultry products, despite the fact that hybridization as the main incentive was taken over by the poultry farmers from corn growing. Corn came to the centre of the interest of experts examining the possibilities of intensive, professional production already in the sixties. Among the cereals this plant has the greatest productivity, and it contains the most energy in a unit quantity, and because of these two attributes it was the most appropriate for the realisation of the aims of corn and meat programme announced by the upper leaders. In Hungary different researches took place already from the beginning of the sixties. They examined the possibilities of increasing the yield, the question of one-crop cultivation all-round, made experiments as concerning variety-comparing and artificial fertilizer and looked into the effects of different weed-killers and machines of different foreign companies.

The operation of the corn production systems were allowed by the Agricultural and Commissariat Ministry in 1971. They used foreign exchange constructional credit form in the import of the necessary production lines. According to this they had to create the conditions of the development of corn growing with the export of a part of the surplus crop. The CPS (Corn Production System) started its operation basically with capital machine system, although later they managed to substitute some machine type for some produced in Hungary. They used the technological system of CPS in 1972 on 60 000 hectares, in 1973 on 124 000 hectares. The centre of the system was the Bábolna State Farm in the first year. The result of corn production sky-rocketed, so it became necessary to create a separate company. On 30th March 1973 the Bábolna Corn Producing Mutual Company CPS was born. (SCHLETT, 2007.)

In Hungary corn became the primary plant of the production systems of cultivation of plough-land plants. Its main attribute which made it appropriate for this was the good monoculture-patience. The average yield increased by 25 per cent per hectares from 1970 till 1980 (see Figure 1). Besides creating fodder base the technical and organizational causes also played a role in that production systems got one-crop nature. Experiences, however, showed that within a relatively short time monoculture resulted in problems of different nature, whose neutralisation required considerable material sacrifices. Such were the unfavourable physical-chemical and biological alteration of the soil. A lot of problems arouse eg. the harsh spread of some resistant weeds connected to certain monoculture, and the accumulation of chemicals. The cut of the optimal time meant further disadvantage in the production during the yearly work.

Figure 1. The set of average yield of corn (t/he)



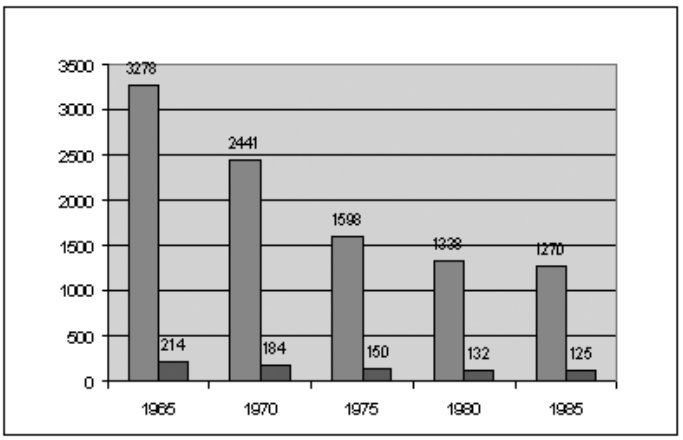
Source: SZÁSZ K. (1995) p. 893

Concentration

In the seventies huge company unifications took place in the agriculture. Between 1970 and 1979 the number of state farms reduced from 184 to 131 (see Figure 2), its average area, however, increased from 5548 hectares to 7598 hectares. (CSIZMADIA, 1981.) Combinations were also organized. In case of combinations main profile activities were not confined to the single sections of agricultural production. They clasped the former separated sections of the output, such as fabrication of the means of production, the production of the primary materials, processing and sale of the agricultural stock and validated these in the same enterprise domain. This company organisation so evolved and set up had to undertake the complex development in its field of activity as well. This could be reached with development work using wider-range research and academic achievements, intense concentration of the production and partner relationships. (KLENCZNER, 1982. p. 123)

In Hungary great agricultural companies evolved never seen before, whose production value matched also with the industrial corporation. Inside the economies more vast sectors evolved and industrial and accessory activities also joined the agricultural production. Almost one-third of the activities of every big farm did not banter close to agricultural production. Agricultural corporations and the first combinations in it evolved in the beginning of the seventies in Bábolna, Agárd, Bóly and Mezőhegyes. The combinations and state farms integrated more and more lands, gave rise to enormous production volumes, developing either agriculture or food industry and different industrial activities. They played great role in the evolution of productive systems. They provided the widespread of up-to-date techniques and technology through the production systems coming into existence.

Figure 2. Changes in the number of co-operatives and state farms



Source: CSETE L. (1985)

In agriculture the integrating activity of the big farms became a characteristic developmental direction beside the centralisation process. The rise of the company size was changed with horizontal and vertical relations. New type co-operation forms were created and the process of production concentration and specialisation got new content. In agriculture enterprise systems came into being with lot of functions and rich profile. In the scope of the company supra-company type of organizations (systems, associations) were formed.

The existence of production innovation assumed changes in the factory organisation, and this went together with the spread of different associative forms in agriculture. These had significant task in the development of the technical-technological innovation. The role of the system centre as innovation centre was based on the genetic, technical-technological and farming complex system, where research development activity had more and more role.

The most characteristic feature of the co-operating process was that certain previous company functions were often separated from the frames of the company and found employment on other organizational level of the integration. The production systems represented technological and organizational innovation and most of them operated as an organisation spreading innovation.

Erosion

In Hungary successful change of the production profile served as the basis of success. Among its conditions they found important to create the human, spiritual conditions, the victory of the affected over the material and political support. As the logic of internal and external planning differed, it meant advantage that in fields of poultry-farming their value judgement agreed, so its end-product proved to be well-saleable in world market. The success of the programme lead further strengthening of the belief of "positive effect of size profitability" and put the stamp on to the reconstruction of the sector proportions of production and agriculture. As the "forced" big enterprise frame not adjusting to the type of the activity in many cases was not effective, the reconstruction in such ways went with many disadvantages. The one-crop corn growing, the ecological conditions, the basic century-old agrarian

technological rules, the compensation of the negative effects with chemicals necessarily increased the industrial dependence of the agricultural production, increased their costs with the rise of the industrial prices and started a deteriorate process by soil. Another time because of the characteristics of the products the advantage of the great organisation, the closed technological systems, the specialization could not succeed, e.g. in the case of sheep-farm.

Special attention was paid to the mechanical improving activity. They particularly dealt with this sphere. Mechanical development was related mainly to buying western licences and know-how, which they developed on. The relations with western companies had an important role till the end. The purchase and use of developed western technique also helped the change of production profile and rise of educational standard of the workers (the training of the workers often went parallel with the installation of new machines) but often the improvement of quality.

Development of the Hungarian agriculture in the second half of the 20th century can be characterised with the apace rise of direct (fuel) and indirect (chemical fertilizer, pesticide, machine etc.) energy input. The proportion of the materials having industrial origin in the total materials utilization of the agriculture was evanescent in the beginning of the sixties but it came near 60 per cent in the middle of the eighties (see Table 1). This was also followed by the revolution of the land structure, concentration, centralization, advancement of size and with this also a drastic reduction of diversity, and variegation. (VARGA, 2000.)

While the growth conditions in the sixties can be characterised with the existence and accumulation of the production factors being at the command relatively at a low price and abundantly, the flare of international relations and broadening of the markets due to this, the changes of the world economy in the seventies and eighties exaggerated and revealed the vulnerability of the allocation systems. (BEKKER, 1995. p. 147)

Table 1. Input-output price index (per cent)

	Index (1980/1975)	Index (1988/1980)
Procurement price of agrarian products	124,4	135,8
Price of means of production with industrial origin	145,8	149,8

Source: SZABÓNÉ M. ÉVA (1991) p. 38.

The industry like production and technology configured in the large-scale agriculture proved to be a method firmly claiming energy and industrial material. This also contributed to the fact that producer utilization increased more rapidly than gross production so the proportion of net agricultural production – and its value as well – decreased. (KLENCZNER, 1982. p. 28) The effectiveness of the investments used in order to expand agricultural production became more and more hard. Contrary to this greater efficiency demand did not appear in the arrangements of economic policy, while the constraining effect of the restoration of the trim prevailed.

NOTES

[1] In this it also played a great role that in Hungary the density of population is smaller than in other agrarian countries.

[2] Meanwhile the employed manpower diminished significantly.

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"THE HUNGARIAN MODEL" – HUNGARY IN THE EIGHTIES IN THE EYE OF POLITICIANS AND EXPERTS IN THE DOCUMENTS OF THE HUNGARIAN MINISTRY FOR FOREIGN AFFAIRS

BY JÁNOS KÁVÁSSY

When discussing the late period of confrontation between the two superpowers during the Cold War it is pivotal to study the United States' policy of 'small steps' that first and foremost meant applying diplomatic tools. Undeniably its most important ground was Middle and Eastern Europe. In the Eighties Romania, Poland and Hungary were always in the focus of the State Department (SD), of national security advisors, of senators and congressmen as well.[1]

Comparing these countries to each other, and making judgments on their own individual political changes were on the agenda all throughout the decade; and the outcome of these comparisons and judgements kept changing time by time. The Romanian dictator Nicolae Ceauşescu and his regime held the best positions at the beginning of the 1980s, yet by the end of the Eighties they were both discredited and found themselves confronting with Washington. The Polish leader, Wojciech Jaruzelski was a *persona non grata* following the military coup of 1981, and the US evidently supported Lech Walesa and Solidarity instead of him. One has to admit, in the second half of the decade US–Polish talks gained rhythm and from then on their relationship was – to some extent – characterized by cooperation. In contrast to this Hungarian–US relations developed steadily during both János Kádár's and later Károly Grósz's leadership. Even more so, in July 1988 – with the Reagan–Grósz summit – political relations between the two countries reached their peak.

Using the period of the two Reagan administrations as a timeframe, and with a focus on matters mentioned above I will try to show when, why, how and in what way did Hungary receive exceptional treatment in US politics. Based upon the previously classified documents of the Ministry for Foreign Affairs (officially marked as MOL KÜM TÜK), now held and stored by the National Archives of Hungary (MOL – Magyar Országos Levéltár),[2] I will try to provide a brief overview of who, where and when referred to such an exceptional role. To set up a background suitable for proper judgment we will also look into some of the key issues and affairs of Romanian–American and Polish–US relations, also based upon the documents of MOL.

Hungarian–US relations began to develop spectacularly in the last third of the 1970s. The symbolical and *de facto* starting point of this process was 6 January 1978, when Cyrus Vance, President Carter's Secretary of State gave back the *Sacra Corona* (The Holy Crown of Hungary) – together with other crown jewels – to Hungary.[3] (Beyond this gesture it was just as important that from the same year's summer Hungary was given the most favoured nation (MFN) status, which at that time was prolonged on a year to year basis.)

Developments in the bilateral relations were much reflected when Hungary joined the International Monetary Fund (IMF) and somewhat later the International Bank for Reconstruction and Development (IBRD) in 1982.[4] Hungary's approval to the IMF became official on 6 May 1982, and was signed by János Fekete – the head of the National Bank of Hungary (NBH) – on behalf of the Hungarian government. In fact József Marjai, deputy chairman of the Council of Ministers, who was staying at the United States at the same time, had already been informed by then – and that message came from Ronald Reagan himself, as Marjai met with President Reagan in the first days of May.[5] Then it is no won-

der that documents originating from after 1982 point out two events as the foundations of Hungarian–American relations.

It is important to note that all these happened not in the time of *détente* but during the so-called Second Cold War[6], when tensions between the USSR and the USA were high. The eight years of Ronald Reagan's presidency were characterized by an uncompromised policy, which is generally referred to in Hungarian documents as a "differentiation policy" or "differentiation"[7], and the main idea behind this was that the Cold War could be won.[8] So Hungarian–US relations moved along these lines, and the possibilities involved were both positively and negatively adjusted by these same forces.

A report from November 1982, quoting the *Christian Science Monitor* and *Boston Globe*, shows an increasing interest in Hungarian affairs: "They don't hide the fact that they are watching Hungarian reform policies through a magnifier, and also that our achievements will be used for making negative comparisons (negative for other socialist countries – JK). Yet they feel that Hungary has problems as well, mainly fiscal problems…".[9]

Due to the fact that in the Kádár-regime's way of thinking the security of consumption was a key issue of legitimacy,[10] meaning a continuous rise in living standards (or at least making people feel this way), liquidity was the Achilles' heel of the system. This meant the back door for American professionals through which they could interfere. As Robert W. Farrand, Deputy Director of the Office of Eastern European and Yugoslav Affairs of the SD worded: "Experts and professionals of foreign policy still agree on Hungary, and put it an unique category. Hungary's living through this period without further problems is also a US interest."[11]

Positive gestures towards Hungary – both on the level of words and deeds, however, did not always serve Hungarian interests; at least not within the socialist countries' alliance. The visit of Vice President Bush to Budapest – to be precise: what he said in Vienna after leaving the Hungarian capital – is a perfect example of this. Bush stayed in Hungary on 19–20 November 1983, and on the first day of his visit he met with the General Secretary of the Hungarian Socialist Workers' Party (HSWP – sometimes simply mentioned as the Hungarian Communist Party). Bush's meeting with János Kádár put US–Hungarian relations to a new level, as these were the first talks between the highest political levels of the two countries since the mid-1940s.[12] The following day George Bush also met with György Lázár and Pál Losonczi as well,[13] telling the latter that the USA was intent on having good relations not only in bilateral but in multilateral connections too.[14] After his meetings with Hungarian political leaders were finished, the US vice president continued his journey and flew to the Austrian capital.

Then in Vienna he made a stand to loosen the ties between the countries of the Eastern Bloc by telling the media and the public that the United States was ready "to respond to the Eastern block (sic!) countries, to the extent that they are meeting their own people's aspirations, are pursuing their own, independent foreign policy and are willing to open up to the rest of the world."[15] He also said that his country was ready to "engage in closer political, economic and cultural relations with those countries – such as Hungary and Romania – who assert greater openness or independence".[16] From the Hungarian perspective it was more than awkward that Hungary was mentioned in such a context, not to mention that in the same speech he also questioned the *status quo*. Bush blamed the Soviets for dividing Europe by distorting the agreements made in Yalta, and said: "We recognize no lawful division of Europe."[17]

His statements naturally stirred Hungarian politicians, and so the new Hungarian ambassador to Washington, Vencel Házi made a complaint to Mark Palmer[18] in the State

Department. “I pointed out that Vice President Bush used quite a different tone in Vienna than he did in Hungary. His speech was aimed at dividing the socialist countries. We accept differentiation…, but we do not accept to be confronted with our allies.”[19] Palmer’s reaction to this was quite sober, and he repeated that George Bush’s speech was a fundamental declaration on behalf of the USA.[20] Just a month later, at the end of November, the vice president himself also confirmed this. He said it was the policy of differentiation and not the division the US wanted to follow, in its relations with countries of the same ideology, but with their own special national traditions, interests and motives.[21]

It is obvious that János Kádár did not ‘pursue’ an ‘independent foreign policy’ – different from the Kremlin’s; and even more so: he was keen to avoid any such assumptions. And yet it is a fact that the general secretary of the party accepted and was supporting the liberalization of Hungarian economy, and that his regime – contrasted with other socialist countries – had a better record of implementing the Helsinki Final Act (HFA). When we look into the reports made for and by the US Congress every six months, it is clear that Hungary’s ‘performance’ in terms of the second and the third basket was satisfactory.[22]

Hungary’s image was improving not only in the Congress and the Senate, or in the SD, but among White House advisors too. A report from December 1984 by Béla Juszel, Press Attaché of the Hungarian Embassy, gives an insight. In the November of the same year he was escorting Mihály Kornidesz, Chairman of the Hungarian National Television (MTV – Magyar Televízió) when they met with the brilliant historian and political scientist of Harvard, the former advisor of President Reagan, Richard Pipes.[23] Actually, it was a meeting of four, as Pipes was, accompanied by Kenneth T. Jowitt, the distinguished political scientist of the University of California, Berkeley.[24] They were both recalling Ronald Reagan’s views on the USSR and Eastern Europe; in other words: the views President Reagan had courtesy of the influence of his advisors.[25]

Jowitt said that research on Hungary for a long time was focused on the reforms of the economy, but as time went by it became more and more concerned with “analyzing the specific features of social development”. In his opinion Hungary was important for western expertise because it gave them a chance “to show up the positive effects of a model different – both economically and socially – from the Soviets’”. Richard Pipes also spoke distinctively about US – Hungarian relations, and about the reasons of their importance for the White House. As he put it, Ronald Reagan believed that “Hungarian reforms will be gradually accepted in the neighbouring socialist countries as well; and in the end even the Soviet leaders will be forced to introduce changes too.”[26]

Reading the once classified documents of the Hungarian Ministry for Foreign Affairs it is the first verbatim record of the fact that already in the middle of the 1980s a part of American expertise and professional politicians saw Hungary as a ‘model’.[27] Later, as we will see, it became the adopted policy of the State Department. As for a possible change in such a direction within the USSR, it was not simply theoretical. Since the late-Sixties Soviet experts and scientists were interested in the changes, restructuring and moderate reforms in Hungary’s economy,[28] and by the time Mikhail Gorbachev became the ultimate head of Soviet-Russia this keen interest had already entered Kremlin’s politics.[29]

To estimate the real value of changes in Hungarian–US relations during 1984, we should contrast it to the key events and issues of Romanian–US and Polish–US relations. In connection with the latter Ronald Reagan was, influenced by many: by US citizens with Polish origins, by Pope John Paul II and by his Western European allies.[30] He had quite big

pressure on him following the Polish political amnesty in the summer of 1984, yet the US vetoed Poland's accession to the IMF.[31]

As for Romania, the regime that always got special attention from US policy makers[32] and received quite special treatment in bilateral relations (in contrast with other socialist countries), not even they were given more attention than the Hungarians. Both countries had MFN status, prolonged – as earlier mentioned – on a year-to-year basis, and so they both did everything to have their MFN status prolonged for a longer period. Finally on 6 July 1984 by President Reagan's Presidential Determination they each received a three-year MFN status, with automatic prolongation. From the Determination's reasoning it is obvious that it was the result of "the political and economic relations with these countries, including the important and fruitful negotiations in the field of human rights and migration".[33]

Taking all these into account it becomes evident that Hungary, precisely: the Kádár-regime held good positions, and played a distinguished role – contrasted with other Eastern Block countries – in American foreign policy. The words 'Hungarian model', however, were first mentioned publically not by experts or politicians, but by the famous tycoon and philanthropic Armand Hammer.[34]

Hammer gave two lectures in February 1985, one at Tufts University, and one at Columbia; his subject was the history of East-West relations, spiced with many personal anecdotes.[35] He spoke about his own six-decade experience – and not without vanity – mentioned his own personal contacts on every occasion. That is how he came in his speech to his previous meeting with Ferenc Havasi in Los Angeles.[36]

He recalled the key points of their discussion, and going further on with this he said: "The USSR should move to *a way of socialism like the Hungarian model*".[37] As I have mentioned earlier, only by the time of General Secretary Gorbachev was the Soviet political elite – at least a determinant part of it – ready to make changes; but by then, their recognition that a change was inevitable was surely involved in the policy of glasnost ("openness") and perestroika ("reforms").[38]

The Hungarian model, however, did not only mean some kind of new methods in socialist economics; the *modus vivendi* of the Kádár-era, the inner stability of the regime was also an example in the eyes of US experts. A meeting in the US Congress, in its House Committee on Foreign Affairs on 2 October 1985 gives us an insight.[39] Headed by Rozanne L. Ridgway,[40] the Assistant Secretary of State for Europe and Canada the committee focused on Eastern Europe, and listened to experts like Sarah M. Terry, Paul Marer (Márer Pál) and Charles Gati (Gáti Károly).[41]

Terry distinguished three categories for the Eastern Bloc countries, based upon their ties to the Soviets (and in contrast with total cooperation, like that of the German Democratic Republic). In the first category there was Yugoslavia and Albania – the Balkan states that achieved complete independence. In the second there was Romania with its partial independence (mainly in foreign politics); and in the last one there was Hungary that was liberalizing its own internal life, without making independent foreign policy (and so not hurting direct Soviet interests). She pointed out that in all these cases Western support was applied to the regimes and not to their opponents; this way evading instability and a possible military intervention by the Russians.[42]

Marer gave an analysis of the weak points and problems of socialist economies, and came to the conclusion that "all East European countries face not only temporary, but fundamental economic difficulties". Charles Gati, who back then was the advisor – among others – of Mark Palmer, said that differentiation was "the only responsible policy for the

United States to follow", and that it was "a system of rewards and penalties" – political and at the same time economic pressure – "for right and wrong behaviour".[43]

Using Charles Gati's terminology by the mid-1980s Hungary was obviously among the 'rewarded'; or even more: it seems that by the end of 1985 it was leading the list.[44] A report from the SD from December 1985 echoes this by saying that "among all Eastern European socialist countries, Hungary has the most positive evaluation."[45] The same document also shows that the Americans wanted "to modify" the policy of differentiation, and goes on to say that from then on Hungary "will not always be treated together with Romania".[46]

Measuring Bucharest and Budapest to each other – from a row of documents it becomes clear – was a generally accepted method of evaluation. Then it is no wonder that Mark Palmer did so in his lecture at the Wilson Centre in January 1986.[47] He was quite direct and outspoken, and said that while Bucharest was "the most liberal Eastern European country in his foreign policy" it was also "in a state of depression in its internal affairs". In contrast with that he said that although Budapest's foreign policy "even by some unique features follows the Soviets'", but its "internal affairs are quite the opposite of Bucharest". "Living standards (in Hungary – JK) are different and better than they are in other socialist countries."[48]

1985, however, was not only a turning point from this respect. With Mikhail Sergeyevich Gorbachev a new era began in the USSR, and a chance that some kind of change will be made in Soviet-Russia was more likely than ever; and such a chance put quite an emphasis on the already existing and working Hungarian model. In October 1985 a delegation of senators visited the region, Hungary included, and their experiences were summed up in a report. A Hungarian summary of this document says that in the original report Hungary appears as such a Soviet ally that "may become a bridge between East and West".[49]

It would be a mistake to suggest that ideas like the ones above were only on the minds of politicians. In November 1986, on a four-day conference in New Orleans 500 (!) linguists, historians, economists, sociologists, and experts of political science were discussing the realities and possibilities of Eastern Europe.[50] At this conference 13 lectures and 9 workshops were solely dedicated to Hungary, and in these "the chance that the Hungarian reforms could be adopted by the Gorbachev administration raised a lot of interest".[51] So the idea that the key elements of the Hungarian model can be put in practice in other countries and in the USSR as well did not dim, but by the changes of the era it became stronger instead.[52]

A change was going on in the US foreign policy of the region, and bilateral relations were also changing. Poland's positions were improving while Romania's began to deteriorate. Poland – at last, four years after Hungary – could join the IMF in May 1986.[53] From the American part, however, they made it clear that "normalized Polish – US relations may improve in the way Hungarian – US relations had improved, following its 'pattern', and there is no way to return to the 'special' Polish – US relations of the Fifties, Sixties or the Seventies".[54]

Bilateral relations with Romania moved quite the opposite way.[55] Due to its new migration policy, and its absolutely discriminative attitude in religious and ethnic (quite simply it meant the Hungarian minority) affairs the US Congress was ready to suspend Romania's MFN status, even if the president was ready to prolong it.[56] Although it was only in June 1987 that Romanian MFN status was suspended, but from early 1986 it was always on the agenda, and US–Romanian relations were fast deteriorating.[57]

It seems that changes in the region on the whole and the formation of US–Eastern Bloc countries' relations both had a crucial role in the strengthening of Hungarian positions. In November 1986 the United States' Deputy Secretary of State, John C. Whitehead[58] direct-

ly said, that "it is Hungary that is closest to the USA among socialist countries".[59] The second man of the State Department also added (more precisely: repeated) that "Hungary may give an example to the Soviet leaders that respecting human rights does not lead to chaos, and that free market operations lead to a more efficient economy."[60]

Hungarian political leaders soon got the hang of this new state of affairs, and using rhetoric like the one above entered their communication too. A year after Whitehead's visit József Marjai Deputy Chairman of the Council of Ministers spent ten days in the United States, and when meeting Secretary of State Shultz he said the following: "We see the traces of Hungarian reforms in those Soviet measures that give companies a greater freedom. The recognition that a price-reform is also bound to be made is also on its way."[61] Later, when he talked to members of the US Senate he added: "Hungary had already started going along this path twenty years ago."[62]

Parallel with Marjai's journey John C. Whithead made another visit to Hungary. He met with a whole scale of Hungarian leaders,[63] and so met with Kádár too. What he told HSWP's general secretary is rephrased in a Hungarian report about the meeting: "In some sense Hungary's economy became more like the American way, and so it is important for them not to let it fail."[64] Later at a meeting with Károly Grósz he said that "the US government handles Eastern European countries individually, and in the region Hungary is the most important for the United States."[65]

The words of the Deputy Secretary of State pointed beyond formality, and the meeting of János Kádár's successor, Károly Grósz with President Ronald Reagan on 27 July 1988 at last brought bilateral relations to the highest possible level.[66] The meeting of the US President with the Hungarian General Secretary – that was first proposed in 1984 by the Americans, and was repeated several times – was the peak of all things achieved within a decade in the affairs of the two countries, and it justified Whitehead's statements. Grósz's visit proved retrospectively that the Hungarian model had always been attracting special attention. The fact that in the same period neither Jaruzelski nor Ceaușescu was invited to Washington DC also underlines the unique nature of the ties made between the United States and Hungary. In the system of "penalties and rewards" – set up by Charles Gáti – the lack of this kind of invitation was – at least – the sign of rancour.

To sum up matters mentioned in this paper, it is obvious that the Hungarian model, correctly speaking: the meaning of it *was changing time by time*. Hungary was a captive of the two superpowers' confrontation, and so roles attributed to Hungary in US foreign politics were different in 1978, 1984–85 and 1988–89. What was consequently present is the special attention of American politics – precisely due to the hidden potential and possibilities in this model. The later stories of these potentials, the way they could be realized in the stormy transition years of 1989–1991, are for further research. But what is already evident is that the period of regime change cannot be understood without the story of the Eighties, or without dealing with US–Hungarian relations at their real value and importance.

NOTES

[1] China and Yugoslavia also drew special attention, the first one developed and changed quite differently than the countries of Eastern Europe or the USSR itself; and the latter – independently from its location and regime – was never among the so called 'satellite countries'.

[2] For disambiguation of further research I will use the Hungarian markers of the MOL to identify the documents from which I was working from.
[3] Overturning the *Sacra Corona* – held for three decades in Fort Knox – to the Hungarians was an idea proposed mainly by Philip M. Kaiser, back then the US Ambassador to Hungary, who descended from a Hungarian Jewish family. He was one of those who convinced President Carter about the importance of such political gestures. Source: *The Washington Post* (17 Jan 1993) and *US Department of State Bulletin* (Dec 1988). http://findarticles.com/p/articles/mi_m1079/is_n2141_v88/ai_6977650 (All internet references in this paper reflect the state valid in Sept 2008.)
[4] IBRD is often simply referred to as the World Bank.
[5] In the eye of Hungarian politicians Marjai's journey to the USA was not without risks. As a coded telegram – sent from Washington in March 1982 – put it: "this journey may miss its goals, and can lead to arguments and confrontation, instead of dialogue; it can also lead to distrust among our allies". MOL KÜM TÜK 4-14 001154/2
[6] The Second Cold War – that is referred to as "kis hidegháború" ("small Cold War") in Hungarian – is most often identified with the period of 1979–1985 or 1981–1986. Well, in my point of view, both seem to be quite arbitrary. No one can deny, for example, that before 1987–1988 there were no real achievements and improvement in the superpowers' affairs.
[7] Strange as it may seem, the documents that use this phrase in Hungarian ("differenciálás/differenciálási politika") do not refer to the original English term, and I was unable to find (even on the internet) an equivalent political term in English, so I was left with translating the term into English from the Hungarian words. Fortunately, we have documents depicting this term and what it meant in real life affairs. A report, discussing debates in the US Congress, forecasted that *in the future the US "will try to improve its relations with Eastern European countries to an extent, at which these countries can or are ready to cooperate"*. The same document makes it clear that in this web of relations, built on consensus, the Helsinki Final Act (HFA) and its implementation will be the milestone (this way going on with the policies of Brzezinski, Carter's National Security Advisor) for all negotiations with socialist countries. But this report does not tell, whether it applies to all countries equally or whether there will be differences in 'making business' with the countries of the Eastern Bloc. A year later, however, concrete decisions were made – and the outcome of those, were quite positive for Hungary. A report by the Hungarian Ambassador, János Petrán, built on White House and State Department sources, gives us an insight. The Pentagon, the NASA, the CIA together with the US Department of Energy, were in favour of a uniform handling of all socialist countries. But the Secretary of State, Alexander Haig and the SD as a whole voted for differentiation. The case was resolved in the National Security Council (NSC) by a Harvard professor, Richard Pipes, at that time Ronald Reagan's Director for East European and Soviet Affairs. He convinced President Reagan not to use 'power politics' in connection with the satellite countries of the USSR, but use it only in the direct affairs with the Soviets. Pipes rejected a unified approach because he thought *culture was more important than ideology*. In this respect, the USSR, built on the traditions of the basically Asian despotic system of Russia, was completely different from the countries it invaded in 1944–1945. So a policy of differentiation, meaning positive distinctions at its roots, gave an opportunity to the US to amplify and strengthen these differences within the countries of the Warsaw Pact and The Council for Mutual Economic Assistance (CMEA). MOL KÜM TÜK 4-503 00503 and 4-10 00645
[8] By overheating the arms race the Americans made in fact an in depth attack on Soviet-

Russia's economy. All research and development programmes, together with military tenders and purchases (I mean both their quality *and* quantity) meant such a challenge, for which the Soviets had no answer. As it appears in a summary, concluding the opinion of the Communist Party of the Soviet Union (CPSU): "Judging by the facts, in this Cold War atmosphere the president (Reagan – JK) has a stable position both within the Congress and the public." MOL KÜM TÜK 4-40 005140/5

[9] MOL KÜM TÜK 4-10 006466

[10] As János Kádár himself told Leonid Ilyich Brezhnev, head of the Communist Party of the Soviet Union: "In Hungary securing public supply and the growth of wages in real terms *is a key issue of security*." Huszár, Tibor, *Kádár 2*, Budapest, Szabad Tér Kiadó–Kossuth Kiadó, 2003. p. 280.

[11] MOL KÜM TÜK 4-146 0116/13

[12]MOL KÜM TÜK 4-131 02059/20

[13]György Lázár was the Chairman of the Council of Ministers of Hungary from 1975 to 1987, while Pál Losonczi was the Chairman of the Hungarian Presidential Council for two decades, until 1987.

[14] MOL KÜM TÜK 4-131 02059/20

[15] Based upon the article of The New York Times, published on 22 Sept 1983. http://select.nytimes.com/search/restricted/article?res=FA0A12FC355C0C718EDDA00894DB484D81

[16] ibidem

[17] ibidem

[18] The career of Robie Marcus Hooker Palmer at the SD – may be not by chance – coincided with the rise of US–Hungarian relations. Previously he was a political advisor at the Belgrade embassy of the US, and he joined the team of the State Department in 1981. From 1982 to 1986 he was Deputy Assistant Secretary for Soviet & Eastern European Affairs, and in 1986 he became US Ambassador to Hungary; he held this position until the regime change of 1990. Many say he became quite influential in Hungarian politics during the years of peaceful transition. (Here I want to thank Ágota Szilágyi, the Information Resources Director of the US Embassy in Budapest, for her kind help in 2004–2005, to get publications on former professionals of US politics from the State Department.)

[19] MOL KÜM TÜK 4-116 005517

[20] As the report of Házi says."They face realities and know that no one can be 'disconnected' from the Warsaw Pact. Yet they want to improve their bilateral relations with those countries that are ready to seek 'independency in their own foreign policies' or are 'liberal in their internal and economy affairs'." ibidem

[21] Quite obviously George Bush was recalling Richard Pipes' views and approach. MOL KÜM TÜK 4-116 005517/13

[22] Both from the photocopies of the original reports and from summaries based upon them is quite clear that decision makers of the USA were well aware that Hungary was following its own fiscal and business interests when it implemented (more or less) the HFA. As for perfect examples let me here suggest two sources: MOL KÜM TÜK 4-20 006185 and 4-10 003598

[23] Richard Pipes was son of a Polish Jewish family, fleeing from the Russian and German occupation of Poland to the USA in 1939 (just like the already mentioned advisor of President Carter, Zbigniew Brzezinski). He finished his studies at Harvard in the 1950s, and soon became an expert on Russia. In the Sixties he became one of the few who rejected

revisionism in history, and also the ideas of those whom he called 'guilt ridden establishment figures'. It was in the mid-1970s, when President Ford took office, and the Nixon–Kissinger era came to an end, that Pipes became directly involved in politics. In 1975 Donald Rumsfeld became the Secretary of Defence, and George H.W. Bush became head of the CIA, soon setting up his own team of 16 outsiders, called 'Team-B'. In Team-B Pipes had colleagues like Richard Perle or Paul Wolfowitz, but Bush put him in charge. They were analyzing highly confidential data gathered by the CIA; their one and only task was to estimate the Soviets' real nuclear capabilities, and to study the Russians' doctrine on nuclear weapons use. Connections – both personal and official – of this period made Richard Pipes a perfect candidate for the National Security Council, and that is how he became President Reagan's NSC's Director of East European and Soviet Affairs. During his White House years he always stood up for his principles, not once against the Secretary of State George Shultz, or the State Department led by Shultz. http://www.boston.com/news/globe/ideas/articles/2003/11/02/the_hard_liner

[24] MOL KÜM TÜK 4-10 006034

[25] Talking about the USSR Jowitt said that in Ronald Reagan's view it was 'a mere canker' and he was not afraid to spend money 'on the treatment'. Richard Pipes was talking about the new weapon programmes, and said that the president was not going to back up from the arms race as 'the fight for power in the highest circles of the Soviet leadership' was far from over. ibidem

[26] ibidem

[27] While studying the causes and effects of Hungarian reforms, one of the authorities on Hungarian economy, Katalin Botos at the Heller Farkas Institute of Economics came to the conclusion that by the mid-Eighties a team of American experts and advisors were in favour of making Hungary a model for other socialist countries. (Here I want to thank Professor Botos for her helping me with information on the subject.)

[28] In the brilliant book of David E. Hoffman, *The Oligarchs: Wealth & Power in the New Russia*, some of the later high-rollers recall their interest in Hungarian affairs. Anatoly Chubais, for example, held two books as his 'bibles': Friedrich August Hayek's *The Road to Serfdom* and János Kornai's *Economics of Shortage*. Hoffman, David E., *Oligarchák – Erő és hatalom az új Oroszországban*, Budapest, Századvég Kiadó, 2005, p. 105-107.

[29] It was at the US–Hungarian summit of July 1988 that Károly Grósz, János Kádár's successor as head of the HSWP told President Reagan about Gorbachev's dedication to implement changes similar to the Hungarian reforms. MOL KÜM TÜK 4-13 001955/36

[30] MOL KÜM TÜK 4-10 004529

[31] Sources of the State Department said it was the result of two things: one was the unacceptable declarations made by the government spokesperson Jerzy Urban, the other was the custody of prominent members of Solidarity. MOL KÜM TÜK 4-10 005341

[32] MOL KÜM TÜK 4-10 003917

[33] MOL KÜM TÜK 4-51 003823

[34] Hammer was a unique and in many respect an extraordinary person. As he - not once and not without vanity – said he was the sole man living on earth who knew both Lenin and Reagan personally. He started his career in Manhattan, where his father – Julius Hammer – had several drug stores. He was a Jewish immigrant from Russia, an eccentric businessman who became a prominent leader of the Socialist Labor Party of America (SLP). (Most biographers of Armand Hammer agree that he even had his name after the symbol of the SLP that is an arm and a hammer.) Hammer finished his studies (MD) at Columbia in 1921,

and right in the same year went to Soviet-Russia to make business with the new regime. In the beginning – obviously due to his family background and his connections – he sold medicine to the Soviets, but soon he found wheat shipping more profitable, as he was paid not by cash but by valuable fur and caviar. His ties to the highest circles become more than obvious if know that Lenin himself issued an order that Hammer should be helped by all offices and officers in all his doings. Although his Soviet "adventure" lasted until 1930, in the end all his business proved to be loss-making. The later tycoon's emblematic and most successful company became Occidental Petrol that was growing fast during the 1960s, and which today is the fourth biggest oil and gas producer in the US. Hammer, in contrast with his father, became a republican, but of course his business was always first before anything else. It is no wonder then that he was awarded by all kinds of governments and regimes, from Italy to Sweden, from Israel to Venezuela, from Pakistan to Mexico.
http://en.wikipedia.org/wiki/Armand_Hammer
http://www.oxy.com/About_Oxy/Pages/historical_highlights.aspx

[35] He was not shy to mention his all kinds of relations with Henry Ford, Richard Nixon, Gerald Ford and of course Ronald Reagan. He did mention Lenin too, recalling the episode when the Soviet leader admitted to him: "communism simply doesn't work". MOL KÜM TÜK 4-10 001816

[36] Ibidem, In our region it was the Yugoslav and the Hungarian communist party where he was in the good books. Among others, he was the man who took Yugo Florida to the United States in the late 1980s; while he became *doctor honoris causa* at Semmelweis University, Budapest. MOL KÜM TÜK 4-16 005395

[37] ibidem

[38] As for glasnost and perestroika, in the 1990s many said that it was the biggest mistake of the Gorbachev administration not to introduce economic reforms right after their political counterparts. Hoffman, David E., *Oligarchák – Erő és hatalom az új Oroszországban*, Budapest, Századvég Kiadó, 2005.

[39] MOL KÜM TÜK 4-10 002241/1

[40] Ridgway was the lead negotiator at all five Reagan–Gorbachev summits.

[41] MOL KÜM TÜK 4-10 002241/1

[42] She put Jaruzelski's coup on 12-13 December 1981 in Poland as an obviously negative counter example. She basically saw the introduction of martial law, and the rise of the hardliners within the Polish United Workers Party (PUWP) as the ultimate threat of such situations. What she did not know then was that Jaruzelski, who used the threat of a possible Soviet invasion to reason and justify his own deeds, was lying. A myth that was widely accepted as a fact (even by such historians as John Lewis Gaddis) proved to be utterly false when the Polish historian, Lukasz Kaminski published his research on previously classified Polish documents in February 2007. What he found in the documents was completely different from what Jaruzelski used to say. It turned out that the idea of a possible 'solution' 'to resolve' the rapid growth and strengthening of Solidarity was already discussed in September 1980. Later, by the spring of 1981 concrete plans were made for use of military power – and in the making of these plans Russia's feared KGB was involved as well. During the same period military forces of the Warsaw Pact launched manoeuvres called Soyuz'81 in Poland – and that could not be a mere coincidence. Yet from the same documents we know the Soviets did not want to use the military force of their alliance, but rather wanted to show their strength to the people of Poland (and of course the world as well). Jaruzelski came to power on 18 October 1981, when the leader of the PUWP,

Stanislaw Kania was forced to step down by the members of his own party, as they found him 'too soft' when dealing with Solidarity. Soon, in early December of 1981 he asked for 'assistance' from the ministers of defence of the Warsaw Pact, who had a meeting in Moscow – but they rejected it. As a reaction Jaruzelski turned directly to the Soviet leaders, with Viktor Kulikov, Chief of General Staff of the Soviet Armed Forces at his back, but his proposal was once again turned down. On 10 December it was the all too powerful head of the KGB, Yuri Andropov who put an end to the case. At the meeting of the Politburo (Political Bureau – the highest level of executive power) Andropov said that it was not in their interest to interfere with the events in Poland; not even if Solidarity would gain power. In his reasoning Andropov said that Western sanctions following an invasion would have led to a catastrophe as the economy of the USSR was already trembling. (In other words, at the end of 1981 Andropov acknowledged – what a part of Hungarian historians are still unable or unwilling to accept – that *the appearance of power does not equate to power itself*.) All in all, by December 1981 Jaruzelski was left with no help from other socialist countries, and so he launched his actions all by himself. His coup and its aftermath shaped Poland during the Eighties, and the myth of a Soviet threat became – a false – justification for all his actions until the regime change. Based upon the Hungarian translation of Łukasz Kamiński's original by Iván Scipiades. Kamiński's, Łukasz „A lengyelországi szükségállapot", *Beszélő*, 12/2, February 2007.

[43] All quotations are from the declassified source. MOL KÜM TÜK 4-10 002241/1

[44] It was (? – first name not mentioned) Demiray the United States Information Agency's (USIA) Hungarian referent who said in December 1985 that in respect of human rights Hungary was even better than Yugoslavia. MOL KÜM TÜK 4-13 001512/19

[45] MOL KÜM TÜK 4-10 002241/2

[46] ibidem

[47] MOL KÜM TÜK 4-10 00653

[48] ibidem

[49] MOL KÜM TÜK 4-13 005019

[50] It was an event organised by the American Association for the Advancement of Slavic Studies. MOL KÜM TÜK 4-10 005614

[51] ibidem

[52] MOL KÜM TÜK 4-14 00323, 4-10 003042, 4-10 0500/1

[53] Polish leaders in the 1980s were convinced that the Hungarians always received special attention from the US. As Joseph Edwin Mroz, the chairman of Institute for East-West Security Studies told *The Washington Post* in May 1984: "Jaruzelski seems to be surprised and embarrassed with the vicious rhetoric of the West, attacking him personally. He feels they are not ready to give him a chance to prove that his views on socialism are closer to *those of General Secretary János Kádár, and that are close to the progressive model of Hungary* (Italics – JK)." Based upon *The Washington Post*'s interview. MOL KÜM TÜK 4-10 003163

[54] MOL KÜM TÜK 4-10 00442 – 0442/6

[55] MOL KÜM TÜK 4-103 003667

[56] On 26 February 1986 four senators (Trible, Helms, Pell and Pressler) met with the professionals of the SD (Palmer, Derwinski), and at that meeting the senators were already suggesting a suspension of Romania's MFN status. In their view Romania was just another oppressive communist regime that had no strategic importance, and so the support of the Romanian regime was not inevitable at all. They also mentioned Securitate (Romania's

State Security Department), which was obviously cooperating with the KGB; and what's more it supported terrorism in Libyan and Syrian fashion. MOL KÜM TÜK 4-52 001664

[57] MOL KÜM TÜK 002822/1

[58] The successful finance expert from Illinois, John C. Whitehead seems to be a key figure in US – Hungarian relations. He served as United States Deputy Secretary of State in Ronald Reagan's administration from 1985 to 1989 under George Shultz. He always supported the Hungarian model, and Hungary had special attention from the SD while he was in a leading position. http://en.wikipedia.org/wiki/John_C._Whitehead

[59] MOL KÜM TÜK 4-135 005368 After leaving Budapest Whitehead went to Yugoslavia and then to Romania (MOL KÜM TÜK 4-135 005863). His talks and meetings - from 13 to 15 November – with the President of Romania, Nicolae Ceauşescu, and with his Foreign Affairs Minister, Ioan Totu reflected all the negative tendencies of the previous period. They both used quite a sharp tone during the discussions. Totu even said that if their MFN status was directly connected to the third basket of the HFA then they were ready to suspend it by their own will. (It was obviously foolish as the sum of the balance of trade between the two countries reached 1 billion dollars, and what is more, it was with a 300-350 million dollar surplus on Romania's side.

[60] ibidem

[61] Marjai stayed in the USA from 8 to17 November 1987. MOL KÜM TÜK 4-13 (with no further reference)

[62] He must have referred to the so-called New Economic Mechanism (NEM) that included a row of economic reforms. In fact in the early-1970s it came to a halt and was called off after hardliners (the party opposition of Kádár) had found a way to Moscow, and Leonid Brezhnev 'reminded' Kádár not to go any further.

[63] Beyond his discussions with Kádár and Grósz he also talked to Miklós Németh, Mátyás Szűrös, Péter Várkonyi, Gyula Horn, László Kovács and László Kapolyi. Most of them played an important role during the transition years of the regime change, and even after that. MOL KÜM TÜK 4-135 002484/6

[64] ibidem

[65] ibidem Still in the fall of 1987 a delegation of the US Congress's House Committee on Foreign Affairs made a visit to the region (MOL KÜM TÜK 4-50 005100). As they summed up their experience: "Hungary is the most reform oriented and flexible country that actively participates in international trade, and where we could witness a growing sense of political pluralism."

[66] MOL KÜM TÜK 4-13 001955 – 001955/36

AGEING SOCIETIES AND INSURANCE POLICY – AN INTERNATIONAL COMPARISON

By Katalin Botos – Peter Halmosi

Abstract

One of the most important challenges to our society is ageing which seems to have been managed successfully by developed countries. This is, however, due to a national institution, called the social security system and not to families. A recent study of the OECD (2004a) presents the income situation of pensioners in the 9 most developed countries. These incomes include pensions financed by the social security system, by private pension funds, other life and pension schemes and wages of elderly people.

Although more and more elderly people want to work but only a few of them have actually a job. An opposite tendency is taking place in developed countries where people retire before reaching the age limit.

According to the quoted study, disposable income for elderly people is highly influenced by the family model in which they live, although a significant effect is only to be felt in Japan and Italy. Some calculations have recently concluded that if families in Great Britain arranged their living according to the Japanese model, elderly people would dispose of 50% (!) higher incomes. This is, however, not surprising since cost of living take a huge proportion of incomes and relying on the solidarity can be performed better by the family than by market solutions. We pay a fairly nice price for „our individualism".

Introduction

Social security systems in the OECD countries vary from a pay as you go system to private pension funds with compulsory membership, fixed contribution or fixed rents to corporate pension funds. In some countries the state supports voluntary pension fund entrance financially. Providing benefits for long-term savings is also common in economic policy except that life insurance companies and pension funds or their combination.

The shift in proportion of people above 65 years has a significant effect on the growth of the economy and on economic policy.

Social security and fiscal policy

In continental Europe, a pay as you go system based on solidarity is in effect. These systems got into a trap of fiscal policy since pensioners have become a deciding factor in political elections. It became clear right after World War II that systems covered by extremely high replacement rates will have sustainability problems. Replacement rate – in this context – means the proportion of working income earned by pensioners to that of active workers. An expert has thus warned Chancellor Adenauer that political engagement is relatively high as opposed to future demographic trends. The Chancellor, however, wanted to win the elections so had actually no choice in this question. Furthermore, later engagement resulted in further increase of the replacement ratio. According to the study of the OECD,

wages of pensioners in leading industrial countries fall only a little short of active workers. Maintaining standard of livings is so feasible, however, it is worth take a look at the trend in ageing:

Table 1: Ageing of the world's population

	World average	G10 countries	China	Latin-America	India	Africa
2005	11	23	11	9	8	6
2050	25	42	37	29	22	10

Source: UN Population Activities Unit (2004): World Population Prospects

It can be seen that G10 countries are leading the way in ageing and this situation will get worse in the next 50 years.

Due to ageing, social security cost rise while contribution remain scarce. One solution is to raise contribution keys a study of OECD (Tax Policy Studies No. 9. Recent Tax policy Trends and Reforms in OECD Countries, 2004b) has however pointed out that social security contribution keys increased between 1965 and 2002 from 18% to 25% on average. The ratio for EU was even higher (OECD 2004b, pp. 18–19).

At the turn of Millennium the proportion of taxes to GDP decreased in most developed countries. This phenomenon was only partly a consequence of economic cycles. The main reason has been the conscious economic policy of states and the changed attitude of state. Increasing international competition namely required the moderation of pay-roll taxes.

Social security funds faced thus growing deficits that had to be financed by the state budget. If we aim to have budget equilibrium enabling sustainable development the possible directions of social security reforms are as follows:

1. increase contribution keys;
2. decrease the ratio between pensions and wages;
3. increase eligibility age.

The first scenario is not a viable path nowadays due to adverse tendencies in taxation by growing international competition. The second scenario presumes deep legal changes so it is also hard to execute. Furthermore, the effect of changes on poor people shall be established. It is clear that the average of pensions is close to the minimum standard of living so this scenario would bring certain people to poverty.

The third scenario will meet dissatisfaction of the society as well. This is, however, probably unavoidable due to the increase of life expectancy. The increase of time spent in working by 1–2 years has a positive effect on equilibrium. It is, however, also true that if more people were willing to work this would have the same positive effect. Experts find this as a key towards a sustainable pension system (Augusztinovics 2005). Probably the most tangible point of social security deficit is unemployment. Unemployment people require unemployment benefit while they do not contribute to the financing of social tasks. If more people took up work the question whether our social security system can be sustained could be answered. The answer to the question is not always yes since we shall consider demographic trends as well (e.g. imbalances of generations may arise again).

There were serious changes in social security systems of many countries in the past one and a half decade. These countries have introduced compulsory private pension funds which is a good on the long run since as opposed to pay as you go systems the importance of individual savings becomes more transparent. People become interested in paying contribution bringing the scale to equilibrium but this only true on the long run. The system

has practically a minor effect on the equilibrium of the social security system and the state budget on the short and the mid run as sources directed to the funds are missing from the social security system. This extra deficit shall be financed by the state budget which has a deficit otherwise as well. The case of the Hungarian pension reform introduced in 1998 is a good example for this. Since compulsory private pension funds shall keep their assets in secured form the funds usually buy state bonds financing the increasing budget deficit.

As the Hungarian reform did not affect elements providing sustainability it is hardly considered as a real reform. Furthermore, it has an adverse effect on willingness to have children which would otherwise be a condition for sustainability. Finally, we shall mention that it is not unfair to provide the same level of pension for everyone without distributing the burden equally. Both the pay as you go and the pay as you earn systems namely do not take into account that families with children have much more burdens.

Savings of pension funds is worth nothing without human capital that brings the economy into moving. Social policies of states take only a small proportion of production cost of human capital. In countries like Hungary state contribution to health care and education is decreasing families having even higher burden to bear. Rising of children can not be interpreted only as an individual question, the burdens on families shall be made more righteous. Social security reforms shall boost employment of members of families with more children even enabling a differentiated contribution system since they do more for the society.

In EU member states where the Treaty of Maastricht is in effect state budget deficit shall be kept under a limit as an exchange for introducing the euro as a national currency. Fiscal and monetary policy is so strictly linked to each other, however, pension system has direct linkage to monetary policy and financial markets as well.

The effect of demographic changes on financial markets

The value of savings depends on the status of the economy. Active workers preparing for their pension buy financial market products. The exchange rate of investments change on the basis of demands and supplies, so investment policy of pension funds and insurance companies has a close link to demography. Modigliani established his theory on the life cycle of investments already in the 1950s. In his article of 1986 (Life cycle, individual thrift and wealth of nations. American Economic Review, vol. 76) he stated that individuals use up their financial assets in the retirement in order to finance their spending. It is thus indispensible to have enough cohort. Consumers of upcoming generations are the savers of previous generations otherwise financial assets will decrease upon the melting of demand so savings will disappear. Elderly people want to sell their savings but there are only a few young savers. Jeremy Siegel, a famous American economist depicted a dark future when people want to sell but there will be none to buy. A Gonsalez-Páramo has stated: „people will find less eggs in their nest after selling all their assets than they would expect" (Gonsalez-Páramo 2006).

Some people dismiss the thesis about the melting of assets saying that financial markets are developed to price products so a wave of selling will not act as a surprise. Another theory worth mentioning deals with FDI that makes demand for bonds to be sold. According to the theory developed societies with excessive middle-age citizens are capital exporting societies since their potentials to invest fall short of savings. As a society gets older it

becomes a capital importing society because pensioners sell their financial assets to foreign active workers in developing countries who have huge savings.

The flow of funds is free world wide so foreign demand tends to substitute insufficient domestic demand. This theory has, however, not been justified in practice. FDI tend to flow to develop and not to developing countries. Since the last years of the second Millennium, economic development has accelerated in China attracting huge potential of FDI into the region. We can see another, adverse tendency nowadays. First of all, capital liberalization is not complete for all countries. Second, due to strict birth control, fertility decreases significantly in China while its population is getting older. By the year 2030, the average age of Chinese people will be higher than in the USA. Since than, the number of old people will have been doubled (Dunaway–Aurora 2007)! This only embraces people living in urban areas causing huge challenges for the government to provide the living of these people.

Since China has no social security system since the great economic change the population is making efforts to save money. They are forced since the new state system has not been established. As a consequence, consumption of Chinese households does not increase intensely giving an explanation for the export orientation of the country. We may know that the Chinese currency is not convertible completely. Its exchange rate has been linked to the USA dollar which made the currency depreciated continuously. This depreciation boosts the further growth of export and brings huge amount of US dollar reserves to China. Since the national bank wants to keep the exchange rate stabile it has piled up of a reserve of more than 1000 billion USD (Bergsten 2007).

There is only one sensible way to invest this money: buying American state bonds. All these changes have reversed the direction of international flow of funds. The world's leading country, the USA became the biggest capital importing country. Capital may in theory flow in each direction but considering its tendency, it flows from developing to developed regions of the world financing the deficit of the USA. We have to admit it would mean set of serious problems if these assets are to be transformed into liquid assets by developing countries.

Returning to our basic question we shall take the amortization of savings into consideration. The reason for this lays the ageing of developed countries where population usually keep their assets in real estates. It is natural phenomenon that the owner leaves the real estate for the successors who – as an exchange – take care of him during his old days. In modern, individualist society's elderly people receive medical and old age attendance in nursing homes (during the communist era it was a common thing in Hungary that young couples contracted with old people living alone to inherit the real estate for old age attendance).

Another option for those who have a big real estate to sell it and buy a smaller one. Any of the two options is chosen, there shall be a buyer. A first degree buyer can be a bank or its affiliate but finally it shall be sold to someone who will use it. We can not exclude, however, the possibility of a mass retiring of a baby-boom generation (e.g. as we will experience when people born during the Ratkó era in Hungary will retire).

The question is whether immigration from Asia will solve this problem or not? Will there be young Asian people willing to buy real estates in Southern Europe? If not, the price of real estates will drop significantly.

There is another reason on the side of the theory of melting of savings. Instead of fixed yield funds fixed contribution schemes will come forward. Due to growing uncertainty, pension funds operating on the latter principle could hardly cover operation cost. There will

be equalization among pension funds because people will definitely change pension funds if this is allowed.

As pensioners belonging to fixed contribution funds are getting older they shall choose less risky investment potentials in order to secure their liquidity. This will decrease average return rate of investments by pension funds making the expected value of assets decrease as well. This fact has got into focus of attention of supervisory authorities only recently. Less attention has been paid previously to asset-commitment ratio, maturity structure and coverage of risks. The coverage of inflation, interest rate and longevity risk is partly feasible but problematic as well. The latter stems from the growing average age of population requiring long-term instruments on the asset side. The maturity of assets of these funds shall be prolonged but there are only few types of bonds for this purpose. In order to raise coverage of assets against longevity risks asset pricing shall be performed better. As these risks can not be evaluated as it would be required issuers are averse to further issuing. Medical treatment units and pharmacies make profit from the increase of average age of population but they are scarce as opposed to the huge demand. In some countries, the government issues long-term bonds that suit this purpose. Since they are forced to find the cheapest sources the effect is moderate.

Ageing of population remains a challenge to society. This is underpinned by the fact that aspects supporting families to take up more children can not be pushed into background.

Covering longevity risks individually is feasible the same was a sin the case of pension funds. Profit oriented market entities (e.g. insurance companies) tend to make continuous payment in the future form previous continuous in payments. This principle goes for state pension system as well. Although this market has narrowed it is possible that in case pensions under state guarantee become lower certain shift of the society will consider making such complementary insurances. Economic policy shall not be restricted to minimize burdens for the state in order to avoid deficit. It shall, furthermore boost savings of households by tax allowances and spreading of financial culture. It is hard to believe that a man on the street in the USA has a rather low level of financial cultivation. The case is also true for former Eastern-European socialist countries where people had been freed from self care for 40 years.

Real estates have a rather good position among long-term investments. Many people live in their flat they earned during their active working period. These people are forced to sell their real estate if maintenance costs are high. Another wide-spread solution is mortgage loan already operating in Hungary (called the Hild mortgage loan). In this construction elderly people remain in their homes and receive a high start-up payment and regular payments based on the value of the real estate. Experts working the construction must have calculated with longevity risks. This solution is comfortable and not fully advantageous for households.

Ageing and monetary policy

Monetary policy becomes more and more important in ageing economies. Individual savings are exposed to inflation so central banks of these countries are under pressure to follow an anti-inflation monetary policy. This is not a direct impact of politics since independence of centre banks is assured. The goal, however, going in front of the interest of governments.

The effect of ageing on the financial intermediary system is worth attention since it may influence monetary policy as well. Since social security systems are moving towards pay as you earn systems, savings in state pension funds are decreasing and savings of households reach 10% of disposable incomes capital market investments will appreciate. This will decrease bank deposits hindering enterprise borrowing. This is not going to happen compulsorily – in case of Sweden banks turned to capital markets and securitized borrowing.

Summary

Changes of demography have a complex effect on monetary policy. This change shall coincide with social security reforms that push individual saving forms into the foreground calling for an anti-inflation monetary policy. There are many signs that the value of assets financed by these savings may drop since there are less young people. The growing importance of individual savings helps the spread of reverse mortgage loans. The whole society is concerned by the longevity risk emerging from ageing. Governments shall consider recommendations slowing ageing and boosting families' willingness to take more children.

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TRADE FASHIONS IN SOCIALIST HUNGARY

BY KATALIN BOTOS

The operation of the former CMEA (Comecon) countries is a grey territory of the recent history of economics, and within this, it is not clear either how the trade between the companies of the former socialist countries worked. Trade was actually a big barter among countries. (Barter agreements still flourish in the world economy; Gubán, Gy 2005.) In my paper I try to treat this problem, more precisely, I want to discuss the 'trade fashions' of the foreign trade companies of the centrally-planned economies in the period 1950–1990.
My methodology is not only a literal or a statistical approach but beside the citation of special literature on the CMEA international „mechanism", it is the description of an 'oral history' which is compiled by the experiences of the experts who were employed in Hungarian foreign trade fifty years ago. I also participated in certain negotiations in the 1970s, so this study will summarize these experiences as well.

Macroeconomic environment

After World War II the Communist regime covering one-sixth of the world introduced the centrally-planned mechanism. This occurred in Hungary, too. The communist rule was able to do this because after the three-year post-war reconstruction, practically, all the relevant ventures in production and services were nationalized. The organization of cooperatives in agriculture had been started but it was finished only after the 1956 revolution. Eventually, all companies could be ordered to perform natural planning. In 1949 the Council for Mutual Economic Assistance (frequently, referred to as Comecon) which embraced all the economies under the influence of Moscow and that of Mongolia was set up.

In the first years exportations due to the high war damage compensation were characteristic in Hungary (Romsics Ignác, 2003; Honvári János, 2007). Companies had no say in the list of goods for exportation. The conquered Hungarian society would experience only the fact that there was just a one-way movement of the laden train of carriages: all they were going to the Soviet Union. Concluding interstate agreements took several months and during that time the experts delegated from government offices had to stay in Moscow. The Soviets who were victorious but had enormous shortages of goods needed all kind of products and their demands could be hardly restricted. (Source: Némethy Gyula, former senior member of the Ministry of Finance, 1977)

From the fifties world market prices were used with interstate agreements. Although steep growth of the prices of raw materials due to the Korean War was favourable to the Soviet Union, the main supplier of raw materials and energy in the region, it was highly unfavourable to the other Comecon members. This is why the so-called Bucharest Price Direction was accepted in 1958. This aimed to stop the cyclical fluctuations of international price movements. Thus, prices were fixed on a five-year average and they were taken as a basis when long-range interstate prices were set in agreements which were concluded for five-year terms. That also meant that the prices of goods reflected a much older state, consequently, they always included different stimulation, compared to western prices. Besides, they hindered technological progress in processing industry, namely: If the same price had been given for a product in socialist international trade, why to invest money in modernization? (Ausch Sándor, 1969; Botos Katalin, 1977)

First, settlements were made in rouble, then after 1964, formally, in transferable rouble. The transferable rouble created in the clearing systems of the International Bank for Economic Cooperation was just formally transferable because it could be used only within the framework of bilateral commercial agreements. (Botos Katalin, 1977). Thus, the course of the conclusion of commercial agreements was as follows (Botos Katalin, 1977).

The natural lists of products to be included in the agreements of the so-called plan coordination were discussed by Planning Offices around the middle of the five-year planning period. The lists were handed over to the Ministries of Foreign Trade which sought to elaborate a great degree of specialization till the signing of the long-range interstate agreements. For calculating the prices of the list the Bucharest Prices were used. They were relatively easily set for raw materials and energy-carriers as well as a part of agricultural produce because they were on the Exchange. It was more difficult in the case of processing industry where some kind of international price quotation had to be submitted. This gave way to many manipulations. The use of a currency of settlement is a characteristic of clearing trade. With the help of this, the separation of external prices from the internal ones was realized. That was a precondition of the centrally-planned system since the clearing prices should not be the obstacles of international trade but it is true they should not be their stimuli either. The question became especially important when Hungary stepped out of the row and introduced the so-called modified centrally-planned economy, i.e. the New Economic Mechanism.

Moscow was made to change this system only by the oil price explosion. Those days it was in Moscow's interest to approach prices to world market ones since terms of trade were favourable to energy suppliers. In the earlier period when reaching the top prices after the Korean War the raw material and energy prices began to fall gradually over 13 years, and thus, the Bucharest Price Direction slowed down the deterioration of the terms of trade for the Soviet Union, therefore it was in its own interest to maintain it (Botos József, 1982)

Again, there were long commercial negotiations in Moscow in 1974. As a participant of the negotiating delegation I had some insight into the course of price bargains. Here, too, state organs and ministerial officials were negotiating but to their assistance they invited the representatives of some foreign trade companies, moreover, ministerial experts who controlled industry. They were expected to convince our partners about the necessity of the 'modernization' of the prices in processing industry at their own level. During the company level negotiations where I participated as a delegate of the Ministry of Finance, together with the Head of Department of the Ministry of Heavy Industry, I could see how the representatives of the Hungarian companies tried to argue, based on the data of a business transaction, the delivery of a motor train which was sold on credit to an Arab country. Company experts on the Soviet part made an objection at once that the price was not typical since the prices of the products supplied on credit were always above the cash prices of the international practice. However, nobody mentioned the fact that the transferable rouble claims enchased immediately in Comecon trade should not be used for anything else but the financing of bilateral barter trade and it was typical of barter prices that they were always above free prices. The negotiations were led by the Ministries of Foreign Trade. Practically, they tried to tire out small countries. The fact how much our colleagues were committed to the Soviet system played a role, too. E. g. after three weeks' staying in Moscow – the bargain was not without a chance at all though – the leader of the Hungarian delegation, who was a committed pro Soviet person, said: I am going to accept the price offered tomorrow whatever happens because we have been staying here for long and, after all, I am bored with it…' That was *ultima ratio.*

Hungarian foreign trade which, in the given period, reached the best terms of trade in capitalist relation, as compared to all the other socialist countries, achieved the worst ones in socialist relation, i.e. we had the greatest losses in terms of trade in Soviet relation, although the Soviets were energy suppliers for the other socialist countries, too.

In other words, in commercial practice Hungarian reform was successful regarding capitalist companies: interestedness forced Hungarian foreign trade enterprises to make considerable price bargain. However, in socialist relation human factor, i.e. political commitment which was not accompanied by so deep an expertise unlikely to that of those working in western relation was more important.

Anecdotes from Hungarian foreign trade

In centrally-planned economies the right to pursue external trade was taken away from companies. For the administration of foreign trade specialized companies were established. E.g. the trade of machinery was done by Mogürt, that of heavy machinery by Nikex, the sale of electrical equipment belonged to Elektroimpex and machine tools were sold by Technoimpex. Of course, there were relevant organizations in other branches as well. In these organizations experts speaking various languages and having some professional knowledge were concentrated. In the fifties the former company owners or leading experts were employed in order that through their connections the companies should remain in international markets. Better qualified people worked in departments for capitalist trade with smaller business but a turnover of convertible foreign currency, while the employees who spoke languages well, especially Russian, and frequently, had studied in Moscow but had little knowledge of machines worked in departments for socialist interstate commerce. These departments performed the greater part of foreign trade. Technical problems could be answered by the staff of industrial enterprises. Relevant negotiations were done by the experts of the National Planning Office and the proper ministries. Thus, company staff was responsible only for technical transactions. In companies economic departments were also established. That was necessary because Hungarian statistics required meeting both expectations, namely, that of the capitalist statistical system and the one of socialist countries which was different from the former. For proper classification some knowledge of languages and professional expertise were necessitated, especially because GATT negotiations in which Hungary participated, contrarily to several other socialist countries, were launched. Employees working in capitalist relation had more difficult tasks. The sale of products often required real attraction of a ‘circus’. Here are two anecdotes from the tradition of Technoimpex to illustrate on what a successful sale depended on. The anecdotes seem to be tales, however, they belonged to the trade fashion of those days.

Technoimpex developed from a little firm the profile of which had been machinery trade even before World War II. The former owner worked there as a sales clerk to make his living. Since for the 1960s India belonged to the group of non-allied countries, it wished to develop trade relations with the countries of the Soviet block, too. Technoimpex sent the former owner, who spoke excellent English, to India. But commission fees were extremely low, therefore Árpád Dugár required to do sales was forced to resort to a trick. He went to one of the elegant hotels and asked if there was a small garret chamber or a servant’s room that he might rent for a small amount because he was unable to pay for proper accommodation. He succeeded in getting a small room without any comfort. Then he spent his

days in the lounge, seeing his guests there. His clients may have thought: he who stays in such an expensive hotel must be an important person!

He was invited to reception by his partner, in fact, a rich maharajah. Again Mr. Dugár urged his partner to make intent of purchase. The maharajah, which stood by the lake in his garden in a good mood, said: 'Well, if you are swimming across this little lake in all your clothes, I shall buy your machines.' Árpád Dugár looked around and asked the other guests: 'Have you heard this?' Then, he sent somebody to the hotel to fetch his changing clothes and dived into the lake… The transaction came about!

A similar case happened in 1969. That time, after the New Economic Mechanism, interestedness in the results of companies grew. Trade companies appeared in international fairs. Those days the Damascus Fair in which Technoimpex also participated was organized. Probably, Hungarian machine tools were somewhat under the technological level of those in the Czechoslovak pavilion. Yet, the Hungarian product was purchased. Here goes the story: One of the rich Arab sheiks was invited to dinner and he returned the invitation to supper to the head of the Hungarian pavilion as well. To the spicy and fat dishes there were delicate western drinks served. The guest tried every dish and then had a sip of drink. The Arab host said with content: 'tomorrow, we will do a deal.' And so was it done! To celebrate the successful bargain, he invited his guest to his home in the desert. In the middle of the sea of sand there was a building of European style with a pond full of fish. The pond gained water from a well of deep bore. For the feast there was a roasted lamb, in which there was a goose, in that there was a hen with an egg inside. When the egg got boiled, the lamb was ready, too. They had to be eaten up with unfermented bread. The host clapped to the three wives and 12 yawning children of his in order that they should introduce themselves to the 'Monsieur'. At the end of the evening the partners exchanged neckties and the host asked the Hungarian commercial representative. 'Do you know why I have bought your machine? Because of the head of the Czech pavilion did not eat even a snack from our dishes when I invited him to dinner.' (Source: Botos József.)

How much depended on human factors, we could see in socialist foreign trade as well. (See the state price negotiations in the former chapter.)

The attempts which sought to realize the multinational specialization of spare parts in the socialist community provided an edifying example. The production of railway linkage seemed to be a promising large project to the implementation of which Hungary was invited. For the negotiations at the level of experts Hungarian delegation made calculations which gave a price guaranteeing profitable production for Hungary. It should be mentioned that it was a brave step of the New Economic Mechanism to put exchange rate on a real basis. It was an exchange rate based on a kind of "ppp" (purchasing power parity) according to which the value of one dollar was Ft 60, one rouble was Ft 40. The exchange rate of rouble/dollar differed from the official Soviet declaration markedly according to which the value of rouble was higher than that of the dollar. (A dollar made up 0.9 rouble). But by Hungarian calculations the exchange rate was l.5 rouble/dollar. Thus, the prices did not coincide at the level calculated by experts at all; the Soviet partner found Hungarian prices high. He said vehemently: 'In this case the Soviet Union will be building a factory to produce this spare part, instead.' The head of Hungarian delegation wished him success to that. The Hungarian expert was not rewarded for the avoidance of the highly unfavourable business to Hungarian economy. (Unlike his boss who led the price negotiations with a great loss in terms of trade!) The report circulated among ministries in which this ominous item was included, underlined with red and three exclamation marks got to the hands of the

author of this paper in the Ministry of Finance, too. The head of the expert delegation was never allowed to partake in socialist price negotiations again. (Source: Botos József.)

This little anecdote demonstrates well how politics affected trade fashion in the socialist block, and through what administrative measures and indirect motivations the political power tried to force human players of commercial mechanism to make decisions which were against the spirit of mechanism.

The Janus-faced effect of economic reform

After the 1968 reforms Hungarian companies became highly interested in the growth of both relations of foreign trade. (Botos K., 1982, Köves A.) From this time on, based on their profits in Ft industrial enterprises were able to establish funds out of which they were able to realize smaller company developments to increase their competitiveness. And what was even more important, they could organize funds for personal interestedness which everybody, ranging from the director to the porter, could share. This is the explanation of the fact that in Hungarian foreign trade companies' employee's interestedness was higher than those with other socialist countries. Although exports continued to be performed through foreign trade companies, industrial enterprises were involved into negotiations much more than formerly. They sold products to countries where it was more profitable. And it was a socialist sale, i.e. it should not be thought that it was some kind of pressure to Hungarian companies. They turned to socialist relations voluntarily, too, for double reasons: One of them was the profit-orientedness, the other was that the socialist market had an almost boundless capacity for absorbing goods besides its certain simplicity. On the one hand, goods could be sold in the socialist market, and on the other, *at relatively favourable prices.*

As has been mentioned, according to the Bucharest Price Direction prices of international trade had to be taken as a basis. Since in processing industry this was not so simple, companies had recourse to the method that they set the prices of products in question based on the prices of former similar products through the identification of technological parameters. The use of spare parts imported from capitalist countries in production was the simplest way for the introduction of a product as a new one, so we could prove that we offered modernized goods. In processing industry they became the so-called hard products. By the way, only raw materials, energy-carriers, agricultural produce as well as meat/corn were ranked here, therefore the practice of socialist trade meant to be a multi-circle barter. By all means, goods had to be equipoised by goods but within this, there was the trade of the *so-called hard products* in which there were an effort to achieve balance as well. The oil for corn and meat construction in the eighties was an outstanding example of that. Owing to the huge shortage of food that was resulted by the kolkhoz farming without people's interestedness in the Soviet Union, Hungarian food exports were accepted as hard products. Within the given economic system this seemed to remain unchanged for ever. That made it possible for Hungarian agriculture to turn to be a strategic sector to some extent despite the fact that ideology did not support 'small peasants' farms which were said to reproduce 'petty bourgeoisie' officially. The permanent shortage of meat in Poland could also be attributed to this. Since after 1956 the Polish communists accepted that peasantry should not be forced into kolkhoz, they punished farmers – but, eventually, the Polish people themselves as well – by the step that the latter were not given proper investment support. The Communist regime did not set higher purchasing prices, so the farmers, who lagged behind

in technological progress, were unable to meet the food demand of the workers. In Poland until the change of regime there were frequent political demonstrations in the background of which we could trace the formerly mentioned problem to a great extent. It would be too strong to call Polish upheavals and strikes as hunger riots but workers were highly dissatisfied with provision. And in other countries like Romania where following the Soviet pattern cooperatives were organized but the labour there had no up-to-date technique either and, first and foremost, they had no interestedness in results, there was great poverty. Here all devices were used to oppress social unrest.

However, Hungary, the only one out of socialist countries, became an exporter of food industry. This could be attributed to the treatment of the agrarian sector and the system of interestedness unambiguously since the structure of the commercial system was as such: The large state farms like Bábolna purchased western technology, pursued industrial cultivation of land, had high yields and offered them to foreign trade. (Schlett A., 2007) But cooperatives – some of them outstanding ones – managed to achieve similar results in the corn sector. And since large-scale live-stock farming was capital intensive, they had smaller chance for economic production. Yet, how was Hungary able to become an important meat exporter? This can be explained by the *cooperation* between the cooperatives and the household farming of their members. A special commercial model emerged in Hungarian agriculture. Cooperatives entered into contracts with their members to raise pigs. They gave fodder to household plots, guaranteed vet's services, and then they took over the animals in contracts and forwarded them to domestic and foreign sales. In the seventies and eighties more than sixty per cent of meat exports derived from household farming. With this method they broke ideological opposition as meat exports did not seem to be the results of small peasant farms but those of the sales of cooperatives. Thus, the most orthodox members of the communist management could not state that small farms would come to the fore. It is true that foreign trade sales would not have been organized by household plot holders. The pre-war *Hangya* cooperatives for sales and supplies did not exist anymore. But the formerly treated method was very apt to make peasants do considerable overwork. As a result, the mortality rate of male population belonging to this age group is definitely higher than the European average. Obviously, the permanent 'two shifts' exhausted Hungarian population, i.e. people paid dear for better life. The other price paid for the higher standard of living produced by the New Mechanism became the considerable indebtedness of the country.

Since the base of the legitimation of Kádár government was people's relative welfare, therefore the regime did not want to hazard it when oil prices rose. The growing world market prices meant also rising oil and gas prices of Soviet imports. Since everybody knew that oil came from the Soviet Union, high prices might have induced anti-Soviet feelings. The shift of the burden of the rising foreign exchange rate to the customer may have caused discontent and provided material to the left-wing critics of the Kádár regime, claiming that the new mechanism reform had not done well. (Naturally, the cause for discontent would not have been the mechanism but the growth of prices itself. However, politicians could have claimed the former.)

Therefore, Hungarian economic management continued to keep consumer prices low, abridging the difference from budgetary sources. But the budgetary deficit arisen like this was covered by credits taken from abroad and exchanged into Ft. In order that Ft deficit in the budget should not grow very high and the general price level should not rise considerably either, Hungarian economic management – against the basic principles of Hungarian reform – re-valued Hungarian forint. Neither the proper indices, i.e. the ratio of the domes-

tic prices of goods to be exported to their external ones justified this step, nor did the dollar demand that grew higher rather than lowered, so revaluation was a forced act by all means. Simply, it was a voluntarist decision. The 'rippling' of external prices into Hungarian economy was not permitted. Having analysed the regulation of Hungarian foreign trade, the author of this study frequently pointed out that 'this Janus-faced reform' was one of the major causes of Hungarian indebtedness, i.e. the fact that market reform was implemented only half-way in foreign trade. As has been seen, companies became interested in foreign trade sales and their profitability, the majority of prices changed according supply and demand but foreign currency had not been the object of market regulation. Forint was re-valued by mere command. And foreign currency was also necessary because the 'hardening' of the trade mentioned before continued to require dollar imports.

Thus, indebtedness was a remedy to the double deficit but to the detriment of future. It is widely-known that the rise of interest rates during Reagan's administration increased the amount of credits all over the world considerably, especially, as we were unable to cover even the interests out of the net surplus of foreign currency (because there were none), so we 'rolled the credit snowball' up to the change of regime. Our debts were covered by the sale of state property to foreign owners. (It is another question that the successive government pushed Hungarian economy again to similar level of indebtedness through their further deficits. And again the sources are mostly foreign countries!)

Foreign trade after the change of regime

After the change of regime, significant changes occurred in the structure of Hungarian foreign trade. Partly, the companies were able to exercise their rights to foreign trade in the more or less restored market mechanism but they lost considerable part of their markets. In addition, Hungarian changes in agriculture also influenced the structure of foreign trade to a great extent. As a reaction to the forced organization of cooperatives, former owners were allowed to get back their former lands with compensation bonds. In the place of ceased cooperatives only few profitable large estates emerged, the structure of estates became fragmented and the competitiveness of agricultural production declined greatly. The sales of agriculture and food industry, which made up 20 per cent of foreign trade before the change of regime, decreased to 6 per cent by the turn of the millennium. The reason and explanation of this may be attributed partly to internal causes and partly to external ones mentioned. Since sales supported by export credits and guarantees were part of foreign trade to western countries, Hungarian foreign trade could not keep up with competition due to the lack of capital and proper institutional system. In agriculture it was of special importance that European countries got rid of their surpluses of agricultural produce readily in the politically motivated actions through which the EU assisted Russia that had enormous problems of supply. With the transportation of goods, free of charge, Hungarian economy was unable to compete, so it lost its markets. Some say there are political prejudices in the background of the decline of socialist trade. We are inclined to claim that the causes of decline may be attributed to the lack of capital and that of concept due to the chaotic property relations. Also, it is obvious that the successor states of the Soviet Union wanted to purchase the best products of processing industry for convertible currency and that affected our exports of manufacturing industry unfavourably, too. As the years passed, Russian language knowledge has been also waning. By all means, the experts in high position who had former

Soviet relations, especially in the field of energy business, made good use of their knowledge. However, it can be stated as a fact that in Hungarian foreign trade after the change of regime there had been a strong geopolitical reorientation and significant structural changes took place. All this has been concomitant with the change of trade fashions and methods as well.

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THE BANKING SYSTEM AND ITS STAKEHOLDERS IN HUNGARY

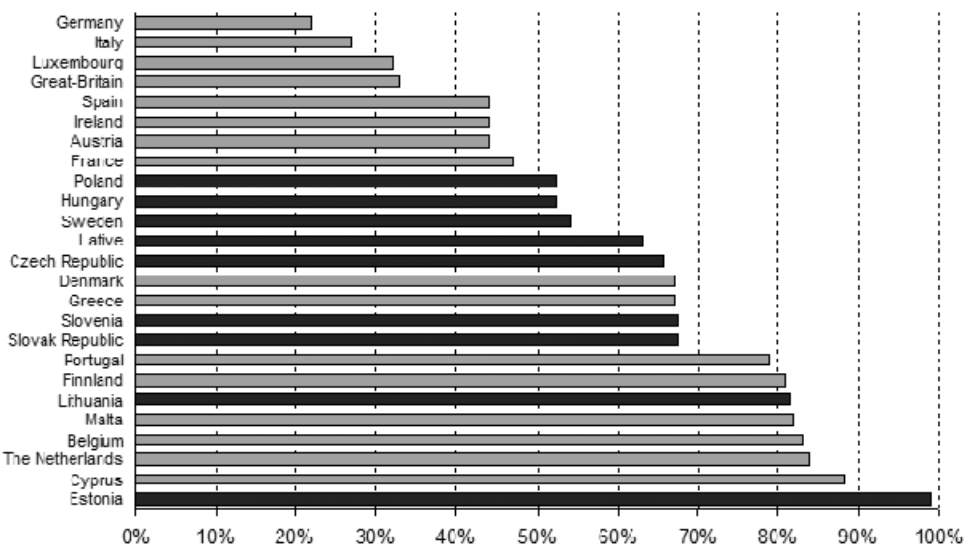
BY KATALIN BOTOS – PETER HALMOSI

Introduction

The basic feature of a market economy is competition, which does not serve its own interests but those of the customers. The banking sector is a special branch of the economy since money transactions are based much more on trust than any other enterprise. The reason is that average customers blindly put their money into financial institutions like banks and hope to get it back with interest. This fact justifies an increased supervision by customer watchdog groups. This is a "my-adventure-with-your-money" game so operation of the sector shall not only be achieved by competition. Secure operation of the sector requires decent supervision with special institutional background (Botos 2003, Farkas 2006).

Consumer watch-dog groups and even competition councils shall supervise prudent operation of banks which, however, cannot exclude the possible interest infringement of certain customer circles disposing of asymmetric information. Banks require additional coverage for the sake of prudent operation which is confronting with the interests of other customer groups. Sometimes the sector seems to work as a cartel due to the constraints of harmonizing conditions of prudent operation. Theoretically, this could be congested by competition on EU market that decreases the prices of services but as we will see this is not happening effectively.

Figure 1: Concentration of the 5 biggest banks in EU countries



Source: Kiss, 2006.

If we analyze the competitiveness of a bank system on the integrated market of the EU, the system shall be embedded in the home economic policy. We have to analyse the relationship of the banking sector to each of its "stakeholders" in order to adjudge whether it is

working competitively. It is a natural case that banks compete for customers. Even the competition among international service providers is typical. Banks shall attract new customers by more and better services which is not easy as protecting innovative products by patent is not feasible. The amount of capital is thus of paramount importance in competition. Competition in the sector is also influenced by the financial power of certain institutions which – as a result of regulation – determines the capability to attract wealthier customers. Banks compete with other intermediary institutions as well. Although the importance of stock market is less than in the U.S, its role has significantly developed overall in Europe. The Hungarian economy shall thus catches up with this tendency in order to retain its competitive ranking. The cost of financing is a competitive factor for companies which shall be considered by the bank system as well. As most Hungarian banks are universal banks they might participate in capital market transactions. The sector shall, however, decide which direction they drive their customers: bank loans or commercial paper issues. To be honest, in Hungary it is not the question of what this sector proposes but rather when will enterprises – like in the U.S. and Europe – choose stock market financing tools. This is not a general practice in Hungary yet. The basic form of capital mediation is credit. This can be drawn back to several reasons. First, credit was not an available tool in the past. Second, Hungary took over European traditions as most banks operating in the country are owned by foreign banks. So, the real question is whether social-economic circumstances enable to keep pace with European developing trends or not?

How does financial culture develop in a country? What possibilities does product innovation offer and what threats does this hide for lay-customers? To what extent are services accessible to certain groups of economic partners and to what extent are they satisfied with the services? These questions immediately raise concerns about the link between SMEs and financial intermediary firms, provoking more questions. Does the size of banks reflect that of enterprises? In what direction does regulation change, namely is it getting simpler or more bureaucratic? Another question relates to the link between the financial intermediary sector and the state: who is really the state? Is it the government as executing organ or the national bank which is owned by the state in Hungary? The national bank received its authorization for an independent monetary policy from the parliament. It is also interesting what special situation monetary policy, taxation, state consolidation interventions have on the bank sector? Changes in regulation are, for instance, approved by the parliament by the proposal of the government.

The state and the banking sector

Considering the stakeholders of the bank system, the state stands not on the first place. The reason is that banks serve not to satisfy the financing needs of the state primarily (it is covered from taxes). The bank sector is rather about to collect households savings and finance enterprises. One of the most important tasks is the settlement of money transactions. Money transactions of the central budget are carried out by special institutions so there are some severe reasons why we put the state on the first place when discussing this topic.

Bank systems in Central and Eastern Europe have revived from a mono-banking experiment of the socialist era. They are not natural formations of the market but that of system transformation. This process has started before the official date of the transformation as the two-tier bank system has been established by reform economists of state socialism. This

artificial intervention resulted in capital-scarce state owned commercial banks with only one profile. These banks also lacked professional bank clerks (Botos 1996).

After the transformation a law on banks was legislated this enabled the formation of banks. It was however also clear that state-owned bank shall be privatized, especially because capital-scarcity hampered the development of modernization and liquid assets could not have been secured by the government, except by raising state debt. Raising the debt was however against the interest of international financial institutions whose attitude was rather important for the country. Not only the state but domestic private persons and ventures as well disposed of enough liquid sources. This is the reason why the bank sector in all Central and Eastern European countries sooner or later became a full foreign property. The private sector had no free capital as savings were spent on flat loans. Neither private capitalists existed in these countries nor were the countries able to follow the pathway of the German economy that happened after the World War II when consolidation avoided changes in ownership. Banks in Germany had been consolidated by 100-year-maturity state bonds until the required minimum level. These banks financed enterprises without coverage balancing on the edge of a knife. The economic upswing helped companies revive in a short time so they were able to pay the loans back. Repayment, on the other side, contributed to the recapitalization of the bank sector. The Bundesbank finally bought back state bonds – that brought eventually few revenue for the banks –from its seignior age income ahead of time. Cash flowing into the sector also helped the process but it lasted for several decades. In the 1990s, countries of Europe – including East-Germany – consolidated the bank sector by short term bonds with market based interest conditions. Foreign banks that decided to buy banks in CEE countries suffered sometimes huge losses due to the lack of skilled bank experts in the country. Not surprisingly, the same motives urged privatization. The reason why CEE countries lacked expertism lays in the fundamentals of the preceding system (for instance, capital accumulation was punished seriously as it was considered as income gained without work). It's worth mentioning the case of OTP Bank which became prosperous due to its management. This is not only true for the biggest Hungarian bank (consider the case of Raiffeisen Bank).

It was decisive factor whether privatization drew strategic or portfolio investors into the country. In the latter case, the management had better chances to survive but the bank could not rely on the expertism of its mother institution. Bank-owners are today foreigners in most cases in all CEE-countries (Botos 2004).

The state is not only shareholder interest in banks. First, the money transmitting system shall serve the interest of the economy smoothly. Second, banks shall be stable taxpayers. In order to achieve this, banks had to be recapitalized. Without liquid assets this could only have been done by notes that are state bonds that will be bought back by the state later. So, banks sold by the states had a portfolio part of 0 risk level, modest profitability and transaction cost. We can say that these banks had – and have even today – a risk free income so these bank can be sold to investors. The privatization was thus a disguised borrowing by the state. The money flowing in from the privatization raised the domestic debt. Losses hidden in the bank sector exceeded the multiple of their basic capital so this new state debt was a heritage of the socialist economy. People did not realize this important thing – they only saw that the health care system was not consolidated. It is however true that the whole society – including all stakeholders – had an interest in the healthy operation of the bank sector. The only thing that can be argued it the price of consolidation. As a result, a significant part of the banks' portfolio is long term consolidation bonds. This is however not the only link between the budget and banks.

The most important link is bank regulation: it shall be secured that no unexpected event happens as a result of risk-accumulation. This is achieved by prescribing a certain level of guarantor capital and provisions to cover potential risky loans. The state shall hamper situations when banks "magically" increase their basic capital from their deposits as it happened in the case of Agrobank and Postabank. In these cases the banks over-credited their big customers while requiring subscribed capital. This is an evasion of the spirit of laws as these activities resulted in huge losses to the clients' constraining consolidation (unfortunately, law-enforcement organs sentenced only the leaders of one bank to prison while the other case was closed by lapse).

Modern state has not only prudential but market supervision tasks as well. Prudential supervision aims at securing risk taking ability at each participant while market supervision concentrates on the changes of financial markets. Products becoming more and more complex make customers' orientation more difficult. The Bank Supervisory Agency cooperates with the Competition Council on market supervision and with the National Bank of Hungary (NBH) on prudential supervision.

The bank sector is also an important buyer of recently issued state bonds. Since 1996, the NBH can not be a primary buyer of state bonds. In 1996, the law on banks has been changed in order to operate as universal banks and, for instance, invest in long term bond. The Hungarian state budget needs the bank sector to finance its overspending.

The bank sector is also an important executor of the economic policy of the government. This relationship shall, however, be put on long term strategic views. Financing of flats in Germany provides a good example of an economic policy that was driven by social policy. German economic policy aimed to boost the balanced development of building industry, the middle class and the state supported institutional system if the bank sector after the World War II. Young employees with decent income can pay the rent and spends on flat saving funds while accepting low interest rates. Pre-savings and mid term loans of the flat saving fund secure the self-part to apply for a mortgage loan. They do not have to pay the rent only the instalments but they live at least in their own home. Unfortunately, this example can not be copied in the case of Hungary. Social and economic circumstances are different just like the stability of the national currency, the proportion of rental flats, employment situation. 40 years of planned economy resulted in the deterioration of real estates. Local governments, thus, sold rental flats to tenants who face serious concerns now to renovate the flat, especially for retired people. The so-called "flat-maffia" also deprived many people of their own flat. The Hungarian government aiming to adapt German institutional solutions could hardly see these negative consequences. This was, however, not the only decision that brought not the most desirable effects due to sudden changes.

The subsidization of SMEs also hides some signs of an inconsequential policy. Existence-loans, start-loans and interest mediate the will of the economic policy. Existence-loans supposed to serve privatization suffered from fewer problems as experts anticipated it. The repayment ration is quite good but the construction led to severe problems in the bank sector, like in the case of Agrobank (Botos 2004).

Preferential loans to SMEs and flat loan interest subsidies became a cornerstone in the economic policy of the third government after the transformation. Some elements continued to exist even in 2006. This attitude did not only put emphasis on social policy but provided one of the leading industries, the building industry with continuous demand. State subsidy is thus – in this form – a remunerative investment resulting – theoretically – in higher tax revenues, less unemployment and thus less government expenses. This hypoth-

esis does not stand, however, for SMEs, especially those in the agricultural sector. Easier conditions and interest subsidies resulted in unnecessary investments and brought financial stress as the economic policy changed. Only commercial companies selling agricultural machines made higher profits but these came from import. These imports meant a burden for the current account bringing more drawback than advantage for the whole economy.

Profitability in the bank sector was extremely good in the past few years. This depended to a large extent on the interest. Experts believe that due to the high volatility of yields relatively high incomes are necessary in order to raise the capital of banks. This high volatility is a consequences of state supported interests. The consolidation package evoked by the convergence program tapped this process after the elections of 2006.

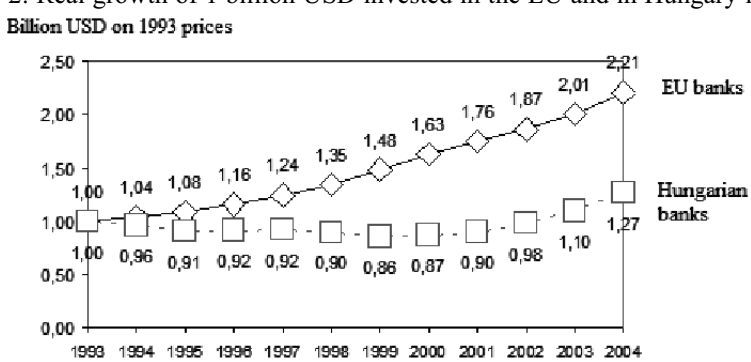
Table 1: Return on equity in the bank sector

Év	Real return on equity in EU banks	Real return on equity in Hungarian banks
1994	4,0	-3,8
1995	4,2	-5,4
1996	7,0	0,6
1997	7,4	0,7
1998	8,1	-2,8
1999	10,3	-4,3
2000	9,8	1,4
2001	7,8	3,4
2002	6,2	9,2
2003	7,7	11,8
2004	9,9	15,5

Source: Csillik, 2006.

The link between the state and the bank system was overshadowed concerns of budget deficits. The Hungarian state as a stakeholder put its interest in higher tax revenues in the foreground. This was the point when the high profit of banks got into the spotlight of economic policy. In 2005, the income was tapped by a special bank tax in respect to the high deficit of the state budget. In 2006, an attempt was made to tax interest revenues of banks which is devolving state social policy on the bank sector as banks can not change loan conditions retroactively. This series of measures mixed state tasks with that of the private sector. It was an absurd case that the measures staggered temporarily the Landloan and Mortgage Bank (LMB) which had a high share in home loans. The loss of shares in value was so significant that trading with LMB shares was hung for a period. The OTP Bank suffered 1/3 of losses in value on LMB shares after the measures according to the press. Western newspapers called this tax as “Csányi-tax” who is the CEO of the bank. The tax touched the OTP as seriously as it was the most interested in the household branch.

Figure 2: Real growth of 1 billion USD invested in the EU and in Hungary in 1993



Source: Csillik, 2006.

The fact that the profitability of the bank sector relies to a great extent on state subsidies questions the market base of bank revenues. It is rather irritating that taxpayer's money flow from the public into the private economy. On the other side, state commitments can more and more be met by private sector involvement. This cooperation acts in favour of development and employment. One fact can not be feasible understood: the process is carried out on the account of the bank sector but without its aim. If the private sector establishes a sensible cooperation with the state and knows what to accept for what price, this cooperation can not be considered as l'art pour l'art. It is however not wise to force the private sector to do state tasks. The financial sector will place the burden the whole economy.

Local governments

Local authorities and utility companies are also big clients but to a rather limited number of banks in Hungary. The OTP Bank had been in a monopole position in the 1980s but this came to an end as the number of banks increased in the 1990s. As the share of central transfers was extremely high in revenues, the soft budget constrains caused moral hazard, resulting in insolvency. This finally led to the 25/1996 law on Local Government Bankruptcy. Since then, localities have a net deposit in the bank sector, so cannot get enough external financing.

Table 2: The Hungarian local government sector and the bank sector (billion HUF, end of year data, except March 2006)

	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Loans	49,9	38,5	30,3	44,4	57,6	73,1	115,1	144,0	182,8	243,0	260,1
Deposit	80,7	86,8	115,8	123,5	148,3	197,5	219,3	211,3	241,8	239,4	256,0
Net position to the bank sector	30,8	48,3	85,5	79,1	90,7	124,4	104,2	67,2	59,0	-3,6	-4,1

Source: Halmosi 2006

A part of the state reform in the mid 1990s was to urge localities to rely more on local revenues. This policy, however, led localities without decent financing. Although EU funds are available to the sector, increasing bank loans prerequisites consolidation. Unfortunately, the central government has only few capacities for this.

We can definitely conclude that there is a strong competition for localities in the bank sector. Localities are free to choose their account-keeping bank where they deposit local tax revenues. As these revenues mount up to around 28–30% of total revenues, banks tend to give special allowances to steel valuable localities from each other. Unfortunately, the sector is only important as an account-keeper. Considering the unclear legal background this is not a miracle. In order to increase local governments' share from bank loans, internal risks shall be established and handled. Furthermore, there is only little information on off-budget commitments of local governments. In the mid 1990s, localities rearranged local public services, in many cases by pushing them into off-budget public service providing entities. The State Audit Office has several times emphasized that these firms may also take up huge amount of bank loans. We can conclude that banks compete for them just like for other private sector companies.

Households and enterprises

The total own capital of the Hungarian bank sector was around 5–6 billion euro, the aggregated balance sheet total 60 billion euro and the off-budget commitments 35 billion euro in 2005. This shows that the sector is rather strong with good capital adequacy ratio but it can not finance bigger scale clients on its own. The balance sheet total is only around 70% of the GDP falling to the last in the ranking of EU-countries, including the Czech Republic and Poland. This is a concern as banks in these countries are not so developed as Hungarian banks (ifj. Nyers 2005). It is worth studying corporate structure and spending customs of households in different countries. Big multinational companies may also rely on loans from parent institutions, the ration of domestic loans to foreign loans is 1:2. So, the growth of corporate loans depends rather on SMEs demand for loans. Bank loans increased from 33% to 50% of GDP between 2001 and 2005, mainly due to SMEs growing interest in loans. SMEs' share in bank loans was less than 20% in 1999 but this increased to 54% by the end of 2005. This means that banks preferred big companies as winning some bigger scale business produced less transaction cost and was also less risky. They opened towards SMEs after the millennium. Several case studies verified that medium size enterprises made banks compete with quite good results at this time. Government policy, however, played an important role in this as these companies won 120 billion HUF tax base allowances and 3 billion HUF investment allowance in 2003 according to the Ministry of Economy and Transport. To put things in a different perspective, creditability of SMEs, perspectives of the economy and profitability alone does not support a dynamic growth. The state shall contribute to this and the bank sector also has a share in it.

In the recent years, the amount of household credits skyrocketed. It had 3 components: delayed demand of households, support of the economic policy and impetuous bank policy. The population lived rather a sparing life after the transformation, especially due to uncertain conditions. Household savings started to grow and reached a significant level relative to GDP, although it remained under EU average level. After the situation consolidated, the delayed demand started to evolve, especially as it was supported both by banks and the government. Banks were stipulated by the restricted possibility to increase the outplacement of household deposits. The state supported SMEs so bank loans to the sector began to grow. The flat support program of the government also boosted households' loan demand. The growth rate of flat loans became 3-digit during the Orbán-administration. The level of households' flat loan increased from 192 billion HUF to the level in the year 1989. The outplacement grew by 50–80% p.a. This only curbed in the 2nd half of 2004 as the new government curtailed the support system. Nevertheless, even in the 1st half of 2005 the growth rate was 20% per month. It was an outstanding opportunity for the banks to improve their profitability. They usually referred to the fact that household loans embody higher risks thus requiring higher interest rates but this was not a real reason because of state support to households! One example against this is car leasing as a higher proportion of people let to take over their cars. In the case of flat loans, however, people try to retain solvency by any means.

The changes in the composition of loans increased the interest (to over 4%) and the profitability of banks. To be honest, households pay higher interest in an international context, mainly due to the fact that this sector is less integrated. Although cross-border bank transactions are available, the importance falls behind that towards enterprises. While bank competition is global for companies, it is still local for households. After flat loans started

to slow down, consumption credits increased. Real estate based free usable loans and car loans are also popular. Recently, banks changed to foreign currency loans pushing the risk to customers. In spite of this, the ratio of households' foreign currency loans increased significantly. The increase of households' flat loans diminished their net savings (even the demand for state bonds suffered a decrease). As banks wanted to make more profits they relied on cheap international sources. But the growing budget deficit forecasted that the forint may depreciate. International environment made borrowing cheaper. Some economist's warning, that this situation can not be maintained on the long run, became however in vain. Problems resulting from the lack of balance became clear by the middle of 2006: the national currency moved downward in the intervention band. The international situation became worse, even the Federal Reserve Bank of the U.S. raised its interest rate waving into European money markets. Although Far-Eastern Countries provide money markets with enough savings, this is absorbed by the huge deficit of the U.S. budget. Rating agencies forecast interest rate premium increases for Hungary. This can be boosted by domestic inflationary expectations which may bring further currency depreciation. It is hard, however, to say tendencies precisely but we can declare that this will bring great surprises for households running up huge foreign currency loans. In the Hungarian case, the foreign currency risk changed into a client risk, thus, the burden of the imbalance of the economy will be paid by the whole population.

The banking system in a competitive situation

The first question is whether the bank sector is in a competitive situation? The high rate of profit suggests it is not really. Was there a general competition then interest would decrease significantly. It is so justified to consider the situation from the viewpoint of competition law (Nagy 2005).

The Hungarian Competition Council examines the bank system in 3 fields on a legislative basis:

1. How big is concentration? Do acquisitions, mergers contribute to monopole situations?
2. Are consumers informed enough?
3. Does the high level of profitability mean misuse of economic power? This assumption is not verified in Hungary at all.

Hungarian competition law places the behaviour of market participants and its distortion in the foreground as opposed to that of the EU which emphasizes the distortiveness of state interventions as well. We must admit that intervention is in the favour of small participants thus strengthening competition, in certain cases.

As far as concentration is concerned, the number of commercial banks (and financial institutions operating as incorporations) increased only to a small extent. The number of deposit banks decreased from 260 to around 180. It seems there are still too many of them on the market. These banks can hardly modify the inherited market share where they have to provide all financial services. Practically speaking this means that financial groups gather around 17 financial institutions.

We can declare that competition exists in the financial sector relating to product range and service providers. No financial institution can afford not to serve its clients' interest, for instance by providing internet access to services. As far as consumers' information is concerned the Hungarian Financial Supervision Authority (HFSA) declared that informa-

tion is sometimes too much but sometimes too few. We need “bank-doctors” to be able to orientate among different tools. This problem is especially big if products of different types of institutions compete. Although the functions are similar or even the same, comparing the prices and cost is difficult. HFSA is thus urging to establish principles and methods.

The Competition Council has serious problems when tackling misuse of economic power. The fact of misuse is hard to prove. Although the population reckons, financial institutions misuse their power, the HFSA has no reported case until now! This question is relevant not only on the Hungarian but also on transition markets. The European Union has launched a comprehensive inspection of 500 banks, including 7 Hungarian banks. We hope that the stakeholders will learn from the moral.

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GROWTH, FINANCIAL DISEQULIBRIA, EMPLOYMENT AND COMPETITIVENESS – PAST AND FUTURE

(THE LISBON PROCESS – IN A HISTORICAL PERSPECTIVE)

By István Kőrösi

1. Crucial questions of the economic growth – a historical approach

In the European Union including Hungary as well, the most important issue is how economic growth, decrease of financial disequilibrum, increase of competitiveness can be provided, while protecting the existing level of the European social market economy as much as possible. It is an extremely complex theoretic, strategic and practical question. An unambiguous recipe to solve the problem has not been found yet. Nevertheless, the participants of the economy and politics have to/should concentrate on dealing with these problems as a whole. The financial crisis which appeared in the summer/early autumn of 2008 made it obvious again that the speculation activities increasing the gap between the real economy and the financial world can lead to a dramatic crisis situation.

The current processes of the world economy take place in four areas: 1. globalisation, 2. integration, 3. upgrading of regionalism and subregionalism, 4. crucial change in the role of the state, especially in its activity in economy.

The active adaptation and its quality and effectivity, as well as the enhancement of competitiveness have been upgraded. Nowadays, there are basic negative tendencies in both the oparation of the state and that of the economy. There is a need for genuine structural reforms in order to put an end to these tendencies.

At the beginning of the 21th century we are the witnesses of the upgrading of human resources. In most part of the 20th century the key elements of development was the capital and its materialised form, the investment. After both world wars there was an obvious lack of the dollar. The main obstacle of growth was the lack of capital, the scarcest factor in production. Therefore, it had to be paid on the highest level. Due to this fact, the share of capital-owners increased and remained high as for the value of production.

Nevertheless, as early as the mid-60s, the lack of dollar transformed into an aboundance of dollar and financial capital. A sort of international financial "balloon" had been created. Due to this fact, the dollar lost its value, the trust in it was withdrawn, and these processes led to the crisis of the Bretton-Wood system, and later on to several other crises on the financial market. In the developed countries the market of standard consumer goods became saturated, the possibilities for rentable investments decreased, several times the rate of net profit decreased, tax and incidental charges increased. All these negative tendencies created negative effects. The fall in real investments and an increasing rate in unemployment caused a significant withdrawal of working capital in most industrially developed countries, especially in those EU countries which were rich in capital. Problems have been worsened by the fact that on long term the net, after-tax profit reached in the real economy by investment was much lower than the result of investments in the speculative, financial market.

These investments have more risk, but may bring more yields. This fact can be well observed at the events of the autumn of 2008. Actually, interests and dividends can/could

be paid only from profits and incomes produces in the real economy. Therefore, it is impossible to overcome financial crisis without them.

There are four crucial areas which are undeniable for the development of economy and human resources: human resources, health care system, education, infrastructure and environment policy. The quality and the development tendencies in these four areas determine changes in each country concerning their future, quality of life and competitiveness on the world market. Countries which develop in a normal way can concentrate on these areas and thus, they can increase their competitiveness, while underdeveloped or regressing countries will be in a hopeless situation for a long period. Therefore, financing these areas should be increased in absolut value, moreover their relative proportion in the national budget has to be grown. It is an essential condition for development and catching-up.

2. The programme and aims of the Lisbon Agenda

The Lisbon Agenda accepted in March, 2000 set the ambitious goal for the European Union to „be the most competitive, knowledge-based economy of the world on the global market" by 2010. Certain economic policy makers and media experts interpret it, as reaching the American economy. Nevertheless, in my opinion the above mentioned aim cannot be interpreted like that. Comparison with th U.S. did not even appear in the original concept. In order to reach the crucial aim of competitiveness, all of Europe's competitors had to be taken into consideration, with a special attention to Japan, China, India, the small, Far-Eastern countries as well and other regions too.

In 2001 the strategy of the Lisbon Agenda has been elaborated in the Lisbon Program and the requirement of sustainable development was added. In 2004, following the Sapir and Kok reports the revision of the Lisbon process was initiated. The concrete issues of the implementation of the program, such as ensuring financement, came into prominence. In 2005, midterm of the Lisbon process, implemented achievments were assessed. The targeted 2010 closing date was cancelled because the realisation of aims seemed to be impossible by that time. However, the basic strategy remained the same, and four new strategic areas were outlined, 24 guiding principles were accepted. The completion of the Lisbon Agenda with the national action plans for cathing-up was also accepted.

The above mentioned four strategic areas are below:

1. extension of knowledge and innovation, 2. realisation of a homogenous inner market, 3. creation of new workplaces and a new European social model, 4. stabilisation policies for the macroeconomy. The enhancement of competitiveness based on the knowledge-based economy could be the only basis on which the decrease of the role of Europe can be reversed.

This approach requires the elaboration of a totally new and steady economic policy in the EU countries. These policies are able to ensure sustainable development, renewal of institutional network, financing and creation of new models for socially sensitive market economies which meet the requirements of the 21th century. Obtaining the goals of development is essentially influenced by the changes of power factors in world politics and economy. (About the main issues and processes see Inotai, 2007)

The main aims of the Lisbon program are: 1. creation of knowledge-based community, 2. dynamic economic growth by enhancing achievement in macroeconomy, 3. ensuring the economic competitiveness on the global market of the world, 4. sustainability of the economic growth with attention to the environmental aspects, 5. social integration including

full employment as much as possible, and the creation of a new European model for social welfare.

In the framework of the Lisbon Agenda common targets were set up in areas determining future development, which earlier had not been included in the regulation of the integration. Thes are the following ones: education, R+D, innovation, stimulation of enterprises, labour market and social security. In these areas coordinated cooperation was targeted instead of central regulation.

Basic structural reforms are needed in the following areas in order to realize the development set-up in the Lisbon Agenda: 1. capital and goods market, 2. investments in the knowledge-based economy, 3. transformation of the labour-market, 4. environment policy, 5. social welfare policy and institutions. The main strategic aims, the key areas of the programme and the crucial reforms are closely intertwined with each other, but it is difficult to realize all of them at the same time, because controversial tendencies can appear when determining the priorities in development, due to scarce resources. Basically, both making the programs tangible and implementing them can be realized on a national level according to the different and unique economic and financing policy of each member country. Nevertheless, the EU community policy projects, R+D framework programs can contribute significantly to the above mentioned processes.

3. Growth, financial disequilibria, competitiveness – the role of human resources

Nowadays, crucial social and economic issues are closely connected with each other. The pace, quality and structure of economic growth, theway of tackling financial dis-equilibria, perspectives of their decrease, the changes in competitiveness, as well as gaining or losing ground in the world economy depend mainly on the quality of human resources.

If we look at the following line: dempgraphy – training of human resources – ability to generate income, we will face the problems concerning the prospects of economic development and the ways of tackling financial disequilibrums on a long term.

Demographic processes determine the human resources and the proportion of different age groups. Due to the decrease in birth, the number of students will also decrease, first in elementary schools, then in the secondary and higher education. Therefore, the number of new employees also falls, thus, the capacity of human resource also diminishes hindering future development.

Rate of activity: The rate of employees in the age group 15–64 is 57% in Hungary, which is the lowest one in the EU. The problems on the labour market and the growth of unemployment after the economic crisis will worsen the ability to create income in the economy. As a result, individuals and families will have less income, the situation of companies will worsen, consumption will decrease, the market will diminish Therefore, there is less tax, what aggravates the situation of the budget of the state.

The quantity, quality and structure of human resource and its abbility to generate income determine the basis on which sustainable development can be founded. Human resource is crucial and undeniable but it is not enough for development. It has to be combined with the implementation of high technology and innovation. Morover, there would be a need for a social and economic policy focusing on human resource development. It is also necessary to create a well- functioning institutional network, as well as a suitable, steady legal system, and its effective implementation with a community control.

In order to understand the above mantioned factors, we should add some basic remarks. The words „growth" and „development" appear very often as synonyms in analyses, strategies and programs. Statistics always show the growth of GDP, although production and consumption may have either useful or harmful effects. For example: the pollution of environment or the usage of non-renewable energy cost more than the value of production itself. It is the same case when statistics show growth in consumption, if there is a growth in petrol consumption due to traffic jams. However, it is a harmful consumption because it spoils the quality of life and welfare. Nowadays, there are index systems which reflect very well the quality of life and environmental influences. Nevertheless, it is difficult to create short-term indices, and they are hardly ever available on time only with a significant delay especially on an international level. From the point of view of economic strategy, we accept only such a real growth which means a sustainable, environmentally frendly development enhancing the quality of life. Any other type of development can be considered as a harmful one.

As for the financial disequilibrums, there is a worry about their absolute size and proportion in comparison with the income-growth of the economy, not speaking about the dramatic speed they are growing by. There is a big gap between real and financial economy. Creating money by speculation and its flow have multiplied comparing with the production and the trade of goods and services. The primary dollar creation is 60 times bigger than the world export, with the derivatives it is 140 times bigger according to the estimates of 2008. The debt-trap is an extremely serious burden. If debts grow more quickly than the national issue, then running into debts will keep going on. It has been the situation during the recent years in Hungary. As for paying debts, paying-off and interests make 30–32% of the budget in Hungary, thus it remains only 68–70% for other costs, for investments and consumption. Debts are three times more than the whole amount spent on education including elementary schools and universities.

It is a serious factor in the crisis that in most countries, especially in Hungary, interests are higher than the post-tax profit created in the real economy. Interests and installments of accumulated debts have to / should be paid from the post-tax profit of companies and the incomes of households. If the interest is higher than the profit rate of companies, then it is not advisable to get credit for investment because the enterprise goes bankrupt. If the indebtedness of the population increases more quickly than its incomes, then individuals and companies, can go bankrupt. Therefore, the extension of credits for the public should be lower than the growth of the incomes of the population. At the moment, there is an inverse situation in many countries, especially in Hungary. On long-term, the financial disequilibrum cannot be tackled without restrictions, therefore there is a need for growth-oriented economic policy, stimulation of investment, creation of new workplaces. However, it is impossible to realize them without the decrease of interest which is possible only if inflation is cut down. New investments to create new workplaces can be initiated by tax-breaks, thus in the end, there is more tax. If there is a lack of new investments, or the value of investments decreases, the production and the tax-paying of the companies can be less, even if tax assessments are higher. If there is a decreasing consumption of the population there is less income from VAT. Therefore, the most important factors in the intensification of the economy are development, stimulation of investment, reduction of disequilibrums and stabilisation of consumption.

Competitiveness is a crucial element from the point of view of the success of national economies, companies, and employees. Competitiveness as a cathegory has been interpreted many times and in many ways." Competitiveness means a sustainably high income with

a high level of employment in an open international competition". (Botos J. 2000) Another interpretation suggests that competitiveness expresses „who is able to produce the best product, who has the disposal of the best educated workforce with the best knowledge, who is on the top-list concerning investments in machines, equipments, R+D, and infrastructure,who is the best organizer,whose institutions /government, education, business/ lead the worldwide list of effectivity." (Thurow, 1992, Csáki, 2006)

One of the most precise phrasing of the notion comes from Porter: Competitiveness is an index of the national economy which shows how effectively a nation can make use of the available human, financial and natural resources." (Porter, 1998, Csath, 2008)

Gaining and losing ground in the world economy are the result of the influence of several factors. In my opinion the evaluation by the world market is expressed by two excellent indicators: 1. The changes in exchange rates indicate that the international market upgrades or underrates the work of a nation. 2. The growth or fall of the export on the international market on mid-term and long-term (It can be indicated in national economies, branches of economy and products). At the same time I should mention that in case of fuels, enhancement and gaining ground can happen without improving competitiveness, as a result of scarceness of natural resources, fluctuation and growth of demand, speculation and exploitation of oligopol situations.

The Lisbon process focuses on the enhancement of competitiveness in the European Union. In the 21th century the key element of it is the development and utilization of human resource. However, it is more difficult to map and analyze the notion of human resource, than other key elements. Human resource can be interpreted as the collectivity of people who create values in a society, cooperate with each other, represent a value system, and have an appropriate knowledge and skills which they utilize in their work during their economic and social activity. Accumulated knowledge, heritage of the past, achievements of culture and civilisation, know-how, inventions and patterns, ability for innovation and its usage, they all belong to the human capital of the society. It is not only the sum of individual knowledge but the multiplication of it. One of the main characteristics of the human resource is that instead of being consumed, it improves during the usage. Therefore, the improvement of human resource is a key element in sustainable development and employment policy. Thus, it is a key factor in enhancing competitiveness according to the aims of the Lisbon process.

It turned out very quickly that the implementation of the Lisbon Agenda is more difficult and controversial and takes longer time than it was expected. Therefore, in 2005 after some investigation, the closing date of 2010 was cancelled. A new date has not been fixed yet. Besides, the enhancement of competitiveness has been pointed out as a continuous, long-term task. According to Kok's recommendation the Lisbon Agenda was given the name of „Growth and Jobs" which expresses that in the complicated structures of aims these two elements should be in the limelight. They are expected to strenghten the position of the EU and improve its competitiveness in the world economy.

4. Growth and employment

During 2000–2008 there was a strong fluctuation in the economic growth in the EU. There are some data which must be emphasized. In 2002–2003 the growth of GDP in the 15 EU countries was 1.1–1.2%, in the 27 EU countries 2.9–3%. In 2004 the growth accel-

erated, in 2005 there was again a slow-down. In 2006–2007 there was a 2.7–2.8% growth in the 15 EU countries and an average of 2.9–2.3% growth in the 27 EU countries. The countries of the EURO-zone represented slower growth than the average of the 15 or the 27 countries.

If we look at the significantly big economies, the growth was the slowest in Germany and Italy, and except for 2005, France had also a growth below average. The growth below average in these big countries as well as the slow growth or even stagnation on their markets did not help those countries which export goods to these big economies. Despite this fact, the Hungarian export to Germany was especially good, what was due to the export of German companies working in Hungary. In 2002–2004 the United Kingdom had a much quicker growth than the average in the EU, but later on its achievement was nearly the same.

The qualitative, quantitative and structural indicators in the EU countries are very different and change in a very different way. On the whole, as for the employment, the European Union has a significant disadvantage comparing with the U.S. and Japan, and it is also problematic that China and South-East Asia, where the employment rate is increasing, have a growing export to Europe and thus they supersed European goods in the competition.

We can quote Katalin Botos' words:" Europe is in a double trap: it should cope with the technical dominance of the U.S., and the growing export of countries with low salaries." (Detailed analysis: Botos K., 2007)

The growth rate of employment in the EU was very slow in 2000–2007, the creation of new workplaces was not sufficient to decrease unemployment significantly, although the unemployement rates diminished a little bit. Recently, in some of the new member countries, there was a significant expansion in employment and thus, the rate went almost half (for example in Poland and Slovakia). The increase of employment in 2000, in the 15 EU countries was 2.2%, in 2001 it was1.4%, then it fluctuated between 0.5–0.8%. In 2006–2007 there was a significantly high rise in it, which was stopped by the crisis of 2008. In 2000–2004 the average rate of growth in the 27 EU countries was lower than that of the 15 countries, but in 2005–2007 it was higher. In 2008, the crisis caused a significant number of laying-offs even in the new member states. In 2000–2007 the creation of new workplaces in the EURO-zone was paralel with that of the 15 EU countries, what meant that better financial stability and common monetary policy neither worsened, nor enhanced the process.

In Europe the employment rate, the number of completed working hours, the increase in labour productivity per capita has been much lower than those of the U.S. and Japan over the last 20 years. In the middle of this decade the employment rate in the EURO-zone was

69.9%, in the U.S 75.4%, in Japan 72.2%. According to the aims of the Lisbon Agenda 70% employment rate should be reached, which seems to be impossible at the moment. The rate is the best in the Scandinavian countries, it is over 70%. Hungary has the lowest employment rate among the EU countries: it is 57%, which is extremely unfavourable from the point of view of economic growth and income-generation, because the missing tax income and the high costs of unemployment deteriorate the position of the budget.

Economic achievement: The number of working hours completed during one year is very important from the point of view of GDP-growth and yearly labour productivity. In this area the 25 EU countries have a significant disadvantage comparing with the U.S. and especially with Japan. In the 25 EU countries this number is 1570 hours/year, in the U.S. 1807 hours/year. The data about the 27 EU countries are missing. Earlier, there was a decrease in working hours in Germany and France, what was much higher than the EU

average, therefore, nowadays one person works less than 1500 hours/year. These rates mean a big handicap in competition. However, the solution is not the increase of working hours/year but the extension of employment, the growth of activity rate and labour productivity/hour, by the aid of a higher added value which can be increased by technological development and better qualified workforce. It means that we are again at the importance of the enhancement of human resource.

In order to realise the aim of the Lisbon Agenda, which set a 70% employment rate, 6 million new workplaces should be created in the 25 EU countries. (There is no data about Roumania and Bulgaria.) This number is not too high but in the current situation it seems to be unattainable.

Creating workplaces offers the opportunity to improve the structure of workforce and qualification, as well as to harmonize them with the demand and the supply on the labour market. It means that there is a need for a human resource which adapts to the social and economic requirements in a more efficient way. Education, training and professional training have to comply with the needs. It is an urgent task to correct the serious failures in the structure of education and its effectivity can enhance the prospects of growth for a long time. Stimulating the creation of workplaces has two main ways: 1. on short and mid-term, the investments should be stimulated in the right segments. 2. On long term, there is no other successful employment policy only if it is a good policy in education, training and pro-fessional training.

5. Modernisation, investments and workplaces

At the end of the 21th century and at the beginning of the new millennium there were crucial changes, as for the economic growth, investments, extension of market and employment. Rationalisation has become the main reason of investments, because it is easier to increase labour productivity and production per capita by lay-offs than to obtain a similar growth in market-share. Therefore, most investments do not create new workplaces even if there is a favourable prosperity. Morover, due to atomation and implementation of complex computer systems, closing workplaces which require unqualified workforce, is going on.

The market of the EU has grown to 490 million people after the accession of 10 countries in 2004 and that of Roumania and Bulgaria in 2007. The number of economically active people is more than 40%. The unemployment rate is an average 8% in the older EU countries but much higher in the new ones. Activity rate is much lower in the 12 new EU countries, than in the developed, old member countries. Hungary has the lowest activity rate among the countries joining the EU in 2004: according to statistics, only 57% of the active population work in the 15–64 age groups. It implies that there is a high proportion of grey and black work.

In the countries of the EU the improvement of the integration and the adaptation to the world economy require modernisation and creation of workplaces which can be competitive on long-term. Everywhere in the European Union a crucial problem emerged: hundreds of thousands of simple, unqualified jobs have become redundant because of technical and financial reasons. At the same time, only much less future-oriented workplaces can be created, which require highly qualified workforce and up-to-date technology. Therefore, these countries have to face a steady unemployment.

As the new technological inventions and the new technologies get into the production process by the aid of investments, especially R+D investments, the success of modernisation depends mainly on the structure and number of investments. The other key elements are the human resource, the general level of workforce, its quality and structure, as well as other factors which are important for the utilization of human resources.

During the last fifteeen years changes in investments have had a complex picture with special features in each country. The same level of investment rate can create a quicker expansion of investment if there is a quicker pace in the growth of economy. A bigger economic potential means a bigger investment volume in absolute number. In the first case Japan, in the second case the U.S. has had a significant advantage up till now comparing with the EU.

The pace of fixed asset investments is important from the point of view of modernisation because when it is quicker, modernisation of fixed assets speeds up, the average age of machines decreases. The interdependence is not unconditional and absolute, because it does not give information about the level of modernisation in the investment. Quick expansion can also happen with less developed techniques, especially in comparison with the competitors. However, on long-term this pace can give important information about the base of technical development. In the EU countries, similarly to other industrially developed countries, fixed-asset investments are carried on with the aim of modernisation, so the speed and extension of technical development depend mainly on the investments.

The EU is in a much worse situation than the U.S. and Japan, if we look at the creation of new workplaces and the way of tackling unemployment. It would be extremely important to improve the situation on the labour market in order to improve economic growth, to enhance position in the competitive market and to create social stability.

The number of employees in the EU countries increased very slowly, with 0,5–1% during the last two decades. After the two oil crises and the increase in additional charges of wages the main goals of investments have become the per unit cost-efficiency, the decrease of energy costs and the replacement of living workforce with technology. This tendency is still valid nowadays.

The EU has fallen behind the U.S. and Japan concerning the expansion of employment. The size of the expansion was very different in each country, the reasons were also very different. It should be emphasized that the successful structural changes, the modernisation, the renewal of supply and the increase of the export are all crucial factors in stabilizing employment. (This fact can be observed in the Irish, Finnish and Spanish experience.)

The issue of unemployment aggravated not only during the recession after the two oil crises: the proportion of the unemployed has not fallen to the earlier level during the prosperity periods after recessions either. The main reason is that investments using less workforce keep going on during modernisation.There is no traditional connection between the creation of workplaces and prosperity, the features of development and the characteristics of the labour market have changed.

The reasons of unemployment in the EU can be devide into three groups:1. The limits of the demend on the market (issues of saturation and demand backed by purchasing power) 2. the limits of capacity available (these limits can be terminated by investments if there is a demand backed by purchasing power). 3. the limits of the structure of the workforce (free workforce with the appropriate qualification is not available or only in limited number on a certain place at a certain time). The main element of unemployment has a connection with

structural issues, therefore it can be changed only by solving structural problems in the economy and on the labour market.

In order to extend employment, there is a need for growth, but growth itself will not ensure the solution for the problem of unemployment. Devaluation of the workforce with little qualification and its replacement with capital will continue during a boom too, because it is required by the decrease of per unit production costs. Most of those who analyze the relationship between growth and employment think that the net expansion of employment and the decrease of unemployment is possible only above a 3% GDP growth. In the crisis of 2008–2009 the issue of unemployment has worsened.

The modernisation has a double effect on the labour market: it accelerates the adaption process (not profitable workplaces are liquidated) and at the same time it creates a steady demand for highly qualified workforce. Modernisation is the basis for development and for creating competitive workplaces. If we take into consideration the basic tendency that modernisation liquidates old and obsolete workplaces, but creates much fewer competitive ones, it is important to appreciate any net number of new workplaces, even if it is very modest.

The most serious issues of macroeconomy are the current deficit and debts of the budget of the state and other public institutions. Because of the financial disequilibrums in macroeconomy, cutting down state and public costs and orders will be definitely an evergreen topic in most EU countries during the next few years. Thus, the state may spend less on investments, therefore modernisation and creation of workplaces will be realized more and more by private enterprises.

6. Innovation and its connection with employment

The direction of development in the EU labour market is aimed at the creation of workplaces which have special advantages in location and unify highly qualified workforce with advanced technology.

R+D costs in the EU make Ľ of the whole innovation costs. Other innovation costs require three times the R+D expenses until it has a success on the market. It is a proof of the fact that R+D activity is a crucial but not sufficient element in technical-economic development. The share of R+D costs has decreased in the innovation expenses, but the share of technological development and preparation of production has increased.

Data procession will be on the top of innovational investments (even) during the next years. Then, automation of production, introduction of new technologies and development of new functions for old products follow each other on the list. The introduction and spread of communication technology results in developing communication systems which work within the company and between companies. It is expected that the integration of data processing, information and communication technologies will strenghten the technical position of the EU on the international market.

The state policy of research-development can take only a smaller risk in innovation, therefore the main task falls to companies. The main direction of the policy for technical development in the EU is supposed to provide the most favourable framework for the technical-economic development in order to enhance the spread of technical-economic information towards the participants of the economy to help them to improve their ability to cope with risks. Besides, it is important to give the most precise picture of orientation about the possible future of technical development and opportunities on the market. It is com-

pleted by a diffusion-oriented stimulation in the technical development, which uses project-orientation as a medium.

Analyses about economic policy expect that the improvement of the framework of economic policy in the field of innovation activity may strenghten the position of technical development and competitiveness of the EU countries on the international market. It is also expected that fiscal and competition policies can regulate the activity which helps to enhance the effectivity of technical development.

Modernisation and employment partly depend on the multinational companies, partly on regional and local institutions, because new workplaces are created mainly by small and medium-sized companies. These companies provide work for 70% of the employees in the 15 EU countries. (At the moment there is no data available about the 12 new countries.)

The EU provides resources for obtaining technologies needed for modernisation and its homogenous inner market is the main target for the export of the companies of the EU countries. The incoming export following the operating assets from the 15 old EU countries dominates the structure of the production and the export. Concerning the export, the importance of return must be emphasized. The need for modernisation and transformation of workplaces has extremely increased after the accession to the EU.

In the 12 new EU countries, including Hungary too, the quality of workforce is relatively high, the human resource is comparatively developed, but its utilization is far below the EU average, and far from the requirements of a stable, knowledge-based society. This situation is worsened by the problems of the health care system and the education. Therefore, we get far away from creating a knowledge-based society or from the realisation of the Lisbon Agenda. It is a worrying fact, that in several transition countries including Hungary, R+D expenditures have been seriously affected by the transformation crisis and their proportion as compared to the GDP has fallen dramatically. The Lisbon Agenda proposes 3% expenditures in comparison with the GDP. However, only the Scandinavian countries surpass it, the EU average is 1.8–1.9% and it does not seem to increase. This proportion is nearly 3% in the U.S. and much more than 3% in Japan. In Hungary the proportion of R+D expenses in comparison with the GDP does not reach 1%, although the R+D expenditures of the foreign companies are also included. This feature stabilizes our dramatic backwardness.

Fiscal policy and changes in taxes and other additional charges play an important role in the realisation of the Lisbon Agenda and in the improvement of competitiveness. In Hungary taxes and other additional charges are higher than those ones in Slovakia and Poland.

In the new EU countries which joined in 2004 and 2007, the policies stimulating investments prefered mainly the investments of multinational and foreign companies. It resulted in positive effects for the foreign operating assets, stimulated the modernisation of technology. However, the small and medium-sized companies have remained at a disadvantage, moreover, their backwardness has strenghtened, and their integration as suppliers has not been realized (except for some well-known examples). The implementation of the Lisbon Agenda requires complex, far-reaching technological and structure-developing programs. When elaborating the requirements of changes in the economic structures, several factors have to be taken into consideration, such as the priority of the development and effective utilisation of the human rsources, as well as the requirements of a stable, future-oriented profitable employment and the fact that these factors can be provided only by an effective improvement of education, professional training and adult education. The active role of the

state is undeniable in this development because future-oriented investments cannot be increased if public financing does not appear in education and professional training.

The Lisbon process and strategy focuses on the improvement of public administration, health care system, usage of Internet, development of infrastructural networks, especially in transport and communication. These areas are given high priority in financing. According to past experiences, the countries which gave high priorities to these areas developed quickly and got in the forefront. The countries which neglected them degenerated on long-term. Any knowledge-based society can be built only by healthy and educated population. Modernisation and up-to-date structural changes can be realized on the basis of the development and effective utilization of human resource.

Research-development and the improvement of innovation can be realized on the base of excellent higher education and scientific training. The participation of companies with solid capital in the R+D expenses should be raised, but basic researches at universities and research institutes should not be damaged, moreover they should be strenghtened. In the 25 EU countries the companies have 55% share in the R+D expenditures, but this proportion is much lower in the 12 new EU countries. The U.S. and Japan are able to involve their companies in R+D in a much higher proportion. The Lisbon Agenda has set a proportion of 2/3, which is supposed to be a very ambitious aim. At the beginning of the 21th century the proportion of people graduated in mathematics, sciences and technology is less than 4% in the 15 EU countries, 4.4% in the 25 EU countries. However, the Lisbon Agenda has set 15% which seems to be an unattainable goal in the current situation and with the current tendencies.

In order to realize the Lisbon aims and to improve human resource, it is necessary to harmonize the increase of labour productivity and employment. As for the allocation of resources, there is a need for an increasing efficiency. Enhancing labour productivity requires the development of technology instead of providing fewer workforces for the same production. The increase of competitiveness means that the participants of the market should invest more in the innovation of the product and the production procedure. The markets of services definitely have to be developed. However, it is not enough to open the markets, but the accession has to be regulated in a sensible way. It means that it is necessary to create a reasonable, public regulation of competition.

In the EU, the number and proportion of those who take part in training and professional training has been increasing. This fact has a significant influence on economic growth, labour productivity and partly on employment. Lenghtening the average time of public education with one year can provide a steady 0.3–0.5% growth of the GDP. In the EU an average 5% of the GDP is spent on education expenditures, in budgets it has about 10–11% share. Quickly developing countries have performed a much higher proportion.

The appropriate utilisation of human resource and reaching the Lisbon aims for competitiveness can be realized only by an active labour market policy and it obviously requires institutional reforms. Finland, Sweden, and Denmark could unify active labour market policy with the system of education and adult education, labour exchange and creation of R+D workplaces.

7. Development of research, human resource, innovation and competitiveness

In the 21th century human resource, education, training, professional training and especially development of research and innovation have been upgraded among the key factors of economic development. The proportion of innovation in increasing added value, the competition of patterns, the competition for employing the best scholars and researchers (worldwide brain-drain) have increased. In this area the U.S. was and still is in the best position due to its financial resources, research possibilities and institutions. On the other hand, Europe is a constant loser in this process, because its scholars and leading researchers, whose education cost a huge amount, are obtained and utilized by the U.S., while it means a continuous financial loss for Europe.

The scientific and technical development is quicker and quicker and thus, both in relative and absolute number there is a lack of leading scholars and researchers compared to the requirements.

Good organisation of R+D activity, shortening the way from research to innovative investments is determining elements in the improvement of economic performance. At the beginning of the millenium, the good utilisation of R+D, the strenghtening of innovation and competitiveness in Scandinavia, the Benelux countries and Ireland can be explained by the above mentioned approach.

The most important factors which determine the effectivity of R+D activity are the following ones: the number of employees working in the area, their qualification and creativity. The number of scientists and engineers is more than one million in the EU. European researchers have had outstanding achievements in the field of discoveries.

In R+D the role of the state has changed, it should put emphasis on the induction of technical development, creation of operational framework based on indirect stimulation. Direct state expenditure is realized in regional support, as well as in some big projects of high risk and public projects with special goals (for example environment protection, management of water supplies, waste liquidation and recycling).

The basic dilemmas of innovations are: rising innovation costs and shorter lyfe-cycles on the market. Because of the shorter lyfe-cycles of the new products companies have to get returns of their expenditure more and more quickly. The growth of per-unit expenses creates a better situation for the big companies with lots of capital in the fields which require much technology. Meanwhile, the general use of developed technologies improves the chances for the closing-up of small and medium-sized firms.

In the EU information-technology (data processing) is on the first place in innovational investments. Automation of production, implementation of new manufacturing technologies, developing the functions of existing products complete the list in company planning. The integration of data processing, information and communication technologies is expected to strenghten the position of the EU on the international market, what can significantly moderate the former disadvantage of medium sized companies. Moreover, some of these drawbacks can even disappear in some areas.

Future-oriented technological development requires more and more cooperation between developers and users. Time and expenditure can be diminished significantly in case of developments requiring lots of research, if there is cooperation. The capital and know-how of certain companies are often not sufficient to realize alone their projects. Cooperations for long-term contractual technological developments are mainly led by big companies.

The technical development policy of the EU contributes significantly to overcome obstacles and risks in innovation. According to some data, support of innovation in the manufacturing industry of the EU is very important both in size and sphere of activity, although the market operates as a liberal one. Beside an indirect, market-oriented support, there is a high proportion of direct project support, what refers to the fact that the means of development are not distributed by the „watering can" idea, i.e. distributing the same amount to everybody, but instead, they are distributed after investigating the aims of development. Technical development is more and more based mainly on innovational investments of private companies. However, basic research, financing and developing the infrastructure of research and education are carried on mainly by public (state) means.

Nowadays and in the near future, the main direction of modernisation is the technological investment in informatics and communication. Investments in information technology are especially high in the production of office and informatics equipment, as well as at banks and in the insurance business. Branches of industry coping with problems try to overcome their difficulties by investing in informatics more and more vigorously.

Europe has lost ground during the last twenty years, mainly because it was not able to provide dynamic and attractive conditions neither for R+D, nor for the quick realization of innovations especially not in structural changes of technology, as it has happened in the U.S.

In these areas the U.S. and the multinational companies have gained ground not only by using their power of capital, but by using their strategic superiority in spreading capital and technology, while Europe has fallen behind.

In the 21th century we have arrived to a new technological turning point. Nowadays, not only the conditions of development are changing but there are also new opportunities for closing-up concerning technological competitiveness.

In the globalisation process there is a must for adaptation, we can also observe in this process that innovation-frendly environment, community and economy policies, as well as R+D and highly qualified workforce are appreciated. Therefore, countries which are able to react to the changes will be able to find a point to break free and to rise. As the above mentioned factors depend mainly on economic, R+D and technology-development policies, countries which are small and not rich in traditional resources for production, can also have a chance for development. In the framework of the European integration regional R+D policies are more and more appreciated on the markets of goods, capital and services.

Since we can find national policies and systems in education and professional training, the education system works basically in a national framework. Therefore, its content and its stage of development are different in each country. As traditional production possibilities and conditions are getting closer and closer, and markets are unifying gradually in the European countries, therefore, the importance of the most effective factors in competition has increased, namely the importance of the human capital and that of the potential of technology and development. Thus, it is a crucial question for Hungary too, in case if it would like to improve its international competitiveness, whether it is able and willing to concentrate on the development of human capital in its economic and development policy and in its choice of priorities.

The R+D policies of the European countries are different from each other not because of the volume of expenses and its proportion compared to the GDP, but because the creation of innovation-frendly environment, the organisational level of R+D possibilities, the existence or non-existence of an innovation chain and its quality are very different in each

country. The success of technological development depends more and more on different relationships, the quality of forward and backward relationships and the diffusion of R+D and innovation.

Enhancing the competitiveness of Europe requires the liquidation of several disadvantages. There is a serious backwardness in general use of information and communication technologies in comparison with the U.S. It is partly due to the fact that the tangible means of ICT are not widely spread (density of PCs, electronic trade, news service and telecommunication). Partly, it is also due to the facts, that the human resource is not qualified enough, the economic policy is rigid and there are also structural disadvantages. These problems should be tackled.

Since the role of innovation has been upgraded, the relationship among R+D policies, effectivity of technical development, ability for innovation in the economy and the position on the international market become more amd more important during the period of 1998–2008. The EU countries spend different amounts on R+D compared to their GDP, the effectivity of research development is even more different.

The last twenty years the technical development of the EU has fallen behind the achievement of the U.S. and Japan in the global competition. It is not necessarily caused by the lack of initiatives in innovation, because there are several inventions in Western Europe, especially in the machine industry, production of vehicles and chemical industry. The causes of backwardness are much more the relatively lower R+D expenses, the lower number of employees in the R+D sector, the heterogenity of investments, the different regulation system, the lack of synergy, the low growth rate in the first part of the 1990s and the integration program of Eastern Europe. These factors contributed to the backwardness of the EU and in many cases it meant that the region become dependent on the big competitors.

Certainly, there is a mixed situation in Europe. The U.K., Finland, Ireland, Sweden and the Netherlands have a good performance due to good capital provision, effective human resource, and state policy, as well as initiatives of companies. The lack of any of the above mentioned elements worsens the chances of catching-up for the other member states. Thus, in the EU a double aim has been set: it is important to improve the competitiveness of the EU on the international market, and to liquidate the technological gaps inside the EU at the same time.

Increasing R+D expenditures and provision of human resources for R+D are very important elements, but nout enough at all. It is undeniable in the 12 new EU countries to enhance the utilization of R+D expenses and to implement the achievements more quickly. One of the main problems of the 12 new EU countries is the slow introduction of innovations.

Improving the environment for investments, reliable and steady economic policy has a crucial role in closing-up of the 12 new countries including Hungary. More and more emphasis has to be put on the effects of new technologies and their acceptance. Acceleration of the technical development can result in significant saving of workforce. Therefore, if future-oriented, steady workplaces are not created successfully, then the issue of unemploy-ment will become very serious. Due to the crisis of 2008–2009, there is a significant rise in unemployment what means that in the Lisbon Agenda the aim to extend employment has failed.

The R+D potential of the EU has grown significantly by the accessions, not in the fields of expenses, but due to scientific capacity and human capital working in R+D. All these elements are the „dowry” of the 12 new member states.

The backwardness of the new member countries are less in education, professional training and adult education than in the production of GDP per capita. Morover, there are some disadvantages in some fields in comparison with some old member countries. Qualitative and quantitative improvment of human capital is the most important factor in economic closing-up, therefore, it should be given high priority both in economic policy and financement. Education and training of human capital have a key role in the rise of the 12 new EU countries including Hungary, and thus, the enhancement of the quality of work-force is the base of steady growth. One year increase in education can increase the labour productivity with an average of 6% in the EU, but we can find even higher numbers too. In order to improve competitiveness, beside economic conditions, there is a need for the acceptance of innovation in the society, for an open environment and for a value-oriented society.

Summary and conclusions

1. Sustainable development providing catching-up can be based only on reasonable growth, structural modernisation, monetary and fiscal stabilisation, as well as good environment policy. However, financial stabilisation cannot be realized by restrictions, only on the base of steady development.

2. The success of the Lisbon Agenda depends on several factors. The following ones are the most important ones: 1. the change of indices of the real economy. We have to emphasize the GDP/per capita, the activity rate, the share of agriculture, industry and services in the GDP; 2. the pace of growth, especially that of the GDP and labour productivity; 3. the requirements of legal, institutional and regulatory systems, namely the harmo-nisation of the legal system; 4. financial indices, with an emphasis on inflation, fiscal balance, unfunded debts; 5. external factors with a special attention to the balance of payments on current account, the change of values in exchange and the flow of foreign capital.

3. The key elements of modernisation from the point of view of the development of human capital and the realisation of the Lisbon Agenda are the following ones: 1. taking over and implementing up-to-date technologies, 2. joining the global innovation pro-cesses, 3. ensuring resources for development, 4. level and operation of the capital markets, 5. ensuring dynamic buyer's market, 6. appropriately motivated and well-trained workforce. In Europe, especially in the EU the technology needed for the modernisation of the Central European countries is available. Financing is an important factor, however, the 1,045% of the GDP of the EU means a limited support for the development. Therefore, the budget transfers from Brussels can be important but incidental parts for the closing-up of the Central and Eastern European countries. Nowadays, the buyer's markets in the big EU countries are less dynamic, they grow slowly, morover, there is more import to these markets from China and the Far-Eastern countries.

4. The following areas have to be advanced for the sake of the Lisbon Agenda and the appropriate utilization of human capital: a/ advancing the reforms on the markets of goods and capital, b/ investments in the knowledge-based society and economy, c/ reforms on the labour market for the suitable utilization of a well-trained and productive human workforce potential, d/ welfare policy reforms to create a viable, 21th century model of the social market economy, e/ rationalization of the environment management in order to improve decrease and recycling of waste.

5. Development of research and innovation can be realized only on the basis of excellent higher education and scientific training. The participation of companies well-provided with capital in R+D expenses should be raised. However, basic researches at universities and research institutes should not be damaged, instead, they should get support. In the 25 EU countries the participation of companies in the R+D expenditures is 55%, but it is much lower in the 12 new countries. The U.S. and Japan can involve their companies into R+D in a much higher proportion. The Lisbon Agenda has set the aim to reach a 2/3 proportion. At the beginning of the 21th century in the 15 EU countries the proportion of the graduates with a degree in mathematics, science and technology is less than 4%. The 10 new countries raised this number to 4.4% within the 25 EU members. The Lisbon Agenda has set 15% which seems to be an unattainable goal, if we take into consideration the current situation and tendencies.

6. In the EU the number and proportion of people who take part in education and professional training has been growing. This fact has a significant influence on economic growth, on labour productivity, and partly on employment. Lenghtening the average time of public education can provide a steady 0.3–0.5% growth in the GDP. In the EU, fiscal expenses spent on education make an average 5% of the GDP and they have a share of approximately 5% in budgets.

7. The competitiveness of the EU on the international market cannot be evaluated by comparing it with the performance of the U.S. The requirements of the international market, the position and behaviour of the different participants have to be taken into consideration in order to create competitiveness.While trying to catch up, Central and Eastern European countries have to adapt their strategy to the developed Western European countries, but at the same time they also have to keep paying attention to the development processes of the world economy as a whole, and especially to the fact that the EU has to face a strong external competition. Division of labour has to be realized also with special attention to the partners inside and outside the EU.

8. The Lisbon Agenda and process tackle the enhancement of public administration, health care system, developing and financing infrastructural, transport-related and communication networks as central elements. According to past experiences, countries which could put an emphasis on these areas, developed quickly and got into the forefront. Countries, which neglected them, degenerated on long-term. Any knowledge-based economy can be built only by healthier and better-educated population. Modernisation and structural changes can be built only on the basis of development and better utilization of human resource.

9. The experiences in the EU countries show that the aspects of modernisation, creation of workplaces and competitiveness are much more interrelated than earlier. Therefore, an active policy in labour market has to concentrate on stimulating all these factors jointly, because of scarce financial resources. The reason is that this method is much cheaper than the passive payment of benefits. Nowadays, modernisation is basically realized by foreign capital and technology, mainly by investments of operating assets. It would be necessary to support the implementation of domestic inventions inside the country and to strenghten and develop the basis of the national R+D and innovation in a reasonable way. On the other hand, national small and medium-sized companies can play crucial role in employment. Therefore, their situation and position in competition should be improved by an active labour market policy.

10. In order to realize the aims of the Lisbon Agenda the following elements are / should be necessary: 1. in an honest competition there is a need for well-functioning markets of

goods, which can induce companies to innovate and which appreciate innovation, help small and medium-sized firms to join the market and to become consolidated on it. 2. There is a need for reasonable, flexible and at the same time stable labour and capital markets, so that viable enterprises could obtain human and capital resources under fair conditions. 3. Structural transformation requires a very serious support in the development and introduction of innovations. In order to realize it the organic, steady and mutually advantageous cooperation of higher education, development of research as well as industry and infrastructure has to be developed and carried on continuously.

11. Only a long-term economic policy, which creates sustainable growth and is stability-oriented, can be successful. In order to reach success there is would be an urgent need for liquidation of accumulated deficits, long-term development strategy, reliable economic policy, decrease of structural disequilibrums, innovations to modernize, as well as complex education and training, creation of workplaces which can utilize the opportunities to close up.

12. The Council Presidency of Hungary in the EU in 2011 is a good opportunity and an important chance for initiatives in order to strenghten and advance the Lisbon Agenda. In this study I had the intention to summarize the main conclusions of the Lisbon Agenda up till now, the current situation and the future prospects of the key areas. The elaboration of the concrete action plan of the Council Presidency of Hungary in 2011 is a national duty. Some important tasks promising achievements can already be outlined thematically.During the implementation of the Lisbon process the main interests of Hungary meet the common interests of the EU member states, moreover they even coincide.These areas are the following ones: the elaboration and development of the European Research Area, the coordinated development of education and training, especially the quality of professional training and higher education, the extension of the fiancement of R+D framework programs in the EU budget after 2013, the creation of common pattern evaluation according to the EU requirements and patterns, the creation of transnational networks on a common European basis (especially those of transport and energy systems), the construction and development of a common European policy and structure for energy supply (gas, nuclear energy), the development of interregional, common environment policy, the creation of innovation funds similarly to R+D framework programs in order to help the activity of venture capital, the support of foreign language trainings in each member country by the means of English , French, Spanish international courses at universities, the organisation of EU-financed projects for international exchanges of workforce, the stimulation of cooperation among outstanding centres of sciences and innovation, the extension of common European cultural projects which can improve cohesion (following the example of the current European Capital of Culture project).

Table 1
GDP per capita at current market prices
(EU-27=100) (%)

	1997	2000	2003	2006	GDP per capita, 2006 (PPS)	GDP per capita, 2006 (EUR)
EU-27	100	100	100	100	23.500	23.500
Euro area	115	114	112	110	25.800	26.600
Hungary	52	56	64	65	15.300	8.900
Czech Republic	73	69	74	79	18.600	11.100
Poland	47	48	49	53	12.400	7.100
Slovakia	52	50	56	64	14.900	8.300
Slovenia	76	79	82	89	20.800	15.200
Germany	125	119	117	114	26.700	28.200
France	115	116	112	113	26.500	28.400
United Kingdom	117	117	120	119	27.900	31.500
Austria	133	134	129	129	30.200	31.100
Finland	111	118	114	116	27.300	31.700
Ireland	115	131	141	143	33.500	41.100
USA	160	159	152	155	36.300	35.000
Japán	127	117	112	114	26.700	27.200

Source: Europe in Figures, Eurostat, Brussels, 2008. 99. p.

Table 2
Labour productivity (%)

	Labour productivity per person employed EU-27=100		Labour productivity per hour worked EU-15=100	
	2001	2006	2000	2005
EU-27	100.0	100.0	...	…
Euro area	113.8	110.3	104.3	102.3
Hungary	68.4	74.8	46.3	54.9
Czech Republic	63.6	71.2	44.3	52.2
Poland	56.3	61.5	40.9	44.8
Slovakia	60.7	71.4	47.2	57.5
Slovenia	75.8	84.7	62.4	…
Germany	107.4	106.4	108.1	110.0
France	125.7	125.3	115.9	119.7
United Kingdom	110.3	110.3	87.0	89.8
Austria	118.6	121.1	101.6	99.2
Finland	113.3	111.5	96.7	94.6
Ireland	128.7	132.1	97.0	105.1
USA	139.5	140.3	111.3	116.7
Japán	…	…	…	…

Source: Europe in Figures, Eurostat, Brussels, 2008. 102. p.

Table 3

Labours costs (average hourly labour costs in industry and services, in enterprises with 10 or more employees) (EUR)

	1996	2000	2006
EU-27	16.17	18.32	20.53*
Euro area	19.39	21.18	24.71*
Hungary	2.86	3.63	6.34
Czech Republic	2.80	3.86	7.14
Poland	2.95	4.48	6.03
Slovakia	2.16	3,07	5.33
Slovenia	7.35	8.98	10.76*
Germany	22.90	25.00	27.70
France	22.09	24.84	30.31
United Kingdom	14.22	23.71	24.47*
Austria	21.96	22.87	25.32**
Finland	20.25	22.10	27.39
Ireland	…	…	…

* 2005

** 2004

Source: Europe in Figures, Eurostat, Brussels, 2008. 133. p.

Table 4

Expenditure on educational institutions

	Public expenditure (% of GDP)	**Annual expenditure on public and private educational institutions per pupil /student (PPS) (EUR)**	
	2004	**1999**	**2004**
EU-27	4.8	4453	5535
Euro area	4.7	5022	5991
Hungary	5.1	2378	3712
Czech Republic	4.2	2535	3736
Poland	5.4	1773	2747
Slovakia	4.0	1641	2606
Slovenia	5.4	…	5552
Germany	4.2	5479	6207
France	5.6	5438	6214
United Kingdom	5.0	4406	6195
Austria	5.0	6903	7870
Finland	6.0	5228	6255
Ireland	4.2	3958	5792
USA	5.1	8756	9960
Japán	3.5	5738	6910

Source: Europe in Figures, Eurostat, Brussels, 2008. 184. p.

Table 5
Employment rate (%)

	1996	2000	2003	2006
EU-27	60.7*	62.2	62.5	64.4
Euro area	58.1	61.5	62.6	64.6
Hungary	52.1	56.3	57.0	57.3
Czech Republic	67.3**	65.0	64.7	65.3
Poland	58.9*	55.0	51.2	54.5
Slovakia	60.6**	56.8	57.7	59.4
Slovenia	61.6	62.8	62.6	66.6
Germany	64.1	65.6	65.0	67.5
France	59.5	62.1	63.3	63.0
United Kingdom	69.0	71.2	71.5	71.5
Austria	67.8	68.5	68.9	70.2
Finland	62.4	67.2	67.7	69.3
Ireland	55.4	65.2	65.5	68.6

* 1997
** 1998

Source: Europe in Figures, Eurostat, Brussels, 2008. 250. p.

Table 6
Unemployment rate (%)

	1996	2000	2003	2006
EU-27	…	8.7	9.0	8.2
Euro area	10.7	8.2	8.8	8.3
Hungary	9.6	6.4	5.9	7.5
Czech Republic	…	8.7	7.8	7.1
Poland	10.9*	16.1	19.6	13.8
Slovakia	…	18.8	17.6	13.4
Slovenia	6.9	6.7	6.7	6.0
Germany	8.7	7.5	9.3	9.8
France	11.6	9.1	9.5	9.5
United Kingdom	7.9	5.3	4.9	5.3
Austria	4.3	3.6	4.3	4.7
Finland	14.6	9.8	9.0	7.7
Ireland	11.7	4.2	4.7	4.4
USA	5.4	4.0	6.0	4.6
Japan	3.4	4.7	5.3	4.1

* 1997
Source: Europe in Figures, Eurostat, Brussels, 2008. 260. p.

Table 7
Gross domestic expenditure on R&D (% of GDP)

	1995	2000	2005
EU-27	…	1.86	1.84
Euro area	1.79	1.85	1.86
Hungary	0.73	0.78	0.94
Czech Republic	0.95	1.21	1.42
Poland	0.63	0.64	0.57
Slovakia	0.92	0.65	0.51
Slovenia	1.57	1.43	1.22
Germany	2.19	2.45	2.51
France	2.29	2.15	2.13
United Kingdom	1.95	1.86	1.73*
Austria	1.54	1.91	2.36
Finland	2.26	3.34	3.48
Ireland	1.26	1.23	1.25
USA	2.49	2.73	2.67*
Japan	2.92	3.05	3.20**

* 2004
** 2003
Source: Europe in Figures, Eurostat, Brussels, 2008. 473. p.

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