Comments on the Present State and the Prospects of the Hungarian Economic Reform¹

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The reform of the Hungarian economic mechanism during 1979 and 1982 is discussed. The new administrative constraints on prices are criticized; the first steps towards disintegration of trusts and large enterprises and towards formation of small enterprises and cooperatives are regarded as promising, as are the measures that give more scope to entrepreneurship and legalization of activities in the “second economy.” The relation between growth policy and the economic mechanism as well as the “investment hunger” and the changes of the intensity of shortage are then examined. The future of the reform process is discussed briefly. J. Comp. Econ., Sept. 1983, 7(3), pp. 225–252. Institute of Economics, Hungarian Academy of Sciences, Budapest, Hungary.

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1. INTRODUCTION

The mechanism of the Hungarian economy has gone through important changes in the last several decades, particularly since 1968. What we call a “reform” is a long historical process, that at times accelerates, at times decelerates, and in some periods even reverses itself. In recent years the reform process has again been advancing. It has already brought considerable results and its new upswing might greatly contribute to economic and social development.

This paper does not aim at drawing up a comprehensive balance of the reform process. The discussion is limited to the recent developments of 1979–1982, and even these only partially, without a claim to completeness. Three topics are discussed: changes in the price system and in financial control in

¹ Several of my colleagues from the Institute of Economics helped me in collecting the data for the paper, first of all Péter Pete. The translation has been done by György Hajdu and revised by the editors. I should like to thank them.
Section 2; new opportunities for the creation of small enterprises and for expansion of the nonstate sphere in Sections 3 and 4; and the slowdown of growth of the economy in Section 5. The last section of the paper discusses the forces working for and against the reform.

2. THE PRICE SYSTEM AND FINANCIAL CONTROL

We shall here concentrate on a few questions concerning the control of state-owned large and medium enterprises (for the sake of brevity, simply “large enterprises” or “enterprises”). Some statements and some of the data in this section also cover, besides state-owned enterprises, the cooperatives, although the particular problems of the latter will be treated in later parts of the paper.

It was a repeatedly declared intention of the 1978-1982 wave of the reform to “harden” the financial conditions of state-owned enterprises. The idea was that enterprise taxes and subsidies must be established according to uniform predetermined rules, not modifiable through bargaining. The 1980 price revision was designed to serve this “hardening” by replacing the “cost-plus” pricing principle with a price system that adjusts Hungarian internal prices to the prices in foreign trade transacted in convertible currencies. This is called in the official Hungarian terminology “the competitive price system”. The intention was to stimulate enterprises to follow the signals of these prices, thus contributing to the improvement of the balance of payments in convertible currencies.

The efforts are remarkable in themselves, but the results have been rather mixed. The fact that the prices of raw materials, primary energy and many semifinished products follow more closely than before the prices of imports from capitalist markets promotes rational calculation. The profitability of exports has become a much more prominent concern for enterprise executives. But in other ways the intentions have been frustrated. I would like to emphasize three groups of phenomena.

Tendency of profitability to revert to the pre-1979 situation. A section of the Ministry of Finance has examined the impact of the price revision on the profitability of industrial economic units (state-owned enterprises and cooperatives). They established what the profitability of the economic unit would have been if they had computed the actual receipts and inputs of 1979 not at the then valid old prices, but at the new prices valid from 1980 on. The confrontation of this profitability with the actual one in 1979 (i.e., measured at the old prices) indicates the “pure” initial impact of the price revision, before the economic units and the central organs could have adjusted to the

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2 The first lessons of the computations were reviewed in the article by Falubiró and Gálik (1981) and the results of a later investigation by a memorandum of Mohos (1982). These are valuable works giving food for thought, and analyze the problem on the basis of rich factual material. In my paper I use only a few summary figures.
new prices. This was then compared to the actual profitability. The latter comparison indicates the continuous impact of the price revision, including the adjustment of output and input to the new prices. The main data are surveyed in Table 1.

We witness a tendency to revert to previous profit rates. It was only in merely 15% of the economic units that the initial impact of the price revision was followed by a continuous impact in the same direction: an increase in profitability by a further increase, a decrease in profitability by a further decrease. In the majority of cases an immediate reversal occurred towards restoring the old profitability proportions.

There are other characteristic data that also show the same reversion tendency. At the old prices industry contributed 60% of the total profit of all enterprises in 1979 (total economy, excluding agriculture and financial institutions = 100). When we compute the actual output and costs in 1979 at the new prices after the price revision, the share of industry fell drastically to 48%. But the restoration of the old ratios immediately started: in 1980 the share of industry had already risen to 54%, and in spite of the profit-decreasing central measures taken at the end of the year, the share was 55% in 1981.

It seems there exist deeply engrained tendencies for old profitability rates to be reestablished despite the efforts of the price setters. A similar tendency also appeared after earlier price revisions. Various explanations might be given: (a) there is a wide range in the quality of enterprise management and in the ability to adjust. A well-managed enterprise may soon recover from the unfavorable consequences of the price revision, while badly managed ones soon lose the advantages obtained by windfall; (b) differences in the

<table>
<thead>
<tr>
<th>TABLE 1</th>
<th>REVERSION OF PROFITABILITY TO PRE-1979 LEVEL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial impact of price revision: Computed profitability in 1979 relative to the actual profitability of 1979</td>
<td>Continuous impact of price revision: Actual profitability in 1981 relative to the computed profitability of 1979</td>
</tr>
<tr>
<td>Increase</td>
<td>Increase</td>
</tr>
<tr>
<td>Increase</td>
<td>Decrease</td>
</tr>
<tr>
<td>Decrease</td>
<td>Increase</td>
</tr>
<tr>
<td>Decrease</td>
<td>Decrease</td>
</tr>
<tr>
<td>Total</td>
<td></td>
</tr>
</tbody>
</table>

*Source: Mohos (1982).*
prestige of economic units, and in their relations to the higher authorities may mean that a "well-in" enterprise soon regains its old position while a "badly-in" enterprise soon loses the new advantages; (c) there may be variations in the extent to which an economic unit can escape restrictions and control.

Consider the most frequent case in which price changes initially reduce the profitability of the economic unit, but then profitability starts to grow again. This is a reflection of two processes. The first we can welcome: the enterprise adversely affected by the price revision immediately starts to improve its efficiency, it adjusts well to the market situation, and its profitability improves because of this. The other process frustrates the most important goal of the price revision: the price-formation principle of "cost plus" again asserts itself and prices rise. Economic units that are favorably positioned for this to occur are those for which—owing to various reasons—the price level of the goods produced generally increases, or are those that produce differentiated products and whose range of products is frequently changed. There are several indications that this second process is at work. It is worth noting that enterprises in this category (initial impact: reduction, continuous impact: growth) are frequently outside the scope of the competitive price system.

Unchanged dispersion of the profitability of enterprises. Genuine competition on the market leads to a great inequality and differentiation of enterprise profitabilities. The 1980 price revision aimed at attaining an overall similar effect; however, that does not seem to have happened. Two reports, made independently of each other and with different methods, agree that the dispersion of profitabilities has not increased. According to a report of the Ministry of Finance the coefficient of variation of profitability of 1163 enterprises was 79.4% in 1979, while in 1981 it was 79.6% for 1168 enterprises—that is, it practically did not change at all.

Diverging tendencies in the profitability of exports and of domestic sales. An important goal of the 1980 price revision was to establish a connection by legal regulations between the profitability of domestic sales and that of export sales. Thus, it was prescribed, among other things, that if the profitability of exports declined, the economic unit had to reduce the domestic price also, which usually entails diminishing domestic profitability. It is difficult to check statistically in an unambiguous manner to what extent this principle has been implemented, particularly because of delays in adjustment. Therefore, we can draw only indirect conclusions. A Ministry of Finance study of 167 units drawn into the system of competitive prices concluded that the profitability of domestic sales was greater than that of sales for export.

1 Here and in what follows the term "exports" means "exports sold for convertible currency on capitalist markets."

4 New regulations allow for exceptions which will be dealt with below.
In quite a few cases the two kinds of profitabilities moved away from each other relative to the previous period: domestic profitabilities increased and export profitabilities diminished. Certainly this violates the spirit of the original idea. Several other observations testify as well that in several cases the profitabilities of domestic and export sales continue to diverge from each other.

We have surveyed three groups of phenomena to show that realization departed from intentions. When preparing this study, I first read the preliminary drafts and publications about the changes in regulators and about the price revision, and then the subsequent reports on the experiences. I saw a vision, as if I first entered a modern dispatcher room of a factory, with various "regulators": hundreds of buttons and switches, instruments and signal lamps. Dispatchers were bustling about, pressing now this button, turning now that lever. And then I got into the workshop, and I saw that materials were pushed about in wheelbarrows and that the foreman shouted himself hoarse. True, production is carried on, but quite independently of when which button is pushed in the impressive dispatcher room. No wonder, the dispatcher room and the workshop were not connected.

Of course, the picture is a caricature. But perhaps it makes clearer what Antal (1979) called "regulation illusion." The regulations valid from 1980 on were worked out very carefully, with much intellectual input, to the tiniest details. But "those to be regulated" are moved by other forces and thus the actual events rather differ from what those working out the new rules expected.

What is the cause for the deviation between intentions and realization? The combined effect of a large number of factors, a complicated causal chain, asserts itself. We merely mention two interrelated causes.

One of those is the artificial nature of the system of rules and regulations. Real market competition is not devised by anybody: living organizations compete with each other for the buyer, ultimately for profit, for survival, and for growth. In our country, however, the intention is to simulate live competition with extremely complicated legal rules devised on a desk—with little success.

It is a natural effort of every producer who is not indifferent to profit that the price cover his costs and secure in addition a profit. The seller wants to get the highest possible price. There is only a single countervailing power to that: the buyer, who would like to pay the lowest possible price. The lowest price will emerge if there is competition among sellers for the buyers. For this, it is first of all necessary that the demand of each potential buyer (and thus also total demand) should be separately constrained, and that the ensemble of sellers should have some surplus supply, at least potentially, so that the buyer might choose from among the sellers. It might then indeed happen that the seller, in vain, wishes to get the price calculated according to the "cost-plus" principle—the buyer is not willing to give it, because he rather satisfies his demand from another seller (an immediate competitor or
the producer of a substitute product). The demand constraint cannot be replaced by an administrative or legal constraint on price.

The price revision of 1980 sought through artificial instruments (legal rules) to induce producers and sellers to abandon their natural efforts and apply instead of the "cost-plus" principle various other pricing principles. In reality, the efforts of producers and sellers were directed toward the evasion of these artificial rules. The horizontal relationship between sellers and buyers, their conflicts and compromises, cannot be replaced by the vertical relationship between sellers and the price office. It soon turned out that the prescriptions for price calculation were exerting a detrimental influence on efforts to raise the volume of exports. Enterprises seeking to raise domestic prices were induced to concentrate on exports of the most profitable products even if that export was relatively small. New rules were issued that allowed exceptions from the original rules. Thus, enterprises may now increase the domestic price of their product even if the profitability of exported goods does not improve, provided that the profits on export are at an acceptable level (for which exact numerical limits were prescribed) and the volume of exports increases. Several other—as concretely defined—exceptions exist.

Another complementary measure is that the enterprises operating in the noncompetitive sphere have to report to the Price Office if their profitability rises above 6% (in the service sphere, above 9%). In such cases the Price Office can forbid the further raising of prices, unless the part of the profit above 6% is expected to be absorbed by rising costs. (This regulation was formulated from the outset so that it allowed for many exceptions from the obligation to report.) Beyond that, every economic unit has to submit detailed documentation to the Price Office every half year. The intention of all these measures is understandable: they seek to prevent "unfair profit." The consequence is that the role of profits becomes illusory. In an attempt to improve the originally artificial system with ever newer corrections and exceptions, it becomes even more artificial.

Another group of causes of the deviation between intention and realization is related to the alleged hardness of fiscal and credit policy towards enterprises. I have the impression that the words about "hard financial discipline" and "hard credit conditions" have not been sufficiently coupled with deeds.

The problem begins with the fact that the new "rules" are, from the moment they are issued, custom tailored to the special circumstances of enterprises. With regard to taxes (except wage taxes) each branch, or subbranch, of the economy is treated differently. This can be clearly seen in Table 2 which presents 1980 data. Column (i) shows the effect of the price revision on profits.

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5 This asserts itself particularly strongly in the so-called "follower" enterprises of the competitive price system, and much more with the units that have not been drawn into the competitive pricing system.
### TABLE 2

**Compensating Effect of Taxes and Subsidies on Profits Resulting from Price Revision (1980)**

<table>
<thead>
<tr>
<th>Branch of economy</th>
<th>(i) Effect of price revision on profits</th>
<th>(ii) Effect of tax and subsidy revision on profits</th>
<th>(iii) Compensation quotient</th>
<th>(iv) Overall effect of tax, tax, and subsidy revision</th>
<th>(v) Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mining</td>
<td>+</td>
<td>−</td>
<td>0.91</td>
<td>+</td>
<td>Taxes and subsidies virtually compensated for effect of price revision</td>
</tr>
<tr>
<td>Chemical industry</td>
<td>−</td>
<td>+</td>
<td>0.90</td>
<td>−</td>
<td>compensated for effect of price revision</td>
</tr>
<tr>
<td>Light industry</td>
<td>−</td>
<td>+</td>
<td>0.85</td>
<td>−</td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td>−</td>
<td>+</td>
<td>0.82</td>
<td>−</td>
<td></td>
</tr>
<tr>
<td>Metallurgy</td>
<td>−</td>
<td>+</td>
<td>13.77</td>
<td>+</td>
<td>Overcompensated for effect of price revision</td>
</tr>
<tr>
<td>Food industry</td>
<td>−</td>
<td>+</td>
<td>8.35</td>
<td>+</td>
<td></td>
</tr>
</tbody>
</table>


Column (ii) shows the change in profits resulting from changes in taxes and subsidies: a plus (minus) sign indicates that profits rose (fell), and the net tax diminished (increased). In column (iii) a "compensation quotient" is computed by dividing the numbers used to define column (ii) by those used in column (i). This quotient is meaningful only for branches in which there are opposite signs in columns (i) and (ii). Column (iv) summarizes the combined impact of the two, as it affects the profits of the industry in question.

Of course, this does not mean that the calibration of the price system and of financial supports and levies ab ovo compensated for every effect. Many enterprises fared well at first, others fared badly. But there remained sufficient possibility for maneuvering, and the course of affairs resembles repeated matches in a game. Both parties are masters in this "regulator game"; in addition they know each other's style well. One of the teams—the ensemble of the central organs—devises new tactics, new clever combinations, how to "get" the adversary. But the other team—the ensemble of enterprises—immediately works out countertactics and tries to get around the adversary. These countertactics have two stable elements.

One possibility, which can always be tried is that the enterprise does not implement the prescription. Here the opportunities of enterprises vary by product group. If an enterprise produces only one or a few kinds of products whose quality can unambiguously be standardized, the price authority can strictly supervise it and check on the relationship between prices and costs.
Such is the situation with primary energy, basic materials, simple standardizable intermediary products. But if the enterprise produces many differentiated products and sells them in several markets, then it is practically impossible to enforce the legal rules relating to price calculations. I had talks with experienced auditors and they acknowledged that an enterprise can evade the legal rules relating to calculations in such a way that it is impossible to prove that they have violated them. We have to put up with the fact that it is the relatively smaller part of production where real administrative prices can be set or the method of price calculations can be prescribed in an administrative manner. With the greater part of production this is sheer illusion, only pseudo-administrative prices come about. The 1980 price revision did not face this fact.⁶

The modifications of the original principles of price calculations and the possibility to obtain individual ad hoc exceptions have acted to perpetuate the bargaining process between central agencies and the enterprise. At most some shift took place in respect to with whom bargaining is worthwhile. At first the main partner in the bargaining was the ministry, directing the production; later it was the financial authorities and the National Bank. Though these institutions have not disappeared from the process, now the weight of the price authority, its power over the enterprises, has grown. But it is still true that the financial position of the enterprise depends not only on bargaining with its partner on the market, but also on bargaining with the state organs.

A paradoxical situation has developed. The changes of 1979–1982 promised an epoch of “hardness.” The combined result of the changes was that too many enterprises got into a situation that, in the absence of a state subsidy, would lead to a catastrophe. If only a small part of enterprises were menaced, the state might perhaps have let things take their course, and these enterprises would have gone bankrupt. But what can be expected if many economic units, with quite a few very big ones among them, would stand at the brink of bankruptcy without support? The experience of the years 1979–1982 left a strong impression on enterprises: the promise of “hardness,” and the very different implementation, a combination of “excessive hardness” and indulgence.

One of the important indicators of the financial dependence of enterprises on the state is the magnitude of income redistribution among enterprises. In one of our investigations⁷ of balance-sheet data of state-owned enterprises we constructed an indicator of “pure,” “original” profitability which was

⁶ This suggests a possible explanation for the reversion of profitabilities to pre-1979 levels, reported in Table 1: there are enterprises that by the nature of their production have difficulty in evading some price fixing or calculation rule, while others can easily do that.

⁷ In this research project, which is directed by the author, A. Deák, Á. Matits, A. Ferge, and M. Locsmándi participated. How taxes and subsidies were changed among individual state enterprises is also investigated on the basis of the 1976–1980 data on all state-owned enterprises.
computed as if the state had not taxed away anything and had not given any subsidy either. A summary of the results of our research is given in Table 3.

As can be seen, 1980 did not bring any outstanding change. (In a more detailed breakdown—by branches or subbranches—the proportions somewhat shifted, but this does not alter the aggregate picture of the whole economy.) Nor has the range of redistribution become smaller after the 1979 reform. Subsidy is still of a compensating or leveling nature; this is indicated by the fairly strong negative correlation between pure profitability and subsidies. Profits distributed to employees (as profit sharing) are almost independent of the "true," "original" profitability of the enterprises. We may add further that the bonus of the manager of the enterprise also does not depend on the "original" profitability, but on the actual profitability after receipt of the subsidies. The manager is thus forced not only by the interest of the enterprise, but by his own immediate financial interest, to acquire as much subsidy as possible.

The most convincing evidence of the "pseudo-hardness" of Hungarian economic policy is that while the Hungarian economy, similar to many other countries of the world, is in serious economic difficulty, and while the government is forced to carry on restrictive policies, only one to two dozen firms show losses. Out of 1735 enterprises only 10 units showed a loss in 1980, and 11 in 1981. Only 13 enterprises were liquidated in 1980, and 11 were amalgamated with others. I took the data on enterprises incurring losses and on those liquidated from two different sources. I do not know whether the liquidated and merged enterprises incurred losses or not. But Laki's data (1982) for an earlier period are available to answer this question. This excellent study performs many kinds of analyses, examining, e.g., the mergers in en-

### TABLE 3

<table>
<thead>
<tr>
<th>Year</th>
<th>Total subsidy per original profits</th>
<th>Total tax per original profits</th>
<th>Correlation between subsidy and original profitability</th>
<th>Correlation between total profit share going to employees and original profitability</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>0.763</td>
<td>1.289</td>
<td>-0.66</td>
<td>0.03</td>
</tr>
<tr>
<td>1979</td>
<td>0.763</td>
<td>1.129</td>
<td>-0.59</td>
<td>0.07</td>
</tr>
<tr>
<td>1980</td>
<td>0.761</td>
<td>1.385</td>
<td>-0.59</td>
<td>0.12</td>
</tr>
</tbody>
</table>

*Source: Computations of our research, cited in footnote 7.*
gineering between 1970 and 1979. In 27 out of 43 cases that could be evaluated in the three years prior to the merger, the profitability of the absorbing enterprise was lower than that of the absorbed one. Often in merger cases profitability diminishes and demand for subsidy grows.

One of the most important criteria of true decentralization is whether difficulties on the national level are passed on to the enterprises so that they directly feel the national concerns. Our conclusions about losses, liquidation, and merger of enterprises suggest that this has not yet happened. Enduring losses do not lead to "death," to the liquidation of the enterprise; and conversely "death," the liquidation of the enterprise and its absorption into other units, may occur by administrative decision, independently of considerations of profitability. It is not the market that performs natural selection, it is the government office that orders decimation.

My book Economics of Shortage (1980) concluded that the budget constraint for Hungarian state-owned enterprises has remained rather soft even after the 1968 reform. From all that is said in Section 2 of this paper, the conclusion may be drawn that the budget constraint of the state-owned large enterprise has not become considerably harder even after 1979.

3. CONCENTRATION AND DECONCENTRATON

In recent years it has been recognized more and more that the degree of industrial concentration in Hungary is excessive by world standards. This is obvious, for example, from the data in Table 4, which show that Hungarian industry is much more concentrated than that of, for instance, industrially more developed Sweden. True, the huge enterprise can enjoy economies of scale in mass production. But it is frequently more cumbersome, it has less flexibility to adjust quickly to changing circumstances. Table 5, which groups enterprises according to the size of capital and shows the average profitability in 1980, shows that profits are almost monotonically diminishing with increasing size of capital. Note also that enterprises in the two largest groups contribute 78.3% of total net output at a profit rate below 10%.

One facet of the reform process starting in 1979 is the intent to diminish the concentration of the state sector, in two ways. One way is the breaking up of the huge existing organizations, to be initiated by high administrative

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8 On the "hardness" and "softness" of the budget constraint see Kornai (1979; 1980a, Chap. 13; and 1980b).

9 This ranking by profitability does not necessarily reflect unambiguously a ranking by efficiency. Many factors contribute to the higher profitability of smaller enterprises: they can more easily enforce the "cost plus" principle; they have perhaps fewer obligations involving unprofitable international deliveries, etc.
TABLE 4
CONCENTRATION OF INDUSTRY (1970)

<table>
<thead>
<tr>
<th></th>
<th>Share in the total number of workers (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Hungary</td>
</tr>
<tr>
<td>Total industry</td>
<td></td>
</tr>
<tr>
<td>Establishments with at most 100 workers</td>
<td>13.6</td>
</tr>
<tr>
<td>Establishments with at most 500 workers</td>
<td>39.8</td>
</tr>
<tr>
<td>Light industry</td>
<td></td>
</tr>
<tr>
<td>Establishments with at most 100 workers</td>
<td>19.1</td>
</tr>
<tr>
<td>Establishments with at most 500 workers</td>
<td>51.3</td>
</tr>
</tbody>
</table>


decisions. In the last one or two years perhaps about 80–90 smaller enterprises have emerged through the breaking up of larger enterprises and trusts. Deconcentration at a similar rate is planned for the next one or two years as well; by dissolving a further 30–40 trusts and large enterprises 120–130 new, smaller enterprises would be created.

Another way of reducing concentration is to found new small state-owned enterprises. According to the new legal regulations of 1982, large state enterprises can found affiliates on their own initiative and ministries and local councils may establish new small firms. Also so-called “small cooperatives” can be founded. There are fewer restrictions than for large enterprises. The central organs interfere less with the financial life of the small firm than with that of the large firm; they cannot issue instructions to small enterprises. The state has no authority either to regroup their assets. On the other hand small enterprises cannot expect financial support from the founding authority in the event that they incur losses.

Here we have again reached the problem of the hardness of the budget constraint. As we saw in the case of large enterprises, an intention to harden the budget constraint does not guarantee that such hardening will occur; the difficulties come in the course of implementation. What we need to assess, therefore, is the chance that intentions to harden the budget constraint will be realized. In my opinion, the hard budget constraint is more likely to be realized in the case of the small firms — although it is not quite certain even there. Let us consider only a single interrelation — that between losses and survival. The bankruptcy of a large state-owned enterprise might involve many thousands of people losing their accustomed workplace, which is a
TABLE 5

SIZE OF ENTERPRISE AND PROFITABILITY (1980)

<table>
<thead>
<tr>
<th>Value of capital plus annual wage bill (million Forint)</th>
<th>Number of economic units</th>
<th>Average profitability (%)</th>
<th>Share in the net output of industry (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>10.1–15.0</td>
<td>69</td>
<td>26.1</td>
<td></td>
</tr>
<tr>
<td>15.1–30.0</td>
<td>232</td>
<td>21.3</td>
<td></td>
</tr>
<tr>
<td>30.1–50.0</td>
<td>183</td>
<td>20.5</td>
<td></td>
</tr>
<tr>
<td>50.1–100.0</td>
<td>219</td>
<td>19.7</td>
<td></td>
</tr>
<tr>
<td>100.1–150.0</td>
<td>75</td>
<td>16.1</td>
<td></td>
</tr>
<tr>
<td>150.1–300.0</td>
<td>121</td>
<td>16.6</td>
<td></td>
</tr>
<tr>
<td>300.1–500.0</td>
<td>72</td>
<td>13.4</td>
<td></td>
</tr>
<tr>
<td>500.1–700.0</td>
<td>61</td>
<td>11.1</td>
<td></td>
</tr>
<tr>
<td>700.1–1300.0</td>
<td>144</td>
<td>9.9</td>
<td>19.1</td>
</tr>
<tr>
<td>1300.1 and more</td>
<td>131</td>
<td>6.9</td>
<td>59.2</td>
</tr>
</tbody>
</table>

Source: Communication by P. Horváth, Section for Financial Statistics, Central Statistical Office.

grave blow even if they can find new employment relatively quickly. Very strong prestige and power interests are attached to the survival of the large enterprise. This is why resistance to the hardening of the budget constraints of the large enterprise is so strong. In the case of a small firm, even if it is state-owned, that is perhaps simpler: both “birth” and “death” might occur in a more natural way. Precisely because the survival of the small firms depends on whether they can profitably compete in the market, these organizations will be prone to more rapid and flexible adjustment.

It would be too early to give a forecast for the number of affiliates, state-owned small enterprises, and small cooperatives that can be expected to come about. The first central estimates are not very promising. For the time being there appears to be no vivid, spontaneous interest on the part of the ministries, local councils, or large enterprises for the new possibilities. There arises another question: whether between the two extremes—the huge and the tiny enterprises—the medium zone is sufficiently represented. If the process proceeds at the conceived rate, it might take one or two decades until the size distribution of enterprises starts resembling the distribution established in the developed industrial nations.

4. THE NONSTATE SPHERE

In the official economics of the socialist countries the dominant idea was for a long time that the economic system would proceed towards an exclusively
state-owned producing sector—a sector in "social ownership"—with large state-owned firms. Cooperative ownership was, according to this view, only a transitory form, even if the transition lasted for a long time. The reality of the socialist economy never conformed to this idea, and it is obvious that the Hungarian economy deviates much from it. The present Hungarian economic system may be justly called a socialist-type "mixed economy" in the sense that it relies on the symbiosis of different kinds of ownership—and this entails a diversity of organizational and institutional forms. Besides the state sphere there exists—competing with it, complementing it, and partly cooperating with it—an important widespread nonstate sphere. The measures of 1979–1982 further strengthened the nonstate sphere. We have a highly heterogeneous collection of activities and organizations. Therefore in the following, we try to survey them according to several classifying principles.10

Self-sufficiency versus activity performed for others

For a long time and by many people the future of the socialist economy was thought to be such that a growing proportion of needs would be satisfied by various specialized large organizations (enterprises or public nonprofit institutions).11 Food would be supplied by large agricultural and food-processing establishments; people would live in rented apartments in large buildings; they would use mass transportation; children would be cared for in nurseries, kindergartens, schools, and daytime homes; sick people would be nursed in hospitals; and so forth. . . . This vision has proven to be extreme and one-sided. A considerable number of people want to satisfy a sizeable portion of their personal needs within the family, within the household, or on the basis of personal ownership and self-determination either because of their own preferences, or because they are forced to by necessity.

Since the beginning of the reform process Hungary has made great changes in this direction although it is still far from satisfying demands, and from the full use of possibilities. The household plot, beyond its role in producing

10 The Hungarian literature on the problems of the nonstate sphere is rich indeed. Agricultural cooperatives, household and complementary plots are discussed by Donáth (1980), Cseresné (1981), and Pálovics (1981). The "second economy" is analyzed in Gábor (1979), Gábor and Galasi (1981), and Kolosi (1979). In drafting this paper I used their ideas—and also different reports on the second economy. But in the paper I have not used the term itself. Many data of Section 4 of this paper have been taken from the works of Kolosi (1979), and Gábor and Galasi (1981). Finally, a third group of works reviews and evaluates the 1982 rules relating to the small enterprises. The most complete survey is offered by Szép (1981).

11 In the subtitle of the first paragraph I have juxtaposed self-sufficiency and "activity performed for others" and not production for the market, because the latter can be carried on not only in "business" units producing for the market, but also in nonprofit institutions.
food for the family, covers a considerable part of the demand for food by those engaged in other sectors. In addition, there are a great many such families where, although the main wage earner is not employed in agriculture, he still has a complementary farm, a garden, keeps animals, and thus is capable of satisfying a part of his demand for meat, vegetables, fruits, etc. Private housing construction is widespread and expanding further, for which the family uses not only its own money, but its own labor, organizing ability, and perhaps its own tools as well. (In 1979, 42% of all apartments constructed were built by the population itself.) In transportation the role of individually owned cars is growing rapidly: more than one-third of total passenger transport is carried out by privately owned cars.

**Formal versus informal sector**

A part of the activities performed "for others" takes place in the "formal sector" (by state enterprises and cooperatives, public nonprofit institutions, and by private artisans and private dealers who operate under official license and under official control, and pay taxes); another part takes place in the "informal sector." According to earlier concepts, in a socialist economy only the formal sector would be allowed to operate. In Hungary today the formal sector is dominating, but the informal sector is at the same time very large. Many people provide services for others—mainly for money, perhaps for other compensation—beyond the formal organization. A few characteristic fields are:

(i) Material services, e.g., repair, construction, gardening, transportation of goods and people, etc.

(ii) Intellectual services, e.g., medical treatment, legal counseling, engineering design, translation, typewriting, etc. There are no estimates available on the volume of this kind of activity.

(iii) Housing services, total or partial, long-range or temporary leasing of dwellings, homes, holiday homes.

The "informal sector" is a collective notion. It comprises activities that are illegal and persecuted, illegal and tacitly tolerated, and those which are not illegal and are carried out outside of the formal organizations but approved of and patronized by the state. The objective of the new 1982 measures is to bring into the open the informal activities judged to be useful, to create for them a legal framework, and—to a certain extent—to support their expansion.

**Forms of ownership**

One of the most important questions is, Who owns the means of production necessary for carrying out the economic activity? The three pure forms are
state, cooperative, and private ownership. In the 1979–1982 period there was an effort to remove obstacles impeding the development of cooperatives not only in agriculture, but in industry and construction as well. Similarly, the intention is also to allow the expansion of the "formal" handicrafts and small retailers—who work under official licenses and pay regular taxes.

The various combinations of public (state or cooperative) and private ownership and of public and private activities now existing are surveyed in Table 6. The 1982 rules introduced a number of new forms (first of all the "economic working teams" in the second row of the table); but it also tried to expand the range of the old forms: the "working teams" are an attempt to channel widespread illegal work into a legal framework.

It is difficult to foretell whether the mixed forms of ownership will expand or contract. There is enterprising spirit in several layers of the population. The question is whether this spirit will be supported or cooled down by the

<table>
<thead>
<tr>
<th>Owner of the means of production</th>
<th>User of the means of production</th>
<th>Arrangement for use of capital equipment</th>
<th>Typical branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>State enterprise or cooperative</td>
<td>Private person or group of private persons (In some cases the lessee is chosen through auction)</td>
<td>Leasing fixed capital for a definite rent*</td>
<td>Catering, trade</td>
</tr>
<tr>
<td>State enterprise or public institution</td>
<td>&quot;Economic team&quot; formed from the employees</td>
<td>The team works under the protection of the employer, and uses part of the fixed assets for which it pays rent</td>
<td>Maintenance, repair, fitting (as yet preliminarily planned)</td>
</tr>
<tr>
<td>Partly state enterprise or public institution, partly the user</td>
<td>Workers of the enterprise or institution in question</td>
<td>Illegal informal work done during regular working hours, perhaps with use of employer's equipment</td>
<td>Construction, maintenance work, repairs, trucking</td>
</tr>
</tbody>
</table>

*A related form is the so-called "contractual" operation; in this form the owner enterprise or cooperative also procures a portion of the materials.
administrative, legal, and economic measures. I mention only the single example of shops and catering units offered for leasing and contractual operation. Till the end of 1981, from the 1868 catering units offered, 1184 (or 63.4%) were actually rented or contracted out, and from the 1630 shops, 461 (28.3%); no lessee or contractual partner could be found for the rest. The main obstacle was said to be the too high rent asked from the private entrepreneur. The experience of the next few years will tell whether the state organs, public institutions, and public enterprises will show sufficient patience towards these “mixed forms,” and whether the stability of their legal position, which is necessary for their taking roots, can be secured.

Worktime

The majority of those employed in the state sector work exclusively the legal hours. (Overtime does exist, but its volume is limited by strict rules. Even so, every third employee works some amount of overtime.) The nonstate sector is much less restricted. A part of its activities is carried on as full-time jobs that far exceed the length of the workday or workweek usual in the state sector. This is the case with work performed on a family basis in private small-scale industry, in private retail trade, and in leased activities, but the lengthening of the worktime (openly or in a concealed manner) is usually accepted by the employees. Many people work the legal hours in the formal sector and continue working in the evening and on weekends in the informal sector, or in their own household plots, or on their own homebuilding efforts. Not infrequently, the nonlegal practice is that the employee does his “private” work at the place of his main job—in the best case when he has nothing else to do, in the worst case to the detriment of the task to be done at the main job. There is increased participation of family labor: housewives or other members of the family can join the productive activity of the family without restriction, be it agricultural work in the household plot or construction. In final analysis, the total worktime of the whole population is substantially longer than what is recorded as legal worktime in the formal sector: it is estimated that about 16–18% of the total man-hours available are spent in the informal sector.\(^\text{12}\)

An appraisal of the situation is difficult. Many people ruthlessly exploit themselves. The extensive lengthening of the individual and family worktime and the increased intensity of work done in the additional worktime can greatly increase the income of the households that make this sacrifice. The additional income can frequently be a multiple of what the employee could

\(^{12}\) See Markó (1980).
earn in the state sector, inclusive of the allowed overtime. A classical subject of microeconomics is the choice between consumption and leisure. There is a widespread, very industrious and self-driven stratum of the Hungarian population that opts for hard work, almost up to the biological limit of capacity or even beyond it in order to get consumption goods. Certainly this is one of the secrets of the frequently mentioned “Hungarian wonder.” One of the features of the 1979–1982 measures is that it soberly reckons with this choice of a considerable part of the population and tries to remove at least the administrative obstacles for those who are voluntarily lengthening the worktime with the aim of personal gain.

**Government regulation and degree of paternalism**

In this aspect the nonstate sphere is very heterogeneous indeed; its various parts are handled differently by the state. The situation has changed several times in the last 10 or 15 years.

The agricultural cooperatives obtained and continue to get much encouragement from the state. (This can hardly be said about the industrial cooperatives.) Even so, the autonomy of the cooperatives—though much wider than that of state enterprises—is far from complete. Higher state authorities and the central organs of the cooperative network interfere with their operation in many forms. It might be said, though, that the relationship between the state and the cooperative is somewhat less paternalistic than between the state and the state-owned enterprise. The financial position of the cooperative depends more on market success; its survival is not automatically guaranteed (though, if it is in great trouble, there is a chance that the state will save it). Its growth rather considerably depends on its own economic results. Because of all this, the interest in profits of the cooperative is stronger and its budget constraint is harder than that of the still dominant large state enterprises.¹³

The other parts of the nonstate sphere—the private sector working under state license, the combined forms of ownership and operation, the informal activities—are characterized by hard budget constraints. Their existence depends on market demand. A unit or an activity survives as long as it produces a profit for its entrepreneur.

But this does not mean that its existence depends exclusively on the market. It depends on the state, on economic policy, as well as on the behavior of state enterprises and cooperatives. A part of the activities requires official

¹³ As a matter of fact, it is not exact to compare the whole cooperative sector to the whole of the sector of large state enterprises. A medium or a small enterprise in an industrial branch which is less in the foreground may be perhaps similarly left to itself, as is an average industrial cooperative. The most favored large agricultural cooperative, however, is treated in the same paternalistic manner as the huge state-owned enterprise.
licensing, unless the person pursuing the activity risks illegality. Another part relies on open cooperation with state-owned or cooperative units (e.g., the forms described in rows 1–3 of Table 6, or the household plot linked to the cooperative). Support of the state and cooperative sectors can be given, or official licenses may be granted, but they can also be revoked. This is why the nonstate sphere is penetrated by an at times weak, at other times stronger feeling of uncertainty. This feeling of uncertainty can be dispelled only by unambiguous experiences of long duration.

5. INTERRELATION OF THE ECONOMIC MECHANISM WITH THE RATE OF GROWTH AND ITS PROPORTIONS

The rate of growth slowed down at the end of the seventies in Hungary, as in many other countries. This paper does not undertake a comprehensive analysis of the causes of the deceleration. I only wish to consider the problem of deceleration to the extent that it is related to the reform of the economic mechanism. We divide the interrelation into two directions of cause and effect.

A. What Role Did the Economic Mechanism Play in this Deceleration of Growth?

Let us address this question by discussing first investment and then consumption.

**Investment.** In the socialist economy decisionmakers are motivated by a strong internal expansion drive on every level, from executives to shop foremen. The investment hunger is permanent and almost insatiable.14 (The central agencies are permeated by this drive also, yet they are from time to time held back by macroeconomic considerations.) From the ministries and the medium-level authorities, from state enterprises and public institutions, and to a certain extent also from the agricultural cooperatives, there is constant pressure on the center to give permits, credits, and subsidies to the greatest possible number of investment projects. This is closely related to the softness of the budget constraint: the investor does not feel that his decision involves genuine risks.

As Table 7 shows, in Western countries investment abated when business prospects became gloomier, beginning with 1973. This acted as a self-generating vicious circle: the brake on the investment impetus made prospects even gloomier.

In the socialist countries there was no trace of this after 1973: the investment boom continued. This fully holds true for Hungary, too. Through the reform the Hungarian state-owned enterprise obtained greater autonomy in short-

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14 See Kornai (1980a, Chap. 9).
STATE AND PROSPECTS OF THE REFORM

TABLE 7

GROWTH OF THE VOLUME OF INVESTMENT (AVERAGE ANNUAL RATE OF GROWTH IN %)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>5.8</td>
<td>9.7</td>
<td>-0.8</td>
</tr>
<tr>
<td>Poland</td>
<td>13.3</td>
<td>10.5</td>
<td>-2.8</td>
</tr>
<tr>
<td>Hungary</td>
<td>8.0</td>
<td>8.5</td>
<td>2.9</td>
</tr>
<tr>
<td>GDR</td>
<td>7.2</td>
<td>6.1</td>
<td>1.8</td>
</tr>
<tr>
<td>Austria</td>
<td>7.5</td>
<td>2.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Denmark</td>
<td>7.0</td>
<td>2.0</td>
<td>-1.1</td>
</tr>
<tr>
<td>Finland</td>
<td>10.9</td>
<td>0.6</td>
<td>-2.4</td>
</tr>
<tr>
<td>Greece</td>
<td>7.7</td>
<td>-3.5</td>
<td>5.0</td>
</tr>
<tr>
<td>Italy</td>
<td>6.0</td>
<td>4.1</td>
<td>2.2</td>
</tr>
<tr>
<td>Spain</td>
<td>9.9</td>
<td>0.4</td>
<td>-1.6</td>
</tr>
</tbody>
</table>

*Source: For capitalist countries: data of the UN and the OECD; for socialist countries: national statistical yearbooks.*

Term decisions, but since the state continued to act as a "general insurance company," no inner inhibition developed against investment hunger in enterprise behavior.

The brake on investment after 1978 was not a spontaneous halt by the enterprises, it was clearly a central action. It was decided and carried out by the highest leadership out of foreign-trade and balance-of-payments considerations and in spite of the unchanged investment hunger of the medium-level and lower executives. Of course, deceleration of investment in itself does not solve any of the economic problems of the Hungarian economy. However, whether or not the sudden deceleration was justified at all, the renewed sudden acceleration of investment intentions has not become justified by any change in economic circumstances. And yet, they have gathered momentum again, as if to prove the investment cycle theory of Tamás Bauer and of others. This does not yet appear in the total amounts of investment, because up to now the center has withstood the pressure. But the number of newly begun investment projects grew in 1980-1981. Total investment-credit requests in 1980 exceeded those of 1979 by 84%, and those in the first three-quarters of 1981 rose by 79% against the same period of the preceding year. The requests for financial state support of investment projects in 1981 are also a multiple of those in the preceding year. Once again it is clear that the 1979-1982 measures did not really harden the budget constraint of the

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15 This is discussed in detail in Nyers and Tardos (1979). I agree with their appraisal.

16 See first of all Bauer (1981). See also Soós (1975-1976), Bauer (1978), and Lackó (1980). In the analysis of the present investment situation I was helped by Maria Lackó.
enterprises. While economic prospects of the country are uncertain, the enterprises are quite self-confident regarding their investment outlook.

Even in 1977–1978 it was not the market prospects that were found uncertain by the enterprises, but rather the expectation of changes in financial regulators and pricing principles. Now their fears begin to calm down; profit has started to revert to the old level—what should then prompt a voluntary suppression of the investment propensity? Enterprises are like war steeds, which, on hearing the bugle call, would like to gallop, tearing the reins. A new investment rush would certainly have started with full vigor if the center had not forcibly held it back.

Consumption. In the 1973–1982 period when the welfare of people suffered greatly in many other countries in East, West, and South, the Hungarian population was relatively well off. This was particularly so in the first part of the period, when, in the framework of general growth, consumption also continued to increase. Though the retrenchment following 1977 reduced investment most of all, a part of the reduction—mainly of investment projects in infrastructure—also affected the living circumstances of the population. In the years 1978–1980 real wages per earner fell somewhat, but the total volume of consumption did not. Shortages of consumer articles and services did not significantly increase. What is particularly important from the viewpoint of the public, the food supply is satisfactory, and in some basically important products it is definitely abundant. This is one of the most important and spectacular achievements of the Hungarian economy.

This achievement may be explained by three factors: (a) the living-standard policy, (b) the reform of the regulation mechanism of state enterprises, and (c) the continuous growth of the nonstate sphere. These three factors are, of course, closely related. The year 1968 was an important milestone in the development of all three. The extension of the nonstate sphere should be regarded as an organic part of the reform process. Yet it is worthwhile to treat these three factors separately.

The traditional view of the source of Hungarian successes in consumer-goods supplies stresses factor (b): the shops are full because market socialism is at work in Hungary. In my view the role of this factor is relatively modest, even if it did indeed contribute to the favorable supply situation. The autonomy of the enterprise in short-term decisionmaking facilitates its adjustment to the demand of the buyer, because it has freed the firm from the bureaucratic restrictions of plan instructions. In a few areas of state-owned industry (food, household chemicals, and in several branches of light industry) a "buyers' market" which stimulates widening of assortment and improvement of quality is about to emerge. But a large part of the Hungarian enterprises of today are not yet forced to compete for the buyer by the economic coercion of market competition. The enterprise may in many cases be interested in rather giving preference to export, even in cases when export is not particularly
profitable and there is a depressing shortage on the domestic market. It
maneuvers among the different sales markets according to the conditions of
bargaining with the state organs and is not necessarily led by the profit
possibilities emerging in the market, thus perhaps pushing the domestic con-
sumer into the background.

The favorable state of supply is due mainly to factors (a) and (c). Factor
(a) is important because for 25 years central economic policy has been "biased"
in favor of living standards and this policy continues even now, in spite of
accumulated economic difficulties. For example, when it was decided recently
to reduce the domestic use of total net output, this happened primarily at
the expense of investment. Central policymakers frequently protect the do-
mestic consumer market through central measures from the "suction" effect
of export, since there do not exist enterprise incentives for adjusting supply
automatically to demand.

The other main explanation is factor (c), the operation of the nonstate
sector. The performance of cooperatives, household plots, and complementary
farms in supplying the population with food is well known. Other elements
of the nonstate sphere also contribute much to satisfying the demand of
households, and make up for the gaps and shortages left by the state sector.
This sphere is one of the built-in stabilizers of the Hungarian economy of
today. It is relatively insensitive to the decelerations and accelerations of the
state sector, to the cyclical fluctuations of investment, and to changes in
foreign-trade and balance-of-payments positions.

It is not my intention to belittle the merits of the 1968 reform, but to call
attention to the fact that the reform has been only halfway implemented to
this very day. A large part of the Hungarian output is contributed by the
state sector and this sector is not controlled by a true market mechanism.
There does not exist a built-in mechanism that could assert itself in the
behavioral rules of the state enterprise, that could hold it back from the
investment drive, and that could force it to adjust to demand. The factors
that guarantee moderation of growth policy and a favorable internal supply
of goods to the population are not sufficiently "institutionalized." This could
only be secured by a really comprehensive reform of the economic mechanism
that also deeply permeates the state sector.

B. How Does the Present Growth Policy Affect the Reform Process of the
Economic Mechanism?

The Hungarian economy, similar to the economies of the other socialist
countries, has been plagued for years by chronic shortage phenomena. While
in quite a few fields this shortage is less severe than in some other socialist
countries, still the Hungarian system may be considered a shortage economy
to considerable extent. In Tables 8 and 9 we survey a few indicators of
shortage to characterize the situation after 1979.
### Table 8
**Shortage Indicators for Production**

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Share of materials inputs in total manufacturing inventories&lt;sup&gt;a&lt;/sup&gt;</td>
<td>Percent</td>
<td>70</td>
<td>71</td>
<td>72</td>
<td>72</td>
<td>72</td>
<td>—</td>
<td>Unchanged intensity of shortage</td>
</tr>
<tr>
<td>(2) Ratio of orders refused by construction industry relative to its annual output</td>
<td>Percent</td>
<td>39.4</td>
<td>41.4</td>
<td>26.5</td>
<td>16.8</td>
<td>16.0</td>
<td>20.8</td>
<td>Improvement in the period 1977–1980</td>
</tr>
<tr>
<td>(3) Shortage in building materials&lt;sup&gt;b&lt;/sup&gt;</td>
<td>Percentage points</td>
<td>1.2</td>
<td>0.6</td>
<td>–3.1</td>
<td>–3.1</td>
<td>–4.5</td>
<td>—</td>
<td>Considerable improvement</td>
</tr>
<tr>
<td>(4) Unsatisfied demand for railway transport</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Demanded but not supplied railroad cars</td>
<td>1000 units</td>
<td>307.2</td>
<td>306.3</td>
<td>478.3</td>
<td>367.3</td>
<td>159.2</td>
<td>172.2</td>
<td>Considerable improvement since 1978</td>
</tr>
<tr>
<td>Missing transport capacity</td>
<td>Million tons</td>
<td>9.1</td>
<td>9.7</td>
<td>15.1</td>
<td>11.6</td>
<td>5.0</td>
<td>5.3</td>
<td></td>
</tr>
<tr>
<td>(5) Partial indicator of labor shortage&lt;sup&gt;c&lt;/sup&gt;</td>
<td>Percent</td>
<td>24</td>
<td>—</td>
<td>35</td>
<td>36</td>
<td>39</td>
<td>—</td>
<td>Shortage diminished in 1978, no improvement since</td>
</tr>
</tbody>
</table>

<sup>a</sup> This ratio is high on the sellers' market (accumulation in input stocks because of shortage); it is low on the buyer's market (swelling of output stocks).

<sup>b</sup> Difference between the index numbers of construction activity and the building-materials industry supply, relative to the preceding year. The larger the indicator, the greater the shortage.

<sup>c</sup> Jobs filled by official labor exchanges as percentage of job openings (only part of labor turnover is reported on the exchanges).

*Sources:* (1) Fáбри (1981), communication by E. Fáбри; (2) Reports, Central Statistical Office; (3) Gács (1976), communication by J. Gács; (4) Major (1981), communication by I. Major; (5) communication, State Office for Wages and Labor.
### TABLE 9

**SHORTAGE INDICATORS FOR CONSUMPTION**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Computed queuing time for dwellings</td>
<td>Year</td>
<td>7.3</td>
<td>6.8</td>
<td>7.1</td>
<td>7.0</td>
<td>—</td>
<td>—</td>
<td>No improvement</td>
</tr>
<tr>
<td>rationed by the state: no. of requests for housing, Jan. 1, divided by allocations during year</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(2) Computed queuing time for passenger cars: orders on Jan. 1, divided by numbers of cars sold during year</td>
<td>Year</td>
<td>2.3</td>
<td>2.5</td>
<td>3.6</td>
<td>5.3</td>
<td>3.1</td>
<td>2.4</td>
<td>Improvement since 1979</td>
</tr>
<tr>
<td>(3) Number of persons waiting for telephone connections</td>
<td>Persons</td>
<td>233000</td>
<td>—</td>
<td>267000</td>
<td>—</td>
<td>—</td>
<td>296000</td>
<td>Growing shortage</td>
</tr>
<tr>
<td>(4) Average length of time required to get serviced (state and cooperative sector only)</td>
<td>Days</td>
<td>7.9</td>
<td>—</td>
<td>8.1</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>No major improvement</td>
</tr>
<tr>
<td>Routine oil and motor check</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Repair of collision damage</td>
<td></td>
<td>15.9</td>
<td>—</td>
<td>16.5</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Washing of linen (by weight)</td>
<td></td>
<td>11.9</td>
<td>—</td>
<td>11.0</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Washing of linen (by piece)</td>
<td></td>
<td>12.7</td>
<td>—</td>
<td>10.9</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Suit made to order</td>
<td></td>
<td>35.9</td>
<td>—</td>
<td>35.9</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Dress made to order</td>
<td></td>
<td>24.9</td>
<td>—</td>
<td>24.4</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>New linoleum</td>
<td></td>
<td>17.9</td>
<td>—</td>
<td>18.9</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Painting of dwelling</td>
<td></td>
<td>21.6</td>
<td>—</td>
<td>26.8</td>
<td>—</td>
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<td>(5) Average length of hospitalization</td>
<td>Days</td>
<td>14.6</td>
<td>14.6</td>
<td>14.6</td>
<td>14.5</td>
<td>14.2</td>
<td>—</td>
<td>About the same</td>
</tr>
</tbody>
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**Sources:** (1, 4, 5) Reports of Central Statistical Office; (2) Kapitány et al. (1981), communication by Merkur Company on the sale of the cars; (3) communication by Post Office General Manager.
As can be seen, the picture is rather mixed: some indicators improve somewhat, others stay constant, still others deteriorate somewhat. No great "dramatic" change has occurred, a point confirmed in a recent public opinion poll. On the one hand, in no field has the shortage become greater to any palpable extent. In the given economic situation this might be considered in itself a considerable achievement. On the other hand, while severity of shortage has abated in some fields, on neither the investment market, nor the markets for labor, means of production, or consumer goods has, since 1979, such progress occurred that the economy would leap from a sellers’ market unambiguously into a buyers’ market.

There were some who hoped that the mere fact of deceleration of growth could bring about a turning point. But this has not occurred. Let us first look at the demand side. The official and nonofficial price rises held demand by the population back somewhat; the financial sources of investment were radically reduced. Still, regarding total demand of the economy, two forces continue to assert themselves: the insatiable investment hunger, which tries to break through in many ways, and the "suction" effect of forced exports. "We improve the balance of payments" is now the key phrase to obtain short- or long-term credits and investment subsidies.

If we are not reasoning merely in macroaggregates, but observe some individual markets, we find that demand has decreased in several fields, but so has supply. There are several factors working in this direction. Import possibilities have declined, for example, in regard to raw materials and primary energy from the CMEA countries. The importation of some consumer articles has been braked. Financial and moral incentives may have prompted a restriction in supply. The so-called "competitive price system," as I have already pointed out, might have made enterprises interested in restricting their volume of output.

To sum up: the primary problem is that the 1979–1982 period still has not secured the consistent enforcement of the reform principles in the state sector. This is why it has not happened that hard constraints have limited demand, or strong stimulation is felt for increasing supply. The scissors of

17 The following question was put in a public opinion poll: "Did, according to your experience, daily purchasing difficulties (a) grow, (b) remain unchanged, (c) diminish this year?" A total of 37% reported increased difficulties, 46% reported no change, 12% felt improvement, and 5% were undecided. (Communication by K. Farkas and J. Pataki of the Mass Communications Center.)

18 In the wake of the brake on investment, it is mostly the construction industry that has come nearer to the state of a "buyers' market." Many construction enterprises now make efforts to please the buyer: they are more willing to undertake renewals, which they earlier warded off, to initiate export activity and so forth. But, for the behavior of the construction industry to change more deeply, for it to really subordinate itself to the demands of the buyer so that, in consequence, the buildings would be ready more quickly and be of better quality, the "buyers' market" has to persist for a somewhat longer time.
demand and supply could not open up. Of course, this leads to a second consequence: the survival of the sellers’ market puts a brake on the development of true competition. The slowdown does not provide for a leap of the economy from a sellers’ market to a buyers’ market; artificial simulation of the market does not replace genuine market competition.

6. FORCES AND COUNTERFORCES

This would be the place to speak about the prospects of the reform; as a matter of fact, this was promised by the title of the paper. But a clear forecast cannot be given because the outcome of the fight between the forces for and against the reform is uncertain. Let us take the major factors in turn.

The future development of external conditions, from outside of the Hungarian frontiers, will have a great impact. Will there be reforms in the other socialist countries, or will the Hungarian experiment remain isolated? What will be the role of the linkage with the CMEA countries in the supply of Hungary with raw materials and energy; how will economic and other relations with these countries develop? How will the situation of the world economy develop and, in this context, what will be the possibilities for Hungarian exports and the conditions of financing our imports? What will be the international political atmosphere and, depending on it, what will be the defense burdens of Hungary? We cannot give a prediction of the development of external circumstances and, as a matter of fact, without those, it is impossible to forecast the internal processes unambiguously.

Passing now to the internal forces, how does the “apparatus” behave toward the reform process—meaning the officials in responsible jobs of the political and administrative agencies and the managers of the economy? My impression is that their attitude toward the reform process is not uniform and that many officials are ambivalent about it. One of the hopes for the reform is rooted in the fact that it has many convinced adherents in the general staff of the economy who try to improve the mechanism and fight resistance to it with great expertise, inventiveness, and perseverance. About the resistance it must be said that nowadays the wind blows in the direction of the reform; open opposition against it is rare and weak. Yet it is difficult to make progress, since every step of true decentralization or deregulation deprives various groups of the influence hitherto exercised. How could they be expected to adopt the principle of “heraus mit uns” (out with us)? If the winds would blow again against the reform, these forces would become much more active.

Ambivalence is particularly strong among the executives of large state enterprises. The majority of them have an aversion to central tutelage, and would like to achieve true autonomy, inclusive of wider rights to export and import independently, to fix prices and wages, and so on. They are irritated by the complicated and volatile changes of the “regulatory system.” At the
same time, they are grateful if the state yields to pressure and helps them in case of financial failure and they would not like to lose the privilege of this safety.19

Large enterprises objected sharply to the 1982 measures on small enterprises because the small firm, in whatever form it operates, might be an uncomfortable competitor. It would be even more dangerous if the less restricted small firm would have an advantage in procuring inputs, especially of labor, as against the large enterprise, which is shackled by many rules. While this might strengthen the demand on the part of the large enterprises that they, too, should be given greater autonomy and fewer rules, it might also turn them against the small firm. Similarly, in quite a few enterprises and state organs aversion and even opposition to the formation of the "economic working teams" is found.

One hopes that finally everywhere the kind of peaceful coexistence and even cooperation will evolve that developed in agriculture between large and small establishments and between state and nonstate spheres. For the time being, however, the relationships are still unclear.

The reluctance to accept the reforms caused by ideological conservatism and orthodoxy, though closely related to the resistance to the NEM caused by fear for losing influence and privileges, is a separate factor. It might show itself also on the part of people who are not affected as individuals by the reform. Foreign analyses frequently underline approvingly—and with justification—that the Hungarian reformers are pragmatic: instead of ideologizing, they implement changes. But one should not believe that everybody is "pragmatic" in Hungary. Many have the feeling that the reform has already relinquished ideals sanctioned by the traditions of the socialist movement; they would become even more indignant if the market, profit, competition, nonstate ownership, and, among the various forms of the latter, private ownership would obtain a wider scope.20 Hungary proceeds along an untrodden path. Who can tell whether there is a critical point where ideological aversion blocks the process of transformation?

Besides, it cannot be denied that the kind of mixed economy that now characterizes Hungary, and will characterize it even more if the reform is to proceed further, resembles a hot furnace that produces iron and slag simultaneously. Achievements are unavoidably accompanied by negative consequences such as the chase after money, ruthless self-exploitation, clever ma-

19 The recentralization efforts of the large enterprises are discussed in Szalai (1982).
20 For example, several strata of the population support private plots. But there are also strong reservations revealed in the interviews by Kispista (1982): "I sincerely say, I look with anxiety at the spreading of the small-scale production so much propagandized . . ."—". . . now that the reins have been loosened, small-scale production is blooming. But this is very dangerous in the long run."—". . . This only happens because we are dependent on it. It is a forced solution. We have to dispose of it, the sooner the better."
neuvering, and corruption. These harmful phenomena, particularly if they are not sufficiently fought against, strengthen the arguments of those who are on an ideological basis against the reform of the socialist economy.

Income distribution is an important factor in the formation of public opinion. Public opinion polls show that a considerable part of the Hungarian society would like an income distribution more egalitarian than the present one.\(^{21}\) It seems that this is not a highly explosive gripe, but rather a disapproval of the existing situation. But who knows whether this remains so in the future? Public opinion may change if inequalities are growing; as a matter of fact, a consistent progress of the reform would presumably entail that. Even more important: society might react to inequality much more sharply if the general standard of living is stagnating or declining. Hirschman (1981) excellently characterized the problem with his tunnel analogy. If there are two parallel lanes in the tunnel and we perceive that our lane has stopped but the other is proceeding, we are initially inclined to consider this as a reassuring sign. It seems there is not a complete stoppage at the end of the tunnel: our lane, too, would also start soon. But if traffic is persistently smooth on the lane beside us and, nevertheless, our own has got stuck for some longer time, we sooner or later lose our patience and try to cross into the other lane. If the income of some people is rising more rapidly than that of others, but everybody's income is rising anyway, this is usually tolerated by society. But if the income of people with low resources does not rise or even declines, while that of others conspicuously rises, the limit of tolerance of society may suddenly sink lower. Therefore, the fate of the reform depends much on whether a general rise of living standards would resume.

Many other factors will influence the future of the reform. But even if we considered all these, I doubt that we could arrive at a more unambiguous prediction. What is unambiguous is the hope of this author that the cause of the reform will not get stuck but will further proceed.

REFERENCES


\(^{21}\) In its public opinion polls the Center for Mass Communications repeatedly asked the question whether differentiation of incomes should be reduced or increased in Hungary. For the reduction were 56% in 1973, 69% in 1974, and 65% in 1976 (only in Budapest), 63% in 1979, and 60% in 1980. For an increase of differentiation, in the same order of years: 28, 14, 14, 18, and 21%. Considering the differences between the samples taken and different times, we may say that the distribution is rather stable, or at least does not show any definite tendency. See Angelusz and Pataki (1976), Nagy et al. (1976), Farkas and Pataki (1980), and Nagy and Virdgh (1981).


