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**Hungarian Joint Venture Promotion 1972-1987:
A Response to Changes in the World Economy**

by

Emily Brown, B.A.

A thesis submitted to the Faculty of Graduate Studies and
Research in partial fulfillment of the requirements
for the degree of
Master of Arts

The Norman Paterson School of International Affairs

Carleton University

Ottawa, Ontario

November 28, 1988

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The undersigned hereby recommend to the Faculty of
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ABSTRACT

This paper analyzes joint venture promotion in Hungary during the years 1972-1987. The central thesis is that joint venture promotion has been a response to changes in the world economy. Included are a review of Hungarian views on the changes in the world economy and the impact of these changes on the CMEA Six in general and on Hungary in particular; Hungarian foreign economic policy; joint venture promotion in Hungary and an evaluation of the policy. Evidence is presented to show that while the joint venture policy has been slow to evolve as a result of ideological constraints, in the 1980s and in particular since 1985, reforms have been implemented which have resulted in an increased number of joint ventures which have in turn brought important benefits to Hungary. Hungary is currently poised for further reform in this area.

TABLE OF CONTENTS

	Page
Abstract.....	iii
Table of Contents.....	iv
List of Tables.....	viii
List of Figures.....	x
List of Acronyms.....	xi
S E C T I O N I	
<u>Chapter 1:</u>	
<u>Introduction</u>	1
<u>Chapter 2:</u>	
<u>Hungarian Views on the Changes in the World Economy</u>	9
Nature and Importance of the World Economy.....	11
Organizing Forces of the New Epoch.....	14
Relations of International Politics and Economic Power.....	16
The Change of Epoch and the Conditions of Growth.....	18
The Oil Crisis.....	19
Exhaustion of Sources of Extensive Growth on a World Scale.....	21
Changes in the International Capital Markets.....	23
Scientific-Technical Conditions and the Multinational Corporation.....	24
The STR.....	24
The MNC.....	26
International Interdependence and Cooperation... The International Division of Labour.....	27
International Monetary System.....	28
Interdependence and Cooperation.....	29
Conclusion.....	30
<u>Chapter 3:</u>	
<u>The Impact of the Changes in the World Economy on the CMEA Six in General and Hungary in Particular</u>	32
The Case of the CMEA Six.....	33
Organizing Forces.....	33
Political Factors.....	33
The Changing Conditions of Economic Growth.....	37
The Oil Crisis.....	38
The Exhaustion of Sources of Extensive Growth.....	41
Debt.....	41

Scientific-Technical Conditions.....	47
Reasons for the Failure to Transform Structurally.....	48
Empirical Evidence of the Failure to Transform Structurally.....	50
The Case of Hungary.....	56
Reform of the Foreign Trade Sector.....	57
Changes in the Organization of Foreign Trade....	58
Reduction in Foreign Trade Planning.....	60
Reliance on Financial Regulators.....	61
Changes in Foreign Ownership Regulations.....	63
An Empirical Review of Hungary's Foreign Economic Performance.....	64
Conclusion.....	70
 <u>Chapter 4:</u>	
<u>Hungarian Foreign Economic Policy</u>	72
In Favor of Turning Inward.....	74
In Favor of Turning Outward.....	76
Problems in Structural Adjustment.....	81
Structural Vicious Circle.....	83
Double Structural Outflanking.....	84
Other Issues.....	86
The Lack of an Export Strategy.....	88
Conclusion.....	91
 S E C T I O N II	
<u>Chapter 5:</u>	
<u>Joint Venture Promotion in Hungary</u>	93
Overview.....	93
EWIC.....	95
Interest in EWIC.....	96
Eastern Perspective.....	96
Western Perspective.....	96
EWIC Data and Analysis.....	97
Decline in Interest in EWIC.....	98
Hungarian Factors.....	99
Western Factors for Decline in EWIC.....	100
Joint Venture Promotion.....	102
1972 Decree.....	102
Legislative Environment.....	103
Goals of the Policy.....	103
Basic Conditions.....	104
Political Environment for Joint Ventures.....	105

Results of the 1972 Decree.....	107
1978 Decree.....	107
Legislative Environment.....	107
Goals of the Policy.....	107
Basic Conditions.....	108
Reasons for Changes in the Legislation....	108
Political Environment.....	109
Results of the Amendments.....	110
1982 Decree.....	111
Legislative Environment.....	111
Goals of the Policy.....	111
Basic Conditions.....	111
Reasons for Legislation.....	112
Political Environment.....	113
Results of the Decree.....	113
1986 Amendments.....	114
Legislative Environment.....	114
Goals of the Policy.....	114
Basic Conditions.....	114
Reasons for the Changes.....	116
Political Environment.....	117
Results of the 1986 Legislation.....	124
Conclusion.....	125
 Chapter 6:	
<u>Evaluation of the Joint Venture Policy</u>	128
Strength of Response to Joint Venture Promotion...	130
Reaction to the Low Level of Investment.....	132
Reasons Identified for the Low Level	
of Investment.....	133
Western Partner Lack of Interest.....	133
Hungarian Partner Lack of Interest.....	135
Export Promotion.....	140
Balancing Imports with Exports.....	140
Participation in the International Division	
of Labour.....	144
Export Promotion to the CMEA.....	147
Technical Development.....	152
Some Examples of Technology Transfer.....	154
Sectors Where the Joint Ventures are Found.....	158
Management and Production Know-How.....	162
Conclusion.....	165

<u>Chapter 7:</u>	
<u>Joint Venture Promotion in Hungary 1972-1987:</u>	
<u>A Response to Changes in the World Economy</u>	169
Appendix 1	180
Bibliography.....	181

TABLES

Chapter 3

3.1	Eastern Europe Convertible Currency Debt to the West	44
3.2	CMEA Six Net Material Product, Percent Change Per Year	45
3.3	Eastern Europe's World Trade - Percent Volume Change	46
3.4	Eastern Europe's Trade Imbalances (Billions of US Dollars)	46A
3.5	Percent Share of the West in the Foreign Trade of the East European Countries	50
3.6	CMEA Six Exports to the OECD	51
3.7	CMEA Six Competition with Southern Europe and the LDC's in Clothing and Footwear	53
3.8	CMEA Six Imports from the OECD - Percent	54
3.9	Soviet Union Share of Hungarian Trade by Hungary's CMEA and Total Trade	65
3.10	Hungary's Debt to the West (Billions US Dollars)	68
3.11	Hungary's Convertible Currency Trade Surplus with the CMEA	69

Chapter 4

4.1	Branch Structure of Hungarian Industry by Gross Production	83A
4.2	Hungary's Country Pattern of Foreign Trade	87A

Chapter 5

5.1	Development of the Total Number of Hungarian Cooperation Agreements and Cooperation Related Trade	99A
5.2	Hungary's Cooperation Linked Turnover with its Principal Partner Nations in Convertible Currency, 1982	99A
5.3	Joint Ventures in Hungary, Breakdown by Period	113A-C
5.4	Joint Ventures in Hungary, Breakdown by Period	113D

Chapter 6

6.1	Breakdown of Joint Ventures by Priority Area	160A
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FIGURES

Chapter 3

3.1	Hungarian Rates of Growth: NMP and Trade Turnover	65A
3.2	Origin of Hungary's Imports by Region	65B
3.3	Destination of Hungary's Exports	65C
3.4	Hungary's Yearly Percent Increase in Imports	66A
3.5	Hungary's Yearly Percent Increase in Exports	66B
3.6	Hungary's Trade Deficit as a Percent of Total Trade	67A

LIST OF ACRONYMS

The following acronyms are used in the text.

ADC	Advanced Developed Countries
CIB	Central-European International Bank Ltd.
CMEA	Council of Mutual Economic Assistance
ENIC	East West Industrial Cooperation
FTE	Foreign Trade Enterprise
FTM	Foreign Trade Multiplier
GDP	Gross Domestic Product
IMF	International Monetary Fund
LDC	Less Developed Country
MNC	Multinational Corporation
NEM	New Economic Mechanism
OPEC	Organization of Petroleum Exporting Countries
STR	Scientific and Technical Revolution

NOTE ON THE FORINT

The forint is the Hungarian unit of currency.
As of January 9, 1989 1 forint= .022 \$CDN

Chapter 1 INTRODUCTION

This thesis is a study of Hungarian joint venture promotion as a response to changes in the world economy. There are in 1988 over 100 joint ventures with Western partners in existence in Hungary and this offers a unique opportunity to study a phenomenon that is relatively new to Soviet-type economies.

Hungary's interest in joint ventures dates back to the early 1970s when in 1972 the first regulations were adopted with the goal of increasing the technical development of the economy. At that time the joint venture policy itself was only one small part of an overall policy which promoted East-West inter-enterprise cooperation (EWIC) as a means to achieve this goal.¹ The success of the joint venture policy was constrained, among other reasons, as a result of its restrictive nature which allowed for their establishment only in the service sector and only with minority equity participation by the Western partner.² As of the end of 1977 only three joint ventures had been established.

In 1978, important amendments to the regulations were adopted which allowed for the establishment of joint ventures in the productive sector and for the possibility of majority ownership by a Western

¹EWIC was to develop intensive inter-enterprise relations with the Western partner and joint ventures were considered the most advanced form of this type of cooperation.

²Other reasons included the transformation taking place in the world economy as a result of the oil shocks and the Western recession, as well as the decline in detente between East and West.

partner in the financial sector. Although by 1982 only four additional joint ventures had been set up, from the mid-1980s, joint venture promotion has accelerated, rapidly raising the number of joint venture agreements concluded.

Hungary has faced the continuation of a number of interrelated problems in her external economic performance, (including its debt burden, the declining interest by Western partners in non-joint venture EWIC, and the continuing structural transformation taking place on a world scale which has necessitated technological renewal and restructuring. As policy makers have begun to acknowledge these problems, joint venture promotion has been accelerated in an effort to both technically develop as well as to increase the export potential of the economy.

As will be shown, Hungary's active promotion of joint ventures in the 1980s is manifested by the further liberalization of the joint-venture regulations, including the introduction of major tax concessions as of January 1, 1986. These actions were aimed at making the environment both an internationally competitive and particularly attractive choice for Western partners. Perhaps most importantly there has been the increasing support and recognition top level Party and government officials have given to this economic policy. All signs indicate that during the remaining years of the 1980s, further liberalization in this area will occur and that the joint venture policy will play an increasing role in Hungary's foreign economic policy.

There are many reasons why a study of this topic is important. As a socialist country, Hungary's adoption of joint ventures challenges

three traditional tenets of Soviet socialist ideology. First is the notion of autarchy and CMEA self-sufficiency. Hungary's joint venture promotion shows the degree to which Hungary has accepted the need to become reintegrated into the international division of labour. While, since the late 1960s, Hungary has been one of the most active East European participants in ENIC, this type of cooperation has limited opportunities for intensive East-West integration due to its ad-hoc and hybrid nature (McMillan, 1981:54). Thus, Hungary's move to promote joint ventures actively with both broadened and transparent legal parameters underscores the desire to link its economy more with the world economy.

Secondly, this change signifies a radical departure from a basic socialist principle that the means of production are to be owned solely by the state. Hungary's promotion of Western equity participation - not necessarily limited to a 49% share - is directly contrary to that principle.

Third, a joint venture policy is a challenge to the traditional view of the central role of the state in the economy. Hungary's reform process initiated in 1968, and the continued commitment to it in the 1980s, modified the Stalinist model of a state-directed economy by replacing detailed central planning with regulated market relations, thus granting greater autonomy to the enterprises. There are three reasons why the joint venture policy limits the role of the state and encourages decentralized market-driven relations. First, the laws governing them give more autonomy to joint ventures than exists for domestic firms. Second, the locus of decision-making is moved to the

joint venture partnership which enables Western decision-making authority and further reduces the potential for intervention by the state. Third, success or failure of the joint venture depends on the economic viability of the potential partnership - its competitiveness and ability to generate profit either domestically, internationally or both.

The study of Hungarian joint ventures is important in other ways as well. As an expression of East-West cooperation at a significantly advanced level of maturation, the joint venture experience sheds light on new ways and potentials for cooperation between differing socio-political systems. This is particularly true as Hungary's experience is directly applicable to the other Eastern European countries and in particular to the Soviet Union which has become increasingly interested in this form of economic cooperation. Thus at the micro level the Hungarian experience enables Western businesspersons to assess the viability of such ventures.

Finally, it may be asked why it is important to understand the promotion of joint ventures as a response to the changing world economy. First, the most fundamental reason, is that the decision to promote further joint ventures in the mid-1980s emerged directly from the concrete environment in which Hungary has found itself, both as a result of the dramatic changes which occurred in the world economy during the 1970s and early 1980s, and as a result of the way in which it responded to those changes. Second, it is important to understand the constraints under which a small socialist economy must operate and the ways in which cooperation can help to alleviate some of these

25

constraints. Without understanding the material basis for such a policy one would be left to wonder whether or not this form of cooperation is simply a fanciful notion. However, as will be demonstrated, Hungary has few options if it wants to modernize the economy and become internationally competitive.

It is crucial to place the joint venture process in the context of the mid-1980s. Especially in recent years, as a result of the - Gorbachev critique, it has become more generally accepted that the state-socialist economic model, as developed by the Soviet Union and Eastern Europe, has failed to provide the necessary environment for continued socialist economic development. While it can be argued that Western intellectuals were prophesying this for many years, what is critical about the present period is that in the Soviet Union and some of the other East European countries this criticism is being voiced by the Party leadership itself. Not only has this led to power struggles taking place within these Parties but it has also generated an acute crisis in orthodox socialist ideology. The failure of the Stalinist economic model has meant that many of the most cherished tenets of the socialist vision must also be reevaluated in the context of this failure.

In each of the East European countries this acknowledgement and reevaluation is taking place in a different way. Hungary, which as a result of the Gorbachev critique is less fearful of Soviet reprisals, has begun to argue vigorously for the implementation of more drastic reforms. In fact, this point is best exemplified by the May 1988 replacement of General Secretary Kadar and seven conservative members

of his Politburo with the pragmatic Karoly Grosz and a group of reform oriented party members.

Hungarian intellectuals have long acknowledged the bankruptcy of the Stalinist economic model and, particularly since the late 1970s, have been engaged in the renewed process of reforming it. Hungarian economic analysis is therefore particularly rich. This is significant for this thesis for two reasons. First, the intent is to articulate Hungarian perspectives on the issues raised in the introduction, using Western viewpoints sparingly. These views represent a socialist critique of the socialist economic experience and, as will become apparent, this critique is surprisingly similar to that of Eastern Europe and Soviet specialists in the West.

Second, due to the diversity of the reforms taking place in the Hungarian economy, it must be stated from the outset that the joint venture experience is only one part of an entire process. The effects of the joint venture policy on the economy as a whole and the foreign trade sector in particular should not be overestimated. On the other hand, the very existence of the joint venture policy - which, as noted, has challenged basic tenets of socialist ideology, has created the space for a further critique of the economic system and its principles. Such fundamental issues as the appropriate form of economic organization at the micro level, the suitable relationship between the state and private sectors, as well as hotly debated policies such as the allowance of 100% owned foreign subsidiaries and the potential for foreign ownership of stock in Hungary's key industries, have all been addressed in the new corporate law passed by Parliament in the autumn

of 1988. All of these new policies will have an increasing impact on the domestic economy.

In this thesis therefore, in an effort to understand Hungarian joint venture promotion as a response to changes in the world economy, I have formulated the following fundamental question: how have changes in the world economy influenced Hungary to promote joint ventures in the 1980s? In order to answer this question two additional questions have been addressed: how do Hungarian economists analyze the impact of changes in the world economy on Hungary's economic performance and what is the Hungarian evaluation of joint ventures and of their actual and potential contribution to the solution of Hungary's economic problems?

The method used to answer these questions was greatly facilitated by the opportunity to live in Hungary for nine months as a result of a Carleton University academic exchange program. In Hungary there was access to extensive English language material pertinent to this subject. In addition the opportunity existed to conduct interviews with persons directly involved in the joint venture process including economists, government officials and businessmen as well as listen to informal discussions with Hungarian social scientists. The analysis and conclusions in this thesis are as a result drawn from this first-hand experience during a time in Hungary's history when the struggle between the radical reformers and their conservative opponents was at an unprecedented level, leading to the final ousting of the more conservative members of the Party leadership.

The thesis is divided into two parts. The theme of Part I is the changing world economy. Chapter 2 focuses on Hungarian perspectives on

the rapidly changing world economy during the period 1970-1985. (Given space considerations and the goals noted on page 6, the Western viewpoint is not addressed here). In Chapter 3 the analysis first looks at the Eastern European economies as a region, emphasizing the similar ways in which these countries responded, owing to their common system and ties with the Soviet Union. The analysis then concentrates on Hungary, and the ways in which it interacted with and responded to the world economy during this time. Chapter 4 entails a review of the Hungarian debates on foreign economic policy, which revolve around whether to turn inward towards the CMEA or to turn outward towards the world economy. It also addresses questions of structural adjustment and an appropriate export strategy. This chapter sets the stage for understanding why, owing to Hungary's limited options, it chose to actively promote joint ventures in the mid-1980s.

The theme of Part II of this thesis is the joint venture experience. Chapter 5 begins with a description of ENIC out of which the joint venture policy grew, and then looks at four different points at which the joint venture regulations were changed. At each point the following issues are raised: the legislative environment, including both the goals and the basic conditions of the policy; the political environment, and the results of the policy. Chapter 6 is an evaluation of the joint venture policy, including an assessment of the strength of enterprise-level response to joint venture promotion, and an analysis of whether the policy was successful in achieving its two main goals of export promotion and technical development. Chapter 7 summarizes the principal results of the analysis.

Chapter 2

HUNGARIAN VIEWS ON THE CHANGES IN THE WORLD ECONOMY

Analyses of the world economy have flourished in Hungary since the early 1970s. An important indication of this was the creation in 1974 of the Institute for World Economics of the Hungarian Academy of Sciences. The analyses emanating from this Institute among others, have been crucial for the development of Hungary's economic development policies. There are a number of reasons for this. First, the elaboration of theoretical viewpoints is particularly significant in a centrally planned economy because their influence on state policy is a far greater determinant of actual economic processes than in a market economy whose economic agents act relatively independently of the state. Second, analyses which start from the perspective of the world economy clarify the constraints placed upon the small, trade dependent, socialist economies which must operate within it. In addition, from the policy making perspective, these analyses have been important for the implementation of new or modified reforms.

In reviewing Hungarian analyses on the world economy a number of points can be made about the differences between the Hungarian world-view and that of other analysts - both from the West and East. One of the most important differences is Hungary's insistence that the socialist countries are indeed an integral part of the world economy and are therefore neither isolated from it nor do they act independently of it. From this starting point a more political analysis is articulated which emphasizes the impact the socialist countries have had on western and third world countries in the post-World War II era.

On the other hand, it is interesting to find that Hungarian perspectives on what specific changes have taken place in the world economy as a result of the oil shocks in the early 1970s and its aftermath are not dissimilar from other analyses available in the West, particularly those analyses emerging from small, trade dependent economies. It is precisely for this reason that the Hungarian viewpoint is of interest. That is, acknowledging the similarity in viewpoint shatters the too often held view that intellectual thought emanating from the socialist countries is strictly constrained by Marxist-Leninist dogma. Finally, detailing this analysis serves to pinpoint -- no matter how similar the outlook is to that of the West -- the limits imposed upon Hungary's ability to function in the world economy, precisely because it is a socialist country.

This chapter emphasizes the writings of four Hungarian authors who are among the leading, if not the leading theorists on the world economy.¹ The selection of these particular authors has been aided by the fact that due to their reputation many of their articles have been translated into English. The choice of these four should not suggest that there is necessarily a consensus among them on all aspects

¹These authors are: Professor Jozsef Bognar who, until his recent retirement was the Director of the Institute for World Economics of the Hungarian Academy of Sciences and is himself a member of the Hungarian Academy of Sciences; Professor Mihaly Simai who has just been named the Director of the same Institute and also a member of the Hungarian Academy of Sciences; Bela Kadar who until recently directed the Department of Developed Market Economies and Latin America -- one of the four research departments at the Institute, and is currently director of Strategic Planning at the National Planning Office; and Tamas Scientes who works at the Institute of Social Sciences and is a Professor at Karl Marx University of Economics.

concerning the world economy. Each of them, in fact, has different areas of specialization. For the purposes of this review however, themes common to their writings, albeit with varying degrees of emphasis, have been chosen.

This chapter first addresses the nature and the importance of the world economy. In the authors' views the world economy encompasses the capitalist, socialist and third world countries, and creates its own processes and logic to which the individual states are subordinate. At the same time however, it lacks a power structure on a world level which could rationally organize these processes. The chapter then describes the four "organizing forces" (Simai, 1987) of the change of epoch. The change of epoch was ushered in by the oil crisis in 1973. The four organizing forces are: the relationship of international politics and economic power, the changing conditions of economic growth, scientific and technical development and international cooperation.

THE NATURE AND IMPORTANCE OF THE WORLD ECONOMY

The primacy of the world economy was first elucidated by Jozsef Bogнар in 1974 in a volume of essays entitled "A Change of Epoch in the World Economy" published in Hungarian.² According to Bogнар, humankind has reached a crossroads and its "alternatives, options and limitations of action can (as yet) be identified most concretely (although still tentatively only) in the sphere of the world economy". Bogнар

²A later publication (in English) entitled End-Century Crossroads of Development and Cooperation, 1980, refers to the same concepts introduced previously in Hungarian.

believes this to be the case because the world economy in the current period is not only an aggregate "of the economic efforts and actions and of the system of relations of a humanity organized into nation-states and national economies, but also a centre of processes (a focal point) which radiates vigorous influences" (Bognar,1980:9). He concludes, however, that because there is no power structure which organizes these processes, it makes it far more difficult to adequately deal with the interests and striving of humankind.

Tamas Szentes, in an manuscript written for a U.N. conference also clarifies the nature of the world economy. First he argues that the rise of the world economy was not a result of the productive and market forces of the national economies simply outgrowing their national framework, but rather that the development of capitalism gave birth to both simultaneously. He is quick to point out that while this has occurred concurrently it has been fraught with contradictory developments. Thus, while the development of the industrialized national economies has been achieved by their international activity in other parts of the world, it has prevented other countries from fully developing integrated economies. Szentes includes in his analysis of the world economy the participation of countries with different socio-economic systems in the international division of labour. Along with the centre-periphery dichotomy there is the additional feature of the socialist economies. These three different economies have created what he terms a multi-sectoral "mixed economy" operating at the world level and interacting in such a way as to affect the domestic processes in each country (Szentes,1984:14).

Szentes, like Bogner, is concerned with the fact that while interactions on the world level increasingly influence national economies, actions taken by the nation state in the domestic sphere in response to world economic phenomena have increasingly resulted in a chaotic situation on the world level. He, too, concludes that what is lacking in the world economy is an "adequate institutional superstructure...the lack of a state power on the world level" to respond to the interactions of the world economy (Szentes, 1984:13).

Bogner attributes epochal changes to economic factors acting "in close connection with political, military, social and cultural factors all mutually influencing one another" (Bogner, 1980:45). According to Szentes (1984:10) both economies imply and manifest "a complex set of the social relations of production and distribution which are affecting and being affected by numerous non-economic factors such as political power relations, the legal and institutional structures, the progress of science and technology, the cultural traditions and moral values, customs and ideas".

Bogner (1980:21), distinguishes two different forms of motion for the world of economic phenomena. He refers to periods in any given society when power relations are stable. During this time changes in economic phenomena "reflect only the usual cyclical and structural growth". However, whenever there are major changes in power relations the entire system of economic rationale is affected. At these times politics takes precedence over economics with the potential that any previous norms in economic practice may be upset. As international

power is essentially bipolar, (although moving towards multi-polarity) events in international politics tend to elicit a fast response. The response in the economic sphere as a result of these changes however tends to be much slower primarily because economic power is essentially multipolar and also multi-institutional. Not only does the state wield economic power, but so do other actors such as the multinational corporations and banks. Thus, in the present period, "any restructuring of international power relations is a problem whose solution will take several generations in a world fraught with extremes of development" (Bognar, 1980:22).

Bognar analyzes the causes of abrupt and secular changes in the world economy. While he notes that there are various causes, he emphasizes external factors (including political, social and institutional ones) which if strong enough, may impose their own laws on the global economy. Another cause is that problems may build up over time, having being either ignored or having been superficially dealt with by decision-makers (Bognar, 1980:31). As a result, new decisions will have to be made.

In sum, the world economy is not merely an actor which acts according to predetermined economic norms but rather is influenced by events which are largely beyond its control. At the same time, the state of the world economy also influences the actions of the other international actors.

ORGANIZING FORCES OF THE NEW EPOCH

Within the context of the importance of the world economy Hungarian analysts have developed the concept of a change in epoch. In this

section Mihaly Simai's (1987:9) concept of organizing forces is used as a format in which to describe some of the most important events and processes which have occurred and/or distinguish this new period.³ He identifies four organizing forces which have determined the change in epoch. These are 1)the relationship of international political and economic power, 2)conditions of economic growth, 3)scientific and technical development and 4)international cooperation.

The particular events and processes chosen for this chapter were selectively drawn from the readings of all the authors and are not necessarily those which Simai himself would use. In addition, these organizing forces are somewhat different than the "prime movers" of the present changes in the world economy to which Bognar refers.⁴ This is because Simai has defined a general framework for new phases (epochs) while Bognar is referring specifically to this new epoch.

³In Mihaly Simai's manuscript "On Contemporary Capitalism in Historical Perspective" he distinguishes between major, longer periods of history and economic history and shorter phases (epochs) which open within it. Thus, two shorter phases have evolved since World War II. One ended in the late 1960s at which time a new phase began. According to his view, the organizing forces of the new phase started to unfold "at the end of the 1960s when contradictions between the old frames still in existence on the one hand, and the new requirements, on the other hand, resulted in grave tensions and a critical situation" (1987:9).

⁴Bognar cites three prime movers of the present changes in the world economy. These are: "1)the efforts of the developing countries to replace the existing mechanism of today's international economic system, 2)global problems which came to the fore at the time the Third World burst onto the arena of international affairs and 3)the necessity of peaceful co-existence between countries with different socio-economic systems, at a time when interdependence is becoming every more widespread, when the global problems have emerged, and the living standards of peoples in different countries exhibit extreme economic inequalities" (1980:25).

THE RELATIONSHIP OF INTERNATIONAL POLITICS AND ECONOMIC POWER

In order to understand the change in epoch that emerged in the 1970s, it is important to analyze the fundamental changes in the relationship of international politics and economics that preceded it; in particular, the emergence and development of the socialist world and decolonialization.

According to Simai, one of the most important driving forces activating the birth of a new age is the emergence and development of the socialist system. The very fact that capitalism is no longer a universal system (accentuated by the fact that one-third of the world's population does not live under capitalism) has shed light on economic, political and social issues.

Simai points to two concurrent tendencies which have emerged as a result of this new reality. First, the socialist system influences the third world countries in their search for an alternative to the capitalist order. In fact, it has been the very existence of the developed socialist system which sped up the process of decolonialization.

Second, as a result of the existence of the developed socialist system, the capitalist countries have had to adopt social development measures aimed at promoting greater alliances among classes and have sought greater avenues for class peace. Capitalist countries have also responded to the existence of the socialist countries by developing closer relations among themselves.

The second major driving force in the birth of the new age is the demise of the colonial system. Although Hungary has not been directly involved in decolonialization, the process has had an important impact

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on her. On the one hand, the newly found power of the non-industrialized countries has improved Hungary's own ability to participate in the world economy as world trade has increased, while on the other hand, decolonialization has expanded the number of her potential competitors in the international arena.

With the collapse of the colonial system the contradictions of uneven development came to the fore. Thus, while there have been advances in terms of Third World countries obtaining political power, much of the economic relations have been left unchanged. This has led to serious contradictions. On the one hand capitalism has considered political changes in the Third World essential, in order to hinder the possibility of socialist transformation in the region. On the other hand, capitalism must maintain international exploitation as a necessity for accumulation, which means that the economic relations remain unchanged.

In response to uneven development the Third World countries have participated in a variety of joint efforts and/or unilateral actions against capitalist exploitation. As a result, uneven development has been elevated to the arena of international relations and inter-state conflicts. National liberation struggles have shifted to the field of economic relations (Szentes, 1984:41). According to Simai (1987:16), eliminating the economic consequences of colonialism constitutes an extremely grave and complex problem on a global scale, "exercising a direct effect on the capitalist system, on its traditional methods and scale of values". It is in this context that Boghar refers to the efforts of the Third World to replace the existing international

economic order with one that meets its needs and interests, as one of the most vigorous prime movers of the present changes in the world economy (Bognar, 1980:24).

These system transforming process, along with growing military constraints as a result of a broad consensus to avoid nuclear war, has resulted in the increasing importance of economic measures. Thus, economic measures "became partly the pillars of detente and international security, but at the same time, an increasingly important means of influencing strategic power relations" (Kadar, 1984:13). This new intertwining of political and economic power has been both beneficial and harmful to Hungary. While efforts at detente have enabled her to pursue expanded economic opportunities with the West, the intrusion of politics in the economic arena has led to a heightened volatility and lack of control in these relations due to her minimal influence in superpower conflict.

In sum, major changes in the relationship of international politics and economic power have emerged. These changes did not simply come about overnight, but were in process during the previous phase. The new phase however is marked by the heightened contradiction between old practices and new requirements as well as the awareness that the status quo has been irreversibly altered.

THE CHANGE OF EPOCH AND THE CONDITIONS OF GROWTH

Within the new world context that followed the emergence of the socialist countries and decolonialization, the most dramatic manifestation of the change in epoch was the oil crisis of 1973. This section analyzes three related aspects of the change in epoch. The oil crisis

itself, the related exhaustion of sources of extensive growth on a world scale and changes in the international capital market.

The oil crisis. According to the Hungarian economist Egon Kenešes in his booklet Cyclical and Secular Changes in the World Economy, "the oil crisis and the recognition finally, of the existence of absolute scarcity, represented a secular change of rapid progress representing a turning point of global dimensions" (Kenešes, 1981:26).²

Kenešes raises a number of important issues in his discussion. First, he emphasizes that this secular trend should be considered different from all others in history because for the first time a new absolute constraint emerged to which mankind has had to adapt. This constraint is the scarcity of raw materials of mineral origin. The fact that the scarcity of oil is of a global nature distinguishes it from any previous scarcity which has been either local or regional in nature. He recognizes that while the possibilities of substitution exist, these substitutes will not only take a long time to develop but are also costly, given the level of global use and the concomitant intensity of use.

Second, the rise of oil prices took place under new conditions of the world economy. A large percentage of the world economy was affected in similar ways due to the increasing structural conformity of the national economies and also the speed at which the price increases

²While much of the capitalist crisis has traditionally been pinned on the oil price increase of 1973, Szentes and others point out that the warning signs of inflation, excess capacity and decline in the investment wave were apparent already in the late 1960s. In their view, while the oil price increases may have exacerbated the crisis, it was certainly not the cause of the crisis.

were felt throughout the world was at an unprecedented level.

Third, the oil syndrome represented a case against neocolonialism as opposed to hitherto colonial struggles. Finally, the abrupt appearance of the oil shocks is attributed to the fact that while knowledge of non-renewable resources had been present for decades, its coming to light had been hindered by world economic forces and in particular the power position of the developed capitalist countries and their enterprises (1981:26). For Kemenes, (in accordance with Bogner's original analysis) the oil price shocks of 1973 express a profound change affecting the entire globe, setting off a change of epoch in the world economy.

A number of significant new features of the world economy emerged as a result of the oil crisis. In the capitalist countries not only did the oil shocks contribute to the recession in their own domestic economies (which reverberated throughout the entire world economy), but the unprecedented actions taken by OPEC to raise the price of oil poignantly showed the capitalist economies the extent to which they were vulnerable to Third World activities.

For the non-industrialized countries which trade primary commodities and natural resources, initial hope was pinned on the consideration that the price increases were a result of the depletion of the non-renewable resources and that as a consequence, there would be a general and lasting improvement in their terms of trade. In addition, the Third World hoped to duplicate the OPEC model in other resource commodity sectors. The false character of this hope soon became apparent as most of these countries saw their terms of trade decline as

a result of different demand elasticities for their products. Moreover, they found themselves saddled with the steep price increases in oil. The Eastern European socialist economies, while affected by the Western recession, were only directly affected by the oil price increases somewhat later (in the mid-1970s) as a result of their particular relationship with the Soviet Union. (See chapter 3 for further analysis on this point).

The Exhaustion of Sources of Extensive Growth on a World Scale.

As was mentioned earlier, the oil price increases were not the only new realities affecting the world economy during this period. In the area of overall growth, the 1970s and early 1980s have been characterized by a slowing down of economic growth. World growth in gross domestic product and net material product grew at an average rate per annum of 5.5% between 1965-1970, 4.2% between 1970-1975, 3.4% between 1975-1980 and 2.0% between 1980-1984. World output of industry grew by 6.7% on average per annum between 1960 and 1970, by 3.9% between 1970 and 1975, 4.8% between 1975-1980 and 1.7% between 1980-1984 (Statistical Yearbook, 1986:8).

According to Bela Kadar (1984:8-10) the dynamics of world economic growth reflect the changes in the world-wide demand and supply relations of different growth factors. Changes in the demand for natural resources, labour and capital will be mentioned below, while the role of technical progress will be mentioned in the following section.

In the area of natural resources, Kadar points out that the structure of demand has changed through the course of the 1970s. For a variety of reasons, of which the most important ones have already been

mentioned. there has been a fast reduction in specific material consumption. He argues that the elasticity of demand for raw materials and energy with respect to growth will be very low, and that during the 1980s existing mining capacities will not be fully utilized.

In the area of labour, different dynamics have appeared. While the 25 years following World War II created the excess demand for labour, this no longer is the case. Unemployment in the OECD countries was 5% in 1974-1975, 5.5% in 1979, 6% in 1980, 8% in 1981-1982 and 9% in 1983. Kadar cites a number of reasons for this changing demand. First, the baby boom generation reached the labour force in the 1970s creating a source of excess supply. Second, as a result of the initial labour shortages, high wage rates and an accentuated bargaining position of labour ensued. This led to labour costs rising faster than the cost of machinery. In response, investment activity and priorities were in labour saving technology. Third, the move to the Third World by multinational corporations in search of cheap labour and the success of industrialization campaigns in these countries resulted in the increasing rate of labour intensive goods being supplied by them, starting in the second half of the 1960s.

The 1970s have also seen additional demographic changes on a world scale which will increasingly affect problems in the area of unemployment. For the OECD countries and the CMEA countries, population growth has either stagnated or declined. Here economic growth becomes unequivocally intensive. On the other hand, the Third World population is increasing rapidly (about four times as fast as in the OECD). These countries however, have acquired technology from the West in efforts to

increase industrialization which have been relatively labour saving. This has in turn, adversely affected the labour-absorbing effects of economic growth, and as a result, since the 1970s, problems of unemployment have come to the fore.

Changes in the International Capital Markets. The availability of capital has also undergone dramatic changes during the 1970s (Kadar, 1986:108a). During the early and mid-1970s real capital costs were very low as a result of many factors. Some of these factors were the slow down of economic growth, economic and political uncertainty and most importantly, the influx of petrodollars. The influx of petrodollars gave rise to a surplus of capital which in turn led to expansive overtures by international lenders to both the socialist and Third World. The results of this expansive lending was the accelerated accumulation of debt by these countries that were unable to increase their export potentials fast enough to pay back the loans. This world-wide indebtedness then impacted on the capitalist countries.

In the 1980s however, the international capital market is very different as a renewed demand for capital has led to sharp competition and the rise in the real capital cost level, well above the 1970s. According to Kadar, interest rates, after moving in a range of 2 to 7% in the 1960s, turned negative or zero in between the two petroleum price increases (in the countries of importance for international credit), but by the early 1980s, rose to unprecedented heights.

In sum, the conditions of growth have changed dramatically during the course of the 1970s and early 1980s. While the oil price increase announced the beginning of a new epoch in the world economy and had a

severe impact on almost all economies of the world, the exhaustion of extensive growth sources and the change from a highly fluid to a highly constrained capital market also unequivocally altered the context within which economies function.

SCIENTIFIC-TECHNICAL REVOLUTION AND THE MULTINATIONAL CORPORATION

The new epoch has seen dramatic changes in the conditions of growth. The emergence of limitations in the traditional sources of growth, constraints in natural resources, labour and capital markets as previously discussed, resulted in the primacy of the "scientific-technical revolution" (STR) as a growth factor.* Of greatest importance was the adaptation of the STR into a direct productive force. Its emergence has resulted in the preeminence of the multinational corporation (MNC) which is particularly well suited for exploiting the scale-sensitive nature of the STR. This section will address both of these aspects.

The STR. The adaptation of the STR as a productive force began in the 1960s and has further intensified in this new period. According to Kadar (1984:8), "changes in global output between 1960 and 1975 were derived not so much from the quantitative increases in employment, or from discoveries of natural resources but rather from improved exploitation of the results achieved by scientific and technological progress".

The STR is based on an increased demand, investment, output and

*This is a phrase utilized by the socialist countries to refer to increases in the level of productivity which are generated by scientific and technological discoveries. These increases in productivity are necessary for intensive development and growth.

consumption concentrated increasingly on high-tech industries, data processing, control equipment, communications, office equipment, recreational electronics, software, specialty chemicals, bio-industrial products and structural materials.⁷

Much of the STR is directly linked with the military sector, where technology has first been developed and then, with a time lag, filters into the civilian economy. The permanent militarization on a global scale and its integral link with STR means political/military decisions are highly influential in determining the direction and conditions of its international diffusion.

The role of technical progress in relation to growth has shown contradictory tendencies. On the one hand, because of the uncertainties in the world economy and the uncertainty in large investment outlays, stricter budget constraints in this period have adversely affected necessary research and development investments, particularly in risky ventures. On the other hand, the necessity for structural transformation, stimulated by increased world-wide competition and the increased importance of strategic technology with its concomitant spill-over effects to the civilian economy, has in fact, resulted in

⁷Particular industrial sectors have also seen a decrease in demand since the late 1960s. These sunset industries include: automotive, shipbuilding, metallurgy and heavy chemicals. However, in some industrial sectors changes in world market supply have had a greater impact than changes in demand patterns. This change in supply is due to 1) acceleration in the industrialization of the developing countries, 2) a geographic shift of comparative advantage in favor of some developing countries and 3) the lack of coordination in world economic growth after World War II. As a result, sizeable parallel capacities of international oversupply have emerged in the sunset industries as well as in light manufactures, including certain consumer goods and some consumer durables of an engineering nature. (Kadar, 1984:8).

increases in the rate of technological development and in the increase in its role in growth (Kadar, 1984:299).

The MNC. Development and production costs of this new technology are considerably more than earlier. This means that currently science and technology can only be exploited in the framework of large organizations. The share of so-called "capital and research and development" intensive industries in the industrial output of the advanced countries "amounted to 15-20% between the two World Wars, to 30-50% in the early 1960s and to about 60-70% in the middle of the 1970s" (Kadar, 1984:8). While on the one hand technological changes are extremely rapid, technical leaps bigger and the international spreading of new technologies faster, the long term rise in the R and D costs and the market conditions of acquiring up-to-date technologies has become increasingly more difficult since the mid-1970s.

Along with scale sensitivity, organizational scale-sensitivity has also become a feature of the STR. This has resulted in the increased concentration of industries and the preeminent role of the MNC. By the middle of the 1970s, the multinational corporation controlled about 30-50% of the production capacity, 30-40% of the international commodity exchanges and 60-70% of the invested capital in the non-socialist world (Kadar, 1984:8).

In sum, STR has contributed to structural transformation which initially began in the advanced capitalist countries and has subsequently impacted the entire world economy as it spread. The STR has not only effected particular growth industries but has also led to the prominence of the MNC who has been able to utilize the scale sensitive

nature of the STR to its advantage.

INTERNATIONAL INTERDEPENDENCE AND COOPERATION

The interdependence of the world has been increasingly recognized in the post World War II era. While the potential for heightened tensions in the world economy exists, (both East-West and North-South, have been exacerbated during this change of epoch), these tensions have been tempered by the recognition that nuclear war could lead to the destruction of the planet. The recognition of interdependence extends to economic factors as well as political and has been reflected in Hungarian economists' analyses.

International Division of Labour. Participation in the international division of labour is still one of the most important driving forces of world economic growth. From 1960-1970 total world exports grew on average per annum by 9.2% while production grew at 5.7% - a difference of 3.5%. From 1970-1975 this difference increased to over 20%. While exports were still outpacing growth rates at the end of the decade this trend was reversed for three years as the world went into recession. But by 1984 exports again outpaced growth by 3%.⁸ As a substantial change from the past decades, since the second half of the 1960s, not only the relatively smaller countries but also the leading powers rely increasingly on the international division of labour. Yet although the productive forces have become increasingly internationalized, the economic structures are still largely determined by national

⁸These figures were based on world export growth rates and growth in world output figures from The Handbook of International Trade and Development Statistics, p. 114 and Statistical Yearbook, p. 8 respectively.

structures.

The MNC has been the institution which has most contributed to the internationalization of these productive forces. The world economy therefore has been heavily influenced by the ability of the MNC to deploy and redeploy its processes, to transfer entire industries or specific industrial activities on a transnational basis, largely according to its discretion. While, in the early 1970s, both the socialist and Third World countries were largely averse to becoming directly linked with the MNC through the internationalization of production, since the mid-1970s this trend has been reversed. Thus, there now exists competition on a world level for the activities of the MNC.

International Monetary System. The international monetary system must also be mentioned in the context of cooperation and interdependence. The international monetary system is internationalized to an even greater degree than the market of other commodities. The changes noted previously in this chapter in the international capital markets affected all economies simultaneously. As capital has become increasingly scarce, the MNC again gains preeminence due to its enormous access to and hence control of this capital.

Moreover, the breakdown of the Bretton Woods System coincided with the emergence of the new epoch and international financial coordination has remained chaotic. Hungary thus faces difficult conditions in the international monetary system at the very moment it is moving from a traditionally non-monetarized economy characteristic of the centrally planned economy, to one which actively participates in the interna-

tional economic arena.

Interdependence and Cooperation. Where does the analysis of interdependence link with the potential for international cooperation? All of the authors share Bogнар's view that interdependence is considered one of the most comprehensive features of international political and economic life. For him, the concept does not simply mean "the mutual dependence of the inhabitants of the world, their community of fate, future and economic development, but also that whenever a national optimum is identified and an economic policy is taken, its effects on other countries must be reckoned with" (Bogнар, 1980:25).

For all four authors, heightened interdependence comes at a time when peaceful co-existence of different socio-economic systems must be assured, despite the unprecedented growth of destructive capacities. It comes at an historical juncture when the very notion of time has been accelerated. This acceleration is partly a result of the greater recognition by people all over the world, who are at different levels of development, of their own specific global social position. This knowledge is a result of the new information technologies emerging as a result of the STR. Thus, the STR has created a development sensitive globe where the demands by the less developed countries for relative adjustment are expected to be sooner than later (Kadar, 1984:10).

Finally, interdependence comes at a time when global problems have arisen out of the epochal changes. Some of the most pressing problems are: 1) the world population is expected to increase four-fold by the year 2000, and 81% of it will live in the developing countries (this includes China);, 2) world food security is jeopardized by this

population increase with the possibility of millions living near the starvation level, 3) while the supply of energy and raw materials is constrained in the 1980s, sources of energy will remain a serious problem, and 4) the side effects of industrialization have meant the destruction of the biosphere, the examples of which are the destruction of fertile soil, pollution of the rivers and oceans and the rising temperature factor related to the presence of carbon monoxide. All of these problems are of a global nature (Bognar, 1985a:20).

International cooperation as a policy is a natural response to an interdependent world. Few global problems can be solved except by participation and cooperation on an international scale. However since there is no single, over-arching institutional structure or state power to which to refer these problems, a call for international cooperation has become the manner in which these global problems can best be solved.

The recognition that international cooperation is not only a value but also a necessity given the increased interdependence of the world, while seemingly obvious, is in fact a remarkable change in perspective from previous Hungarian notions exemplified by the autarchic period in the 1950s and 1960s. This recognition has profound implications for Hungarian foreign economic policy.

CONCLUSION

As has been argued in this chapter, an analysis of the world economy and the changes it has undergone in the 1970s and early 1980s is particularly relevant to Hungary. The essence of this analysis has finally, as of the mid-1980s been generally adopted by Hungary's party

leadership.⁹ Moreover, a review of Hungarian analyses on this subject provides a context within which to understand Hungary's foreign economic policy choices during the 1970s and 1980s which contributed to the change in attitude vis-a-vis direct foreign investment. Understanding this context is essential for answering the basic question of this thesis which is why Hungary moved to promote joint ventures in the 1980s.

The two features of the world economy considered most significant by Hungarian analysts are the prominence of the world economy as an organism distinct from the nation-state and the change of epoch. The change of epoch has had far reaching implications. The most visible manifestation of the change in epoch was the oil crisis but it has become apparent also in the exhaustion of sources of extensive growth and the change in the international capital markets. In addition, the STR has emerged as a productive force and has contributed to the preeminence of the MNC and the acceleration of structural transformation on a world scale.

Finally, the new epoch has seen the heightened interdependence of the world, exemplified by the increasing importance of the international division of labour and the international monetary system. The Hungarian analysts assert that this interdependence has necessitated increased international cooperation in order to solve those problems of a global nature.

⁹For the government's perspective on the effects of the world economy on Hungary see the speeches by Janos Kadar and Karoly Grosz at given at the 1987 Autumn Session of the National Assembly (BudaPress, 1987:2,3).

Chapter 3

THE IMPACT OF THE CHANGES IN THE WORLD ECONOMY ON THE CMEA SIX¹

IN GENERAL AND HUNGARY IN PARTICULAR

This chapter is devoted to understanding the Hungarian critique of how the change in epoch impacted the CMEA Six as a region and Hungary in particular and how their economies have responded to these world historic events. The first section focuses on the CMEA Six as a region with a discussion of political factors, the changing conditions of economic growth and questions of scientific technical development affecting structural adjustment.² The chapter then looks at Hungary, focussing on two aspects: the changes to the foreign trade sector as a result of the reform process initiated with the introduction of the New Economic Mechanism in 1968 (NEM); and the effects of these reforms on Hungary's economic position.³

¹The discussion is limited to the CMEA Six (Hungary, Bulgaria, Poland, the GDR, Czechoslovakia and Rumania), excluding the other less developed CMEA countries because their experience is concretely different. In this thesis the CMEA Six and Eastern Europe will be used interchangeably. The Soviet Union is excluded from the discussion except where pertinent.

²It is of interest to look at the CMEA Six as a group because Hungary has had many of the same characteristics and experiences as these countries. Not only do they share the same socio-political system, but also they are the more developed and more industrialized members of the CMEA, are bound by interests of cooperation and share certain common features and interests in the relations with the USSR and the rest of the world.

³This discussion only covers the reform of the foreign trade sector. For a more detailed account of all aspects of the NEM see Hare, Radice and Swain eds., Hungary: A Decade of Economic Reform, George Allen & Unwin, London, 1981.

THE CASE OF THE CMEA SIX

ORGANIZING FORCES

POLITICAL FACTORS

In Chapter 2 it was shown that the emergence and development of the socialist system was one of the most important driving forces activating the birth of a new age. In the post-World II period, the newly socialist countries of Eastern Europe found that their relationship to the world economy had dramatically changed. As a result of the adoption of the Stalinist economic model, which emphasizes self-sufficiency and import-substitution to the detriment of foreign trade, as well as being subjected to the numerous cold war policies instigated by the U.S. as the economic corollary of containment and deterrence (albeit directed primarily at the Soviet Union), the Eastern European countries turned inward and were thus primarily autarkic during the first 15 years of their development.

Growth rates during this period were high, approximately 6% annually; however by the mid-1960s it became increasingly apparent that the dynamism of the economies was weakening (Bognar, 1987:6). Part of the explanation for this slowdown lies in the economic strategy which relied on extensive development by "increasing the employment of and reallocating the factors of production" (Holzman and Legvold, 1976:-145). Manpower reserves became exhausted however, labour productivity did not increase, and capital productivity actually declined (Holzman and Legvold, 1976:279). It became apparent that the economic model was not adequate for intensive growth (an increase in the productivity of the factors of production in the existing structure of the economy) and

consequently reform was needed (Bognar, 1987:7).

The CMEA countries recognized that the West had succeeded in intensive growth as a result of the scientific and technical revolution. Thus, according to Hoffman and Laird in their book The Politics of Economic Modernization in the Soviet Union (1982), an ideological reformulation of the East's relations with the West was promoted under the rubric of advanced modernization.

Advanced modernization assumed that science and technology were the central factors in economic and social progress. Physical labor was no longer considered the chief element in production. Instead, science was transformed into a direct productive force whose production process is subordinated to the general principles of management and self-management. In order for the CMEA countries to take part in this revolution, increased ties with the West were needed. The CMEA countries were to increase their areas of specialization in order to participate in the international division of labour. The East's integration into the international division of labour was considered acceptable because of the notion that the productive forces of the scientific and technological revolution were neutral and thus Western techniques could be utilized in the socialist world (Hoffman and Laird, 1982).

Finally, it must be added that there was an increasing recognition on the part of the Eastern European countries that given their paucity of natural resources and the dependence of their economies on trade, modifications to the self-sufficient Stalinist model would have to be made, particularly in the area of foreign trade.

By the end of the 1960s conditions in the West were such that export restrictions to the East were being reduced. This was partly a result of West European opposition to such restrictions. The West Europeans were interested in the Eastern European markets because they had previously been traditional trading partners, had accumulated large trade deficits with the U.S. and so could benefit from the import of raw materials such as coal, lumber and foodstuffs from the East, and because they were interested in reducing tensions on the continent - not exacerbating them (Koves, 1985:57).

From the perspective of the U.S. and in particular, on the initiative of Secretary of State Henry Kissinger, the policy of detente became the ultimate example of how the U.S. linked political goals with economic issues. Detente was based on the recognition that the East was looking to the West for technology and it was this economic need which Nixon sought to exploit for political ends. As Holzman and Levgold put it, detente was an example of how "economic interdependence had served - as an element...in a political strategy designed to induce the Soviet Union to deal comprehensively and systematically with issues capable of seriously disrupting the Middle East, Indochina and the strategic arms race" (1975:294).

The Soviet Union recognized that if it wanted to obtain technology from the West it would have to accept the U.S. strategy of obtaining political concessions for economic ones. Due to their lack of economic leverage the Soviets would not be able to offset U.S. political demands with political demands of their own. Even so, the Soviets were interested in increased trade and cooperation on the one hand and

reduced tension on the other, seeing these processes as mutually reinforcing.

In 1971-1972 as an integral part of the overall detente strategy, "U.S. trade controls were liberalized in an effort to build in both countries a vested economic interest in the maintenance of a harmonious and enduring relationship" (Jentleson, 1984:644). By 1975 however, this agreement had become void. The Soviet Union refused to sign it once the U.S. Congress passed the 1975 U.S. Export Trade Act which linked Soviet MFN status with granting Soviet Jews greater freedom to emigrate (Jackson-Vanik amendment) and when, through the Export-Import Bank Amendments (Church-Stevenson) an overall ceiling was placed on new credits to the Soviet Union and a total ban was placed on credits relating to energy production, processing and distribution.

By 1976 with the U.S. elections, political forces which opposed East-West cooperation had gained strength. Bela Kadar attributes the rising neo-conservatism in part to the economic situation of the Organisation for Economic Co-operation and Development (OECD) countries which, having experienced a recession and slowdown of economic activity, hoped to maintain economic dynamism by a renewed effort in the military industry (1984:208). In addition, he cites the continuing national liberation successes throughout the world to which the East was believed to have contributed and which were seen as a threat by the West as accelerating the decline in East-West cooperation. Moreover, Kadar points to the ascendancy of the Trilateral Commission whose importance was enhanced by the membership of many officials of the Carter Administration and which promoted "the strategic concepts and processes of intra-OECD cooperation and of coordinated external

actions" which meant that the international environment for expansive East-West relations had diminished.

Finally, it can be seen that in the 1980s renewed tensions in relations occurred as a result of Soviet intervention in Afghanistan and the Polish crisis, both of which compelled the Western countries to attempt to extract political concession through the use of economic levers. Thus embargoes were imposed and although the effectiveness of these embargoes is questionable, they did serve to heighten tension in East-West relations overall.

In sum, it is clear that the political environment between East and West, conducted primarily between the two superpowers was of a highly erratic nature. This volatility of relations affected the foreign economic development strategies of the Eastern European countries. In the post-war period the inherent structure of their economic model as well as the impact of the Cold War led to a period of turning inward. While links began to develop in the mid-1960s and blossomed with detente in the early 1970s this improved cooperation was achieved in no small part because the Soviet Union and Eastern Europeans recognized weaknesses in their economic model. By the mid-1970s however new East-West tensions arose which stunted any further development. In fact, by the early 1980s, greater tensions had surfaced and have only in the post-1985 period begun to weaken, opening up a new period in East-West relations.

THE CHANGING CONDITIONS OF ECONOMIC GROWTH

The change of epoch affected the CMEA 6 in many of the same ways felt throughout the rest of the world. While the oil crisis impacted

them, the full severity of it was experienced only at a later date. While the CMEA 6 recognized that they had to shift from extensive to intensive growth, their ideological commitment to high growth rates at whatever cost inhibited this transformation. Finally, they were severely affected by changes in the international capital markets as they took advantage of the excess supply of capital, only to later experience the averse effects of the ensuing dependence. This section will discuss each of these aspects in turn.

Oil Crisis. There are two main points which are essential to any understanding of the impact the oil crisis had on the Eastern European countries. First is the impact of the oil price hikes during the 1970s. Second is the relation between the oil crisis and their industrial structure.

The impact of the oil price hikes in 1973 which ushered in the epochal change in the world economy, did not have an immediate direct effect on the Eastern European countries. While each of the countries is predominately energy (particularly oil and gas) dependent, it is from the Soviet Union that they receive their supplies. In the context of CMEA relations, the Soviet Union did not, during the early 1970s, change world market prices for its exports. While world market prices increased fourfold as a result of the OPEC price hikes in 1973, the CMEA countries were insulated from these increases. In 1975 the price structure within the CMEA was changed however. The new formula allowed for price changes every year on the basis of a five-year moving average of world market prices.

While price increases for energy began in February 1975, the

direct effects of a pronounced increase of world market prices were not felt until the second oil shock of 1979. According to E.A. Hewett in Energy Economics and Foreign Policy in the Soviet Union (1984:205) in 1979 when world market prices increased by 45% the Soviet ruble price of oil to Eastern Europe only increased by 25-28%. While world prices increased by 65% in 1980, the prices charged to Eastern Europe increased between 21-27%.

The second impact of the energy crisis is in relation to the industrial structure of the CMEA. During the period of socialist industrialization, material and energy intensive industrial structures evolved in Eastern Europe. However according to Lazzio Csaba, between 1975 and 1979, despite the oil shocks on the world market and the subsequent pricing policies within the CMEA signalling the end of a period of cheap raw materials and fuels, nothing was done about reducing the energy intensity of industry in these economies. Thus, he states, these countries "wasted nearly a decade in arriving at decisions to save energy and raw materials by means of structural policy and qualitative changes in the economic mechanism" (Csaba, 1985:18)⁴. In fact, he points out that it was not growing intra-CMEA prices that constrained the energy demand of CMEA countries but the October 1981

⁴In an article written in 1983, Csaba cites three factors for the defensive attitude of the Eastern European countries toward changing their industrial structure. First, they could rely on domestic sources by mining poor quality brown coal and lignite. Second, due to their high share of energy and material intensives branches already in existence there was major resistance to major changes and third, owing to the fact that the centralized economies used gross output or realized output as a measure of success there was little incentive to change energy intensities of production (1983:65).

decision by the Soviet Union to reorient supply, which effectively forced the Eastern European countries to curtail their demand (Csaba, 1985:22).[•]

The result of both the price increases and the lack of response in changing the industrial structure was that the Eastern European countries accumulated an enormous debt with the Soviet Union -- to the tune of 30 billion transferable rubles (Csaba, 1985:23). This debt, according to Csaba, reflects the amount the Soviet Union gained from terms of trade changes between 1973 and 1985 and which was a direct outcome of changing the pricing mechanism within the CMEA without altering anything else within the mechanism. As a result, Csaba states in a 1985 article that at the time of writing it, "while 80% of the debt has been paid by the Eastern European countries and about 5 billion transferable rubles or 1/5 of their terms of trade losses were to be credited by the USSR, the problem is far from being solved" (1985:23).

In short, while the energy crisis was a phenomenon originating from outside the Eastern European countries, these countries soon found that they were not insulated from its effects. Not only were they to find themselves facing an enormous loss of terms of trade with the

[•]It is important to note that in Csaba's view, the Soviet decision not to continue to expand and/or even maintain supplies to Eastern Europe was based on a number of reasons. The two most important are that 1)the Soviet Union had to increase its export earnings in convertible currencies in order to not allow the country's indebtedness to grow and 2)the ability to do this is a function of either a radical positive structural change in commodity composition or, cutback of consumption. This is because the Soviet's raw material and fuel production basically does not grow anymore in any significant amount, with the exception of natural gas.

Soviet Union, with a resulting transferable ruble debt, but they were also faced with the growing recognition that steps had to be taken to reduce their dependence on energy resources.

The Exhaustion of Sources of Extensive Growth.

As mentioned earlier in this chapter, there was widespread recognition within the CMEA by the early 1970s that it was necessary to shift to intensive growth. The same exhaustion of sources of extensive growth as described in Chapter 2 at the world level were present within the CMEA. Indeed they recognized that as the West was becoming increasingly successful in bringing about intensive growth, particularly as a result of the scientific and technical revolution, the more their economies lagged behind. As will be shown later in this chapter, the CMEA failed to take the fullest advantages of growth from the scientific and technical revolution.

Debt: As was discussed in Chapter 2, capital was abundant in the 1970s and was lent on extremely favorable terms to debtors. By the 1980s however, this trend had been reversed. This phenomenon, as will be shown, had serious consequences for the CMEA 6 in general and Hungary in particular. While the CMEA 6 shared many of the same experiences with debt as did the Third World countries, they also suffered from problems peculiar to their own economies.

There are three factors which were a result of Western practices during the 1970s which contributed to Eastern European debt. The first was the very existence of an abundance of loanable funds due to the recycling of petrodollars from the oil price explosion. The second factor was the eagerness of Western governments to stimulate exports

and hence grant large credits and credit guarantees. By exporting to the socialist countries they hoped to alleviate the problems faced by their own countries as a result of the 1974-1975 recession, the four-fold oil price increases and the price increases in raw materials. Third, the credit policies of the Western banks were such that for a very long time they assumed that lending to Eastern Europe was relatively risk-free because the state holds a monopoly on foreign trade and hence external disequilibrium could be effectively controlled by the state; the fact that historically the Eastern European countries have had a practice of being good, reliable debtors and it was assumed that if serious problems occurred and the potentiality of a default arose, the Soviet Union would step in and function as the ultimate guarantor of credits (Koves, 1985:132). For all these reasons the Western countries and banks were willing to grant large credits, not seriously evaluating the viability of the various economies and their future potentiality for repayment of the loans.

From the Eastern dimension, there are two main ways in which the CMEA Six's response to the debt crisis reflected the unique problems of their economies. In the first period, the severity of the problem was underestimated and in the second period, while the policy of import restriction was successful in controlling and in fact reducing the levels of indebtedness, its very success was at the expense of adequate structural adjustment.

The first period, 1965-1975 was characterized by an import substitution policy which led to an opening toward the West and increased levels of East-West trade. The policy was based on the

assumption that the Eastern European countries could participate in the world economy in a controlled manner, allowing them to obtain the technology from which to develop their STR while insulating themselves from the adverse effects of dependence on the world economy. While on the one hand there was a recognition that imports from the West were needed to achieve modernization necessary for intensive growth on the other hand imports from the West were utilized only when the items were unavailable in the CMEA or were of insufficient quantities. At the same time it was assumed that the export sector would not need to change to accommodate this import demand. Instead, exports (necessary to pay for the increased imports), continued to be determined by the 'residual principle' - that exports consisted of what remained after domestic and CMEA needs were met. Thus, while this import substitution policy advocated imports, a concomitant integration into the international division of labour was deemed unwarranted because the socialist economy develops independently of the capitalist economies.* This policy was soon proven untenable as trade balances deteriorated (see Tables 3.3 and 3.4) and indebtedness soared (see Table 3.1).

According to Koves, "indebtedness came about and accumulated because the CMEA countries could not, and/or did not believe it to be

*It must be recognized that any strategy of import substitution within the CMEA is not only a national strategy but a regional strategy as well. As Koves points out, "while these countries try to make themselves self-sufficient by import substitution, they get on quite well with regional import substitution generally, that is to say, with the idea of mutual cooperation, the primary aim of which is the satisfaction of the joint needs of the CMEA countries out of the production of the community (that is, out of domestic production and imports from other CMEA countries) to the largest extent possible" (1985:117).

necessary to adjust the increase of their imports to the actual increase of their exports" (1985:131). Running into debt as a means to develop the economy was seen as worthwhile and, as was noted previously in this section, was sustainable in the short term as credits could be obtained in large amounts on very favorable terms. From a low of 4.9 billion dollars net debt in 1971 the CMEA 6 debt steadily grew throughout the 1970s. The rise in the level of indebtedness is shown in Table 3.1

TABLE 3.1
Eastern European Convertible Currency Debt
to the West*
(billions of US Dollars)

<u>YEAR</u>	<u>GROSS</u>	<u>NET</u>
1971	6.1	4.9
1975	23.2	18.9
1976	29.4	25.3
1977	36.7	32.9
1978	47.5	42.9
1979	58.2	51.7
1980	66.1	58.5
1981	67.1	61.1
1982	62.0	56.5
1983	61.6	53.0
1984	59.3	48.6
1985	68.6	54.7

By 1981 it had increased eleven-fold to 61.1 billion dollars U.S.

While net debt decreased in 1982, 1983 and 1984, it rose again in 1985 reaching 54.7 billion dollars U.S.

In addition to growing trade imbalances and increasing debt, the CMEA 6's ideological belief that high growth rates were intrinsic to the socialist economy prevented authorities from adjusting to lower

*Source: East-West Technology Transfer: The Trade and Economic Aspects, p.56, Table 8 and Economic Bulletin for Europe, Vol. 38, p.44.

growth once it became apparent that external indebtedness was becoming unmanageable. According to Csaba, the maintenance of and the acceleration of rapid growth of national income was considered "as an attribute of the socialist mode of production and it had become conventional to use comparative national income growth statistics as a proof of the higher quality of the socialist system" (1983:55). Thus, the apparent unwillingness to accept the declining rates until 1978 was manifested in "an almost complete denial or at least a serious underestimation of the scope as well as the size of the impact of world economic changes on the socialist economies" (Csaba, 1983:56). The percentage change per annum in net material product is shown in Table 3.2:

TABLE 3.2
CMEA SIX*
Net Material Product
% Change Per Year

<u>YEAR</u>	<u>CHANGE</u>	<u>YEAR</u>	<u>CHANGE</u>
1970	5.7	1978	4.3
1971	7.3	1979	2.0
1972	8.1	1980	0.1
1973	8.3	1981	-1.9
1974	8.6	1982	0.1
1975	7.6	1983	3.9
1976	6.1	1984	5.3
1977	5.7	1985	3.7

In the post 1975 period however, a policy of import restriction prevailed. This policy, which emerged to correct for the ever-increasing disequilibrium in trade and rise in the stock of debt, was implemented at the expense of adequate structural adjustment necessitated by the change of epoch. The shortcomings of this policy are discussed in

*Source: Economic Survey of Europe 1986-1987, p.333.

next section of this chapter. Here however, the purpose is to show that the policy did succeed in its immediate aim.

From the data in Tables 3.3 and 3.4 a number of points can be made. First, it can be seen that throughout the 1970-1985 period Eastern European exports grew dramatically between 1970-1979 and at a much slower rate between 1980-1985, although growth rates for both 1983 and 1984 matched the late 1970s. The trend with imports however is different. While imports grew very fast between 1970 and 1974, twice growing by 13.7%, from 1975-1979 the growth rate decreased - only once reaching a high of 6.9%. From 1979 to 1982 the growth rates were extremely low, reaching -5.3% in 1981 and -6.3% in 1982. While 1983 and 1984 saw a growth of imports by 3.2% and 5.9% respectively, in 1985 this growth was 5.7%.

TABLE 3.3*
Eastern Europe's World Trade
% Volume Change

YEAR	EXPORTS	IMPORTS
1970	10.7	13.7
1971	8.6	8.2
1972	11.9	9.3
1973	9.7	12.7
1974	7.8	13.7
1975	7.0	4.0
1976	7.6	6.9
1977	9.4	4.9
1978	9.2	5.7
1979	7.2	1.9
1980	2.8	1.2
1981	1.2	- 5.3
1982	5.1	- 6.3
1983	7.2	3.2
1984	8.5	5.9
1985	1.7	5.7

*Source: Economic Survey of Europe 1986-1987, p.351

TABLE 1.4
 Europe's Imports and Exports
 (Millions of US Dollars)

Year	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
WEST																
Ex.	4.78	5.25	6.41	8.83	12.01	11.99	13.54	14.33	16.21	20.43	24.19	22.38	22.15	23.67	24.97	24.10
Im.	5.25	5.92	7.53	11.19	16.97	18.09	19.57	19.61	21.72	25.00	27.43	24.76	20.47	19.93	20.28	21.32
	-0.47	-0.67	-1.12	-2.36	-4.96	-6.10	-6.03	-5.28	-5.51	-4.57	-3.24	-2.38	1.68	3.74	4.69	2.78
EAST																
Ex.	11.56	12.71	16.02	19.66	21.96	27.77	29.05	33.21	37.31	42.05	44.89	44.16	44.43	47.92	49.18	51.54
Im.	11.71	12.77	14.95	18.53	21.67	28.56	29.82	34.88	39.10	42.85	46.83	47.48	45.73	48.35	49.69	51.50
	-0.15	-0.06	1.07	1.13	0.29	-0.79	-0.77	-1.67	-1.79	-0.80	-1.94	-3.32	-1.30	-0.43	-0.51	-0.05
OTHER																
Ex.	1.75	1.95	2.13	2.65	3.98	5.07	5.27	6.22	7.13	8.52	10.57	12.12	12.44	11.35	11.84	11.67
Im.	1.48	1.55	1.76	2.49	4.05	4.17	4.63	5.54	6.46	8.31	11.18	9.08	8.43	8.70	9.14	9.40
	0.27	0.40	0.37	0.16	-0.07	0.90	0.64	0.68	0.67	0.21	-0.61	3.04	4.01	2.65	2.70	2.27

Note: West= Economic Community of Europe Market Economies + Japan
 East= Eastern European CMEA + Soviet Union
 Other= Rest of the World

Source: Economic Survey of Europe 1986-1987, p. 353

Second, it is important to note the extent to which the Eastern European countries incurred trade imbalances during this time. Trade imbalances with the West grew at a rapid rate between 1970-1975. 1975 marked the largest trade imbalance, reaching -6.1 billion U.S. Dollars. Between 1976 and 1981 the trade imbalance decreased and by 1982 a trade surplus was achieved and maintained through 1985. The CMEA has incurred a trade deficit with the East for almost the entire 15 year period with the exception of three years (1972, 1973, 1974). The size of the trade deficit however during its 13 years is relatively small (compared to the deficit with the West), reaching a high of more than 3 billion U.S. dollars only in 1981 and reaching more than 1 billion U.S. dollars only in three years. Finally, in terms of the other countries (principally LDCs) a small surplus has been maintained for all but two years. In the two deficit years the imbalance reached its highest level of -0.11 in 1980.

In sum, it has been suggested that the policy of import restriction with the West in the post 1975 period achieved the desired balance in trade which had been exacerbated by the failure of previous import substitution policy. The CMEA Six's trade with the East and with the other countries has been generally stable, albeit characterized by deficits with the East and surpluses with the other countries.

SCIENTIFIC-TECHNICAL CONDITIONS

As noted in Chapter 2, the STR became a more important productive force beginning in the late 1960s. The CMEA Six hoped that by acquiring Western technology they too would be able to move their economies' reliance on extensive growth to one more intensive in

nature. The first section of this chapter demonstrated how on the one hand, these countries set the stage for adapting the STR to their economies by formulating at the level of ideology an argument in favour of such a transformation. On the other hand, the first section also showed the constraints under which such transformation could occur, owing to the volatility of the political environment emerging primarily from U.S. - Soviet relations. The following section examines those constraints inherent to their economic system which prevented them from transforming structurally.

Reasons for the Failure to Transform Structurally. It is important to first point out some of the factors which led to the inadequate structural transformation of the Eastern European economies. These are factors whose roots precede the change in epoch and are less subject to policy decisions.

Kadar points to five factors. First, there is historical heritage. He considers this heritage to be a 'persistent fellow-traveller' in any period of economic development. While some of the Eastern European countries arrived at a higher stage of development in the late 1960s due to extensive economic development, their historical heritage (not including Czechoslovakia nor the GDR) is one of economic backwardness or moderately developed areas, along with an inadequately developed foreign trade sector. Second, while the level of development achieved by the CMEA 6 has been relatively rapid, their current level of development can only be considered to be at an intermediary stage. Third, there are problems associated with functioning in different socio-political-economic systems. Thus the socialist economies have

had difficulty functioning in the environment of free competition and fluctuating markets. Kadar adds that the difficulty in functioning intensively in the international division of labour becomes more pronounced between different economic systems, the higher the level of development. Fourth, as discussed earlier in this chapter, political factors have restrained Eastern Europe's involvement in the world economy. Fifth, is the differing economic size between the Western countries (predominately Western Europe) and the relatively small economies of the CMEA 6 (Kadar, 1984:214,215).

An additional factor inhibiting the Eastern European countries' ability to transform is the problem of adequately adapting and diffusing those technologies which have been imported - owing to the particularities of their economic system. Finally, it must also be noted that while these countries maintained that they intended to participate in the international division of labour, the share of the West in their foreign trade never reached more than 28.9% which was achieved only in 1964. During the 1970s, the actual percentage was more like 24%. In terms of imports, the highest point reached was 34.7% in 1976 while the remainder of the 1970s saw an average closer to 11%. During the 1980s the percentage of imports from the West varied between 29.4% in 1981 to a low of 24.7% in 1983. See Table 3.5.

TABLE 3.5¹⁰
Percent Share of the West in the Foreign Trade
of the East European Countries

<u>YEAR</u>	<u>EXPORTS</u>	<u>IMPORTS</u>
1970	23.7	26.7
1975	24.1	34.1
1976	25.8	34.7
1977	23.9	31.2
1978	24.0	31.4
1979	26.0	31.6
1980	27.9	30.6
1981	26.3	29.4
1982	26.4	26.7
1983	27.1	24.7
1984	28.9	25.0

Empirical Evidence of the Failure to Transform Structurally.

Exports: In terms of export structure, Kadar has assessed that in the period 1965-1975 one of the most significant features of CMEA-OECD trade has been its essentially stable commodity structure which "did not adequately reflect either the trends in the structural transformation of world trade or the development levels of the CMEA countries" (1984:219). In particular, this commodity structure has been primarily based on energy and raw materials and food.

¹⁰Source: East-west Technology Transfer: The Trade and Economic Aspects, p.55.

TABLE 3.6¹¹
CMEA Six Exports to the OECD
(%)

EXPORT ITEM	1965	1975	1983
Food, beverages and tobacco	21.1	10.2	10.6
Crude materials (raw materials, fats, and oils)	26.2	17.3	9.9
Minerals, fuels	18.1	36.6	23.2
Chemicals	4.7	5.3	11.1
Manufactured goods chiefly by material, miscellaneous	24.3	21.4	32.5
Machinery and trans- port equipment	5.0	8.6	12.5
Other	0.5	0.7	0.6

These sectors totalled 65.4% in 1965 and 63.8% in 1975. It is significant to note however that by 1983 the percentage of these sectors in exports to the OECD dropped to 43.7%. Kadar raises a number of points regarding the heavy reliance on these sectors:

1. The slow development of agricultural trade during this period is due mainly to the agricultural protectionism of the Common Market. The decline in raw material trade was due largely to increased consumption at home.

2. Within trade in the raw material sector, the unprocessed products were those that expanded most, specifically primary energy.

¹¹Source: Kovcs, A., *The CMEA Countries in the World Economy: Turning Inward or Turning Outward*, p.117, Table 16 and Kadar, Bela, *Structural Change in the World Economy*, p.216, Table 27.

3) The problem with reliance on the extractive sector is its higher than average capital intensity which is contrary to the relatively poor capital endowment of these countries. While the industrial sector has grown in importance since 1975, manufactures consisting of material products and miscellaneous articles predominates. Thus,

4) A large part of the CMEA Six's industrial exports are in the declining sectors of the OECD. For instance, in 1983, 30% of those industrial exports which grew faster than average during the early 1980s were basic chemical and metals (Weiner, 1986:399).

5) In addition, their fastest growing manufactured exports are increasingly subject to severe competition from both Southern Europe and low cost producers in the Third World. For instance, clothing and leather products constituted 17% of those industrial exports growing faster than average in 1983 (Wienert, 1986:399). The competition from Southern Europe and the Third World is significant particularly because they have the advantages of both tariff preferences with the Common Market and are able to produce more cheaply owing to their comparative advantage in natural resource endowments.

6) While the CMEA Six's share of OECD imports of industrial products increased from 1.6% to 2.0% between 1970 and 1979, the Southern European share increased from 1.5 to 2.5% and the developing country share increased from 5.3% to 11.2%. As Table 3.7 indicates, in the area of clothing and footwear, the change in the OECD import share

is similar.¹²

TABLE 3.7
CMEA Six Competition with Southern Europe
and the LDCs in Clothing and Footwear¹³
(%)

<u>CLOTHING</u>			
<u>YEAR</u>	<u>LDC</u>	<u>SOUTHERN EUROPE</u>	<u>CMEA</u>
1965	21	3	3
1979	42	7	4
<u>FOOTWEAR</u>			
1965	8	3	3
1979	27	10	3.5*

*as of 1975

7) In engineering, the imports of the OECD from these countries is marginal but the growth rate of Southern Europe and the developing countries is twice as high as the CMEA 6.

8) In the engineering industry one of the great potentials for development is in intra-sectoral specialization within the framework of the large MNC. Eastern Europe's virtual absence, and/or very weak relations with the Western MNC impairs its ability to adequately progress in this arena.

Imports. This section will highlight some of the structural

¹²While the figures in 3.7 include the Soviet Union, its export commodity structure in 1983 was primarily (88.8%) crude materials and mineral fuels so should not distort the figures in terms of identifying the trend for the CMEA 6.

¹³Source: Kadar, Bela. "Hungary's External Economic Strategy in the Second Half of the 1980s", Acta Oeconomica, vol. 36 no. 3-4, 1986.

problems of the import sector:

1) The share of industrial products as a proportion of imported products from the OECD was 66.5% in 1965, 81% in 1978 and 77.6% in 1983.

TABLE 3.8
CMEA Six Imports from the OECD (%)¹⁴

<u>IMPORT ITEM</u>	<u>1965</u>	<u>1975</u>	<u>1983</u>
Food, beverages and tobacco	21.0	13.0	12.9
Crude materials (raw materials, fats, oils)	12.1	5.2	7.4
Mineral fuels	0.4	0.8	2.1
Chemicals	12.9	11.3	18.4
Manufactured goods chiefly by material, miscellaneous	24.0	33.1	28.4
Machinery and trans- equipment	28.8	36.0	29.0
Other	0.8	0.6	1.9

2) The lack of specialization and participation in the international division of labour on the part of the CMEA 6 had led to a disproportionately high level of imports of machines, chemical and metallurgical products (although some of this disproportion is a result of an appropriate and positive self-sufficiency in agriculture) (Kadar, 1984:219).

¹⁴Source: Koves, Andras. The CMEA Countries in the World Economy: Turning Inward or Turning Outward, p.117., Table 18 and Kadar, Bela. Structural Change in the World Economy., p.218, Table 28.

3) The shift to importing semi-finished products reflects the greater use of primarily metallurgical products within imported machinery (Kadar, 1984:219).

4) Adverse trends in the import requirements of the CMEA 6 are also becoming increasingly apparent. These are, in addition to the problems of acquiring appropriate technology for structural transformation, the fact that more and more of the content of Western imports are of a non-competitive nature. The necessary imports are simply not available within the CMEA or it would require lengthy periods of time to develop substitutes.

5) Also, increasingly, the intra-CMEA content of trade, particularly that with the Soviet Union is of a higher Western import intensive nature. Thus, import restriction alone cannot solve the fundamental problem facing the CMEA 6 countries. Nor can the hope of acquiring the needed goods from within the CMEA region solve the problem. Given the commonality of their problem, turning inward would not provide an adequate solution.

Kadar points out that overall, the type of specialization which characterizes East-West trade is of an inter-sectoral nature rather than intra-sectoral. It therefore typifies the trade specialization among that of the OECD and the developing countries rather than that among the OECD countries themselves. Thus, "while CMEA exports consist mainly of raw materials and primary energy, they import mostly industrial goods. And while CMEA industrial exports include mostly goods for final consumption, their industrial imports consist of investment goods" (1984:219).

Although the external balance was achieved, the CMEA 6 failed to restructure their economies. The implications of failing to restructure are quite serious if one considers that their ability to maintain an external balance of trade relied on a forced restriction of imports and the expansion of primarily traditional exports or exports which face increasing worldwide competition. This therefore is not a viable strategy in the long-run. Without a genuine development of an internationally competitive export structure these countries will be condemned to ever-increasing backwardness and austerity. In order to achieve this export structure however and ever changing import structure is necessary. Continued import restrictions serve only to impede this reality.

THE CASE OF HUNGARY

How different has Hungary's response been from that of the CMEA Six as an aggregate? In general, not all that different. Certainly the political factors between the two superpowers were beyond its control as they were for the other CMEA countries. In addition, the energy crisis and the change in CMEA pricing of oil also affected Hungary as a result of its energy dependence on the Soviet Union. Moreover, as with the others, the 1970s saw Hungary's external indebtedness rise to unprecedented levels, as well as the adoption of both import substitution and import restrictive foreign economic policies. Finally, Hungary is also suffering from problems of structural adjustment vis a vis the world economy.

There is however, one major step that Hungary has taken which substantially distinguishes its economy from the others. This has been

the reform of the economic system which was initiated in 1968 and although curtailed during 1973-1979, has since seen a renewed commitment and an accelerated pace of implementation. The reforms have not only had an impact on Hungarian economic life, but have also altered Hungary's economic relations with the world economy. The following section addresses those changes which were implemented in the foreign trade sector as a result of the NEM and then looks at the empirical data to draw conclusions on the effects of the reform on Hungary's economic position.

REFORM OF THE FOREIGN TRADE SECTOR

While the details of the NEM as they apply to the economy as a whole will not be addressed here, there are two general points worth noting. First, the primary goal of the NEM was to transform the traditional centrally planned and state-directed economy into a centrally regulated market-directed economy. The economy was to be guided indirectly by economic regulators (instead of central directives) which would influence the financial environment within which enterprises operated. Second, while the reforms were launched in 1968 by 1973 a counter-reform period elapsed, stunting and/or turning back reforms already taken and paralyzing any new progress. This period lasted until approximately 1978 when the reform proponents gained the upper hand and have since then, begun the reform process anew - amidst the dramatically changed world and domestic environment of the late 1970s. This section includes a discussion of the following changes in

the foreign trade sector¹⁹: 1) the change in organization, 2) reduction in foreign trade planning, 3) reliance on financial regulators and 4) change in ownership regulations.

CHANGES IN THE ORGANIZATION OF FOREIGN TRADE

Under the traditional model of the centrally planned economy there is a state monopoly of foreign trade. Under this system the Ministry of Foreign Trade supervises all foreign trade which is carried out by specialized foreign trade enterprises (FTEs), which are the only authorized enterprises engaged in foreign trade. These enterprises each handle specified products and do not compete with each other either on the domestic or foreign markets.

A major objective of the 1968 reform was to establish direct links between Hungarian enterprises and world economy. At this time many producing firms were given foreign trade rights, although "90% of foreign trade continued to be realized through specialized FTEs" (Naray, 1986:111). For those firms granted foreign trade rights the state continued (through the Ministry of Foreign Trade) to exert control over most of foreign trade decision-making. Between 1972 and 1979, when the reform movement was curtailed, only 10 new firms were given foreign trade rights. Between 1980-1985 however, 150 enterprises were given foreign trade rights and another 1000 or so were given non-hoc rights (Naray, 1986:111).

In 1980 an additional reform was adopted which allowed for competition between FTEs. In other words, parallel foreign trade

¹⁹This discussion is limited to changes as they pertain to trade with the convertible currency market.

rights were introduced. Thus, some products were allowed to be sold on the world market by more than one FTE or enterprise. According to Naray however, more than 90% of Hungary's trade continued to be transacted by centralized means - with one FTE responsible for all of a product's foreign trade activity.

In 1985 more substantial reforms were adopted in the organization of foreign trade. While enterprises had to obtain foreign trade rights from the Ministry prior to trading, the forms for application were increased to 2 - thus expanding the possibility for approval. The simplified procedure gave producing firms the possibility to obtain export rights for the goods they produced provided they exported them to the convertible currency markets and the product was not on a list of exceptions. Imports rights could be applied for if they were to be used for production by the applicant, if they were from the convertible currency market and if they were not on a list of exceptions. A second category of applicants were considered for those who were not direct producing firms, were to trade in nonconvertible currency areas or were interested in items which were on the exception list. This application was for an individual license.

All applications were reviewed by the Ministry of Foreign Trade and could be rejected only if "the foreign trade activity of the applicant would adversely influence the market reputation of other Hungarian enterprises" (Naray, 1986:12). The new rules shortened the time within which the Ministry was to make a decision. Moreover, if an application was rejected, the reasons for such an action had to be stated and could be appealed by the enterprise.

In 1988 the reform in the organization of the foreign trade sector proceeded. First, a merger of the Ministry of domestic Trade and the Ministry of Foreign Trade occurred. In addition a new Decree emerged which allows the firm to decide whether or not it will handle the major part of its foreign trade or arrange for a specialized FTE to do so. Currently, any company, producing or otherwise need only register in order to conduct foreign trade.

In short, it can be seen that while some modifications to the organization of the foreign trade occurred in the 1970s the most significant changes - those which would have a more lasting effect on foreign trade overall - were indeed not implemented until 1985 and after.

REDUCTION IN FOREIGN TRADE PLANNING

Since the initiation of the NEM and up until the 1985 and 1988 reforms, foreign trade planning has been achieved primarily through economic tools and hence was largely indirect. The Ministry of Foreign Trade and the Planning Office developed projected targets for foreign trade based on the economy's overall objectives. Consideration was given to foreign credit availability, external market conditions, import needs and export potential. Enterprises constructed their own plans and told the center what they planned to do.

It is generally acknowledged however, that despite this supposed enterprise autonomy, the national plan substantially affected the priorities of the enterprise. Since staying in good favour with the Ministry was of considerable importance, particularly since the Ministry determined manager bonuses, provided potential subsidies and

other favors, managers were likely to accept the expectations outlined by the Ministry in areas such as exports and imports growth. According to Paul Marer, during the 1970s ministries "typically exerted pressure variously to increase convertible currency exports, to participate in CMEA programs or to supply a domestic manufacturer which in turn affected production, licensing and investment decisions of the firms" (1986:42).

In 1985 changes were made to the enterprise law which gave firms greater autonomy over all aspects of enterprise decision-making, including foreign trade. Ministerial and party intervention in the affairs of the enterprise in the post-1985 period has continued to be high however. As a result, efforts at developing a new corporate law (which would give enterprise legal autonomy from the state) have been accelerated and expected to be passed by Parliament in October 1988. In addition, for the foreign trade sector, the merging of the domestic and foreign trade ministries in mid-1988 should also significantly limit the potential for such intervention.

RELiance ON FINANCIAL REGULATORS

Foreign exchange: One of the most powerful tools the state has controlled even in the present period, has been foreign exchange. Foreign exchange regulations and quotas effect foreign trade targets, enterprise decision-making and the possibility for implementation of foreign trade plans. While these regulations have always been components of the state monopoly of foreign trade, in the late 1970s and 1980s these methods have predominated as a means by which to correct for the imbalances in the external equilibrium.

Foreign exchange and quotas are controlled by the National Bank of Hungary. Enterprises receive foreign exchange only upon authorization from the authorities. When an enterprise earns foreign exchange on the world market it must turn it in to the state in exchange for forints. Other foreign exchange operations such as loans are likewise liable to these restrictions. Such a system provides little incentive to firms to conduct convertible currency trade. It offers no guarantee that a firm earning foreign currency in an efficient manner will be able to obtain it for its use and purposes. In addition, the central dispersal of foreign exchange means that the market is not working and hence the allocation of funds is not based on efficiency criteria but other priorities determined by central authorities.

As reform of the economic system has proceeded in the post-1985 period, control over foreign exchange has become more and more contradictory. Enterprise decision-making, including foreign trade decisions have become increasingly decentralized. Yet foreign currency movements have remained centralized. It is clear that the effectiveness of the reforms in the foreign trade sector can not be fully realized until a genuine market in foreign exchange is established.

Exchange rates: Action was taken in 1968 to improve the linkages between domestic and international prices by simplifying and reducing the number of exchange rates in existence. This was aimed at improving the efficiency in foreign trade. As a result, a unification of trade related effective exchange rates, which previously had been implemented through taxes and subsidies differentiated almost to the product level was instituted (IMF, 1982:18). Thereafter, three exchange rates

existed: the foreign exchange forint used for statistical purposes, the value of which was based on gold parities (considered the official exchange rate), the noncommercial rate of exchange which applied to tourism and certain other nontrade transactions, and the commercial rate of exchange. The commercial rate of exchange was identified as foreign trade multipliers (FTM) which were essentially ratios of the forint to the dollar and to the ruble. The FTM set the terms at which state enterprises, with authorization from the government faced the world market.

At the end of 1981 Hungary adopted a unified exchange rate policy. Since then only one exchange rate has existed for all transactions - commercial or otherwise. In addition, Hungary has chosen to operate its exchange rate regime in line with the international monetary system. The exchange rate is derived on the basis of a weighted basket of nine currencies. The weights are adjusted annually and reflect a suitable average of market exchange rates vis a vis the currencies of its nonruble trading partners. The value of the forint in terms of the basket is adjusted weekly. The National Bank of Hungary has the authority to raise or lower the rate by a cumulative maximum of 1% a year. Larger changes require a decision by a group of government officials. If there is no agreement or the adjust is larger than 4% the decision must be made by the Council of Ministers (IMF:1986,272). The forint has been devalued against international currencies several times in the post-1985 period.

CHANGES IN FOREIGN OWNERSHIP REGULATIONS

From 1972 to the present there has been a dramatic change in

government attitude towards foreign ownership of Hungarian enterprises. While joint ventures in the service sector were legalized in 1972, their legal parameters failed to create attractive conditions for foreign partners. The key points in improving the environment occurred in 1978 - joint ventures were allowed in the productive sector; 1982 - joint ventures were established in custom free zones; and 1985 - major tax concessions were given in key sectors. Over this period of time the government also revised its attitude regarding ownership rights. While initially foreign partners were only allowed a minority share in ownership, currently this restriction does not apply. Furthermore, while joint ventures were only allowed to be established as new enterprises between a Hungarian and Western partner, a new law passed in the Autumn of 1988 allows foreign companies to set up wholly owned subsidiaries in Hungary and to buy into, or even take over, existing Hungarian enterprises through stock purchases. The net result of all of these changes has been to lay the groundwork for an expansion of foreign ownership -- a situation that would have seemed unimaginable 30 years ago when state ownership was regarded as an inviolable aspect of socialism. For a detailed discussion on joint ventures see Chapter 5.

AN EMPIRICAL REVIEW OF HUNGARY'S FOREIGN ECONOMIC PERFORMANCE

Hungary is a small trade dependent economy. Looking at figures for the period 1976-1985 it can be seen that while the percent change in national income (net material product) per year increased rapidly in the early 1970s, it has slowed considerably since then, with two years recording only negative percent changes. The average change per year was 1.97% . On the other hand total trade turnover has increased

rapidly over the same period despite some years of negative percent changes, the average yearly percent increase is 4.21%.¹⁴

The share of trade by region for Hungarian imports and exports has seen no dramatic changes over the 1976-1985 period. (See Figure 3.2 and 3.3.) The CMEA has predominated in Hungary's external trade - ranging from an all time share high in 1976 of 51.5% of its imports to a low of 47.35% in 1980. In Hungary's exports the CMEA also predominate with a high of 56.56% achieved in 1977 and a low of 49.6% reached in 1984. The Soviet Union's share of Hungary's CMEA trade is shown in the following table.

TABLE 3.9
Soviet Union Share of Hungarian Trade,
by Hungary's CMEA and Total Trade

Year	Imports		Exports	
	CMEA	Total	CMEA	Total
1976	53.28	27.46	53.47	30.22
1977	55.01	27.54	53.76	30.41
1978	56.79	27.88	55.13	30.46
1979	58.03	29.35	52.80	28.08
1980	58.46	27.68	56.89	29.27
1981	59.71	28.63	61.47	33.42
1982	59.21	29.50	62.83	33.52
1983	58.83	28.55	62.75	31.57
1984	59.92	29.10	60.72	30.12
1985	60.12	30.04	62.66	33.61

Source: Statistical Yearbook, Hungarian Central Statistical Office, various issues.

¹⁴It is not possible to determine growth of trade as a percent of GDP over time because of the way in which socialist countries determine prices. While foreign trade prices are based on world market prices, domestic prices are based on other criteria. In addition, whereas Hungary's exchange rate has been uniform since 1982, prior to this time it was decided almost by product. Thus, value terms of GDP and foreign trade are not equivalent and hence cannot be compared. Despite these problems, and according to figures by the Hungarian Chamber of Commerce, in 1983 the value of both exports and imports amounted to, respectively 50.3% and 49% of national income (1984:24).

FIGURE 3.1
Hungarian Rates of Growth:
NMP and Trade Turnover
(Constant Prices)

Source: Statistical Yearbook, Hungarian
Central Statistical Office, 1986 and 1984.

FIGURE 3.2
Origin of Hungary's Imports by Region

Source: Statistical Yearbook, Hungarian Central Statistical Office, 1986 and 1984.

FIGURE 3.3
Destination of Hungary's Exports

Source: Statistical Yearbook, Hungarian
Central Statistical Office, 1986 and 1984.

The advanced developed countries' (ADC) share in Hungary's imports achieved an all time high of 40.22% in 1981 and 40.21% in 1980 and reached a low of 34.44% in 1983. Hungary's exports to the ADC achieved a high of 56.56% in 1977 and a low of 49.60% in 1984.

The figures which are the most dramatic are those which look at the percent change by year of both imports and exports broken down by the CMEA and ADC regions. See Figure 3.4 and 3.5. These changes reflect the change in policy which took place as Hungary faced an increasing disequilibrium in its balance of payments and stock of trade. While in the 1968-1973 period both imports and exports to the convertible currency market increased rapidly¹⁷, with the onset of the anti-reform period starting in 1973 new priorities took precedence. Hungary sought to isolate its economy from the turbulent international arena. As a result, export incentives to efficient firms were reduced. Subsidies were withdrawn to those firms that made profits in exports and additional taxes were imposed on excessive profits. Conversely, subsidies were given to those firms that incurred losses in exporting and import subsidies were provided to enterprises to shield them from the effects of world market price increases - particularly of commodities. The net effect was that while exports to the convertible currency market declined during this period, imports from this region continued to grow - and with the additional factor of a loss in terms

¹⁷Index numbers utilized by the Hungarian Statistical Office are calculated by foreign exchange forints until the end of 1975. It is therefore unwieldy to compare the yearly percent change prior to and after 1975.

FIGURE 3.4
Hungary's Yearly Percent Increase in Imports
(Constant Forints)

Source: Statistical Yearbook, Hungarian
Central Statistical Office, 1986 and 1984.

FIGURE 3.5
Hungary's Yearly Percent Increase in Exports
(Constant Forints)

Source: Statistical Yearbook, Hungarian
 Central Statistical Office, 1986 and 1984.

of trade due to the world wide inflation, a considerable disequilibrium began to appear in Hungary's trade balance with the West. (It also experienced a small deficit in trade with the CMEA). See Figure 3.6. In addition, Hungary borrowed heavily from the international financial market in order to pay for the imports and this stock of debt began to reach unprecedented levels as the Table 3.10 on the next page indicates.

It was not until October 1978 that Hungary moved to improve its enormous trade imbalance and growing indebtedness by implementing an import restrictive policy. It also moved to reinstate the reform process at this time. A resolution was passed at a 1978 Central Committee meeting which stated that "the establishment of the foreign economic equilibrium is a major goal to which any other was to be subordinated" (Havasi, 1982:1980). A reemphasis on the central role of exports in Hungarian economic growth was addressed as well as the need to let firms decide their own production structure and the product composition of their exports (Balassa, 1985:177).

These resolutions were adopted at the 12th Party Congress in 1980. This Congress supplemented the initial priority of foreign trade equilibrium with a declaration that "living standards already achieved should be maintained and that living conditions should improve" (Havasi, 1982:190). In the Sixth Five Year Plan (1981-1985) these two major goals were reaffirmed with the addition that "they must be achieved in the right way however to create the right conditions for later more dynamic development" (Havasi, 1982:190). Despite this second commitment, in the 1980s consumption was curtailed in order to

FIGURE 3.6
Hungary's Trade Deficit as a
Percent of Total Trade

Source: Statistical Yearbook, Hungarian
 Central Statistical Office, 1986 and 1984.

achieve the external equilibrium.

TABLE 3.10^{1*}
Hungary's Debt to the West
(Billion U.S. Dollars)

<u>YEAR</u>	<u>GROSS</u>	<u>NET</u>
1971	1.1	0.8
1975	3.1	2.2
1976	4.0	2.9
1977	5.0	3.9
1978	7.3	6.3
1979	8.1	6.9
1980	9.1	7.0
1981	8.7	7.8
1982	7.9	7.2
1983	8.2	6.9
1984	8.8	7.3
1985	11.8	9.5

While austerity measures began in the early 1980s, Hungary was again hit by unfavorable world market events. These included further increases in world energy prices, which substantially affected its terms of trade with the Soviet Union, and rising interest rates on external debt due to the tightening of the international capital market. Moreover the availability of Western credit to the CMEA became restricted in the early 1980s in response to the Polish crisis. A final factor exacerbated Hungary's problems. In 1981 the maturity structure of Hungary's loans showed that more than 38% of the convertible currency debt outstanding had to be repaid within 5 years. Debt-servicing payments already amounted to 33%. In order to solve this financial crisis which peaked in 1982, Hungary joined the IMF and World Bank and obtained loans totalling two billion U.S. dollars. In

^{1*}Source: East-West Technology Transfer: The Trade and Economic Aspects, p.56, Table 8 and Economic Bulletin for Europe, No. 138, p.44.

addition, Hungary introduced a stronger domestic stabilization programme than the one initiated in 1979, obtained bridge financing from the E.I.S. and renewed its commitment to the reform process (Marer, 1986:63).

TABLE 3.11
Hungary's Convertible Currency Trade Surplus
With the CMEA
(Constant forints in billions)

<u>YEAR</u>	<u>FORINTS</u>
1976	5.51
1977	5.31
1978	2.48
1979	8.32
1980	16.92
1981	21.93
1982	23.87
1983	20.02
1984	17.66
1985	13.06

In the post 1982 period Hungary managed to balance its trade in 1983 with a small deficit and 1984 with a small surplus. (See Figure 3.6.) In 1985, however, this achievement was not repeated. It is important to note that while exports did increase in the post 1982 period it is felt by most economists that these exports were of a forced nature and do not reflect a successful process of structural adjustment. This belief is confirmed by the large percent decrease in exports in 1985. Finally, it is worth noting that it is widely believed that a factor in Hungary's ability to achieve a trade balance with the West in 1983 and 1984 was a result of the large surpluses in convertible currency trade conducted within the CMEA. These surpluses have declined post 1983. Figures for Hungary's convertible currency

trade surplus as a result of CMEA trade are indicated in Table 3.11.¹⁹

CONCLUSION

During the past twenty years there have been a number of significant milestones in CMEA Six relations with the world economy. First was their recognition in the late 1960s that systemic features inhibited their ability to develop their economies intensively. As a result, an opening towards the West was needed, if only to acquire the necessary technology. Second, the two decades saw an ebb and flow to political relations which had previously been acutely polarized. Third, the CMEA Six saw their own economies affected by the change in epoch, not only in terms of the oil crisis, but also increasing debt burdens and the problem of adjusting to the structural transformation taking place on a world scale. Finally, by the early 1980s, with an import restrictive policy, the CMEA Six as a region was quite successful in reversing the 1970s trend of increasing external imbalances in trade. However the deleterious effects of a prolonged import restrictive policy have become increasingly recognized.

Hungary's path has not been much different from the other CMEA countries despite the reform process initiated in 1968. That process in the foreign trade sector was impeded by the crisis Hungary faced in its external economy. While certain reforms were initiated, this was done slowly and incrementally, and left intact the basic policy of

¹⁹These figures are approximate, based on taking the difference between the value of all CMEA trade and the value of rouble CMEA trade (expressed in forints) and then converted into constant forints with the use of a socialist price index - a method suggested by Sandor Richter an economist at the Institute of Economics in Budapest. All figures are from Hungarian Statistical Yearbook.

import restriction which itself impeded the reforms from flourishing fully. Despite this it must be acknowledged that the reforms have nevertheless had some effect - even if difficult to quantify in that each modest change resulted in only minor gains. This led to further reforms as Hungary has had to recognize the problems encountered from insufficient reform. This reform process has meant that now, two decades later, Hungary is poised finally to gain from these reforms (government policy willing) - a process which some of the other CMEA countries are only beginning to come to terms with.

Chapter 4

HUNGARIAN FOREIGN ECONOMIC POLICY

Foreign economic policy is and has been, since the 1970s a hotly debated and contentious issue in Hungary. For a small trade dependent economy this should come as no surprise. Yet as a socialist country, where under the traditional centrally planned economy the state holds a monopoly over foreign trade and exports are determined largely by what is left over from the plan, the very existence of the debate is indeed testimony to the extent to which reform thinking, since the 1970s has penetrated all aspects of the Hungarian economy. While in practice the Hungarian authorities have been slow to implement concrete changes in the foreign trade sector (see Chapter 3) this inaction stems in no small part from unresolved policy debates on this very subject.

What then has been the content of this debate? In essence it has focused on the question of whether Hungary's foreign economic policy should turn increasingly inward towards the CMEA or outward towards the West.¹ This question emerged as Hungary began to assess the changes in the world economy brought on by the new epoch and as a consequence of the need to account for how its economy ended up in such a disastrous state by the late 1970s, a state which has continued in the 1980s. There was a need to assess whether its unprecedented external disequilibrium was a result of excessive imports from the West - and hence too great a dependence on the West - or if it was the result of

¹This concept is explained fully in the book by Andras Kovacs, The CMEA Countries in the World Economy: Turning Inwards or Turning Outwards, 1984.

an extremely weak export sector - attributed to either external causes or from the inadequate export potential itself.

The debate has been a highly charged one because of the obvious ideological nature of it. On the one side are those who have argued that Hungary's economy is in a disastrous state precisely because it had opened up too much to the West in the 1970s, reaffirming the Marxist-Leninist notion of the dangers of dependence on the capitalist world economy.² On the other side are those who believe that Hungary's economic disarray is a result of not responding sufficiently to the world economy so that the only possibility for improving its economic position is to further open the economy to the West. This debate has been crucial in determining the future course of economic policy in the second half of the 1980s.

It is important to note that today this debate has become a common theme of Gorbachev's perestroika as well. In Hungary however, because the debate has been in process for so long, the context is considerably different. In fact, since 1985 a general consensus appears to have emerged among policy makers and economists on the side of opening further to the West - and hence reforms have been implemented to expedite the opening. Yet many still feel that the reforms have not moved quickly enough and that a consistent foreign economic policy has yet to be initiated. The ousting of the Kadar leadership in 1988 however signifies the extent to which reform proponents have gained the

²This view was strengthened by the predominance of conservative ideology in the Soviet Union at that time and the fear of stepping too far afield from this line.

upper hand - and the new leadership is expected to adopt a foreign economic policy that is unequivocally oriented towards the West.

This chapter focuses on some important aspects of the debate including: arguments for turning inward; arguments for turning outward; Hungary's structural adjustment problem and, its failure to adopt an appropriate export strategy.³

IN FAVOR OF TURNING INWARD

One of the main Hungarian proponents of turning inward is Ferenc Kozma who has written on the question of economic integration - addressing specifically the process of CMEA integration and economic strategy.⁴ His starting point is that further CMEA integration is the only means by which these countries will be able to develop economically in a manner that a) promotes long run development, b) is of a socialist nature and c) will provide solutions to the particular problems faced by economies of this type (1982:7). He considers the capitalist world economy to be in a new stage of crisis both in terms of the monetary system and inflation as well as the occurrence of shortages in primary energy, raw materials and foodstuffs. This has meant that the system can be maintained only as a distorted system with the following negative consequences. First,

³This discussion does not examine fully all aspects of the debate owing to its complexity. Aspects concerning measuring the degree of openness in an economy is not dealt with, nor measuring Hungary's import absorption potential. The most up to-date writings on these aspects can be found in Acta Oeconomica Vol. 37 (3-4), 1986.

⁴See Economic Integration and Economic Strategy, Akademiai Kiado, Budapest, 1982. This discussion is based on Kozma's book published in 1982. It is not clear whether the author in 1988, still holds these views.

development activities are becoming further centralized in a few centers with the result that development potential is becoming increasingly polarized; and second capitalism has continued to abuse nature - leading to potentially devastating effects on the human environment. Kozma considers both problems to be fatal for mankind. Finally he notes that the capitalist crisis has been particularly destabilizing for West-European capitalism exemplified by what he considers the less than successful expansion of the Common Market (1982:8).

What does this mean in terms of foreign economic policy - specifically with the West? First he argues that one has to understand what motivated the socialist countries to obtain Western technology from the West. In his view they were motivated

"not to simply use the Western technology - nor to use it with the main aim to produce commodities which are competitive on the world market and then export them. Rather the Soviet leadership buys Western equipment, technology and systems of organization first of all as factors accelerating the development of domestic productive forces of production and spurring the imagination of designers, even if after a few years or decades Soviet industry will appear on the Western market with modern finished products as well" (1982:30).

Import substitution then was the aim of the importation of Western technology. It was not considered a means to integrate their economies into the international division of labour. His fear of taking part in the international division of labour stems from the inadequate level of economic development achieved to date by the CMEA countries.

"It would greatly harm the cause of socialism if, in the decades to come, the developed capitalist countries could, in the shape of the European socialist community, set up for

themselves a base of raw material and food suppliers with a cheap medium-skilled workforce to which certain jobs can be farmed out, and which is dependent one-sidedly on Western capital and technology" (1982:31).

Thus while East-West cooperation may yield gains for the socialist countries it must be approached more cautiously than was the case previously and short term policies of cooperation must be couched within an overall strategy, constructed on "the basis of class principles" (1982:31). These policies include the drawing of additional funds either in the form of credit or as operating capital (within limits) to accelerate development, and the increase of trade in order to increase Hungary's absolute solvency and change the dichotomy of Hungary's commodity trade. Finally he argues that these gains from cooperation can only be limited at best because:

"The development of the capitalist world economy including the STR cannot serve as an example for the socialist societies in respect of either the way of life or the model of organizing society and technology and, however important and mutual interests are related to the development of East-West economic relations they will always occupy a secondary place in our foreign economic relations and we can exploit them in the interest of our development only if we link the East-West cooperation closely to the cooperation with socialist countries" (1982:236).

IN FAVOR OF TURNING OUTWARD

One of the leading articulators of this position is Andras Koves. In his view the choice is between regional import substitution and opening up to the world economy. It is not equivalent, however,

"to choosing between world economic relations and CMEA cooperation. To think that the opening would undermine CMEA cooperation is to turn actual economic interrelations upside down. The problem is actually in reverse: without intensive development of world economic relations, cooperation within CMEA would halt..." (Koves, 1984:177)

2

NEC
NEC
NEC

For Koves, Hungary did not open its economy excessively in the 1970s as is argued by Kozma nor does he believe that the existence of the deterioration in Hungary's terms of trade with the West was the primary cause for the increase of imports during this time. Furthermore he disagrees with Kozma's contention that an increase in export activity may counterbalance deterioration in the terms of trade but results in either "efficiency sacrifices or cannot compensate for price losses even with such sacrifices" (Koves, 1985:141). Instead Koves believes that Hungary's ability to cover its import needs has been adversely effected by problems within the CMEA because of declining terms of trade encountered with the Soviet Union and because of the CMEA region's deterioration in economic performance. This section examines each of these arguments in turn, and then addresses the conclusion that imports from the West during the 1970s were in fact not excessive and why such imports must be a necessary and ongoing component of Hungary's foreign economic strategy.

In a significant article by Koves and G. Oblath entitled "Hungarian Foreign Trade in the 1970s" the authors ask whether there is an "unambiguous relationship between the deterioration in the terms of trade and the growth of debts on the basis of a temporal coincidence" (1983:90). The issue therefore, is whether or not a loss in the terms of trade also induces a growth in debt. According to their calculations they argue that this is not necessarily the case. They show that while Hungarian indebtedness grew (mostly towards the West), the deterioration in the terms of trade was in fact greater in relationship to trade within the CMEA and in particular with the Soviet

Union. Between 1970-1980, they have determined that the deterioration in Hungary's terms of trade was a result of import prices in trade with the nonsocialist countries increasing 14.5% more than export prices, whereas with the socialist countries import prices increased 20% more than export prices (1983:90).

If the distinction between industrially developed and developing countries is made, it is also shown that the greater loss in terms of trade (50.2%) is with the LDCs, compared to 5.9% with the developed countries. They attribute this significant loss in terms of trade (both with the Soviet Union and the LDCs) to Hungary's greater trade in commodities with these countries. It is precisely commodities whose price was significantly increased during the 1970s. (Within the CMEA this is due to the new pricing principles adopted in 1975, as was described in chapter 3). Hungary's structure of trade with the West was less adversely effected.

The authors proceed to look at the volume of imports and exports, noting that Hungarian exports to the Soviet Union increased such that a balance was achieved in the early 1980s, despite the loss in terms of trade. This increase in exports however was at a considerable cost. During 1970-1980, imports from socialist countries increased at an annual rate of 5.5% while that of exports increased by 8.5%. What is more, the increase of exports over imports was most significant after 1975 when imports increased by 2.2% annually whereas exports increased 5.4%. Koves and Oblath account for this slowdown in the volume of imports from the Soviet Union as a result of economic constraints within the Soviet Union itself. Thus, contrary to explicit economic

policy intentions of the Hungarians to increase imports from within the CMEA in the second part of the 1970s as a response to the increasing Western debt problem, this policy was not adhered to because of the deteriorating economic growth within the CMEA and mounting internal and external difficulties.

Furthermore, although by 1976-1980 the rate of growth of Hungary's imports from the West overtook those from the socialist countries, had it been able to increase its imports from within the CMEA, the level of imports from the West could have been lower. Hungarian authorities recognized however that if they were to maintain even minimal growth rates some increases in Western imports had to be allowed, even if it was at a reduced rate. As a result, Hungary experienced a simultaneous slowing down of imports from the socialist countries while there was an emerging disequilibrium with its trade with the West (1983:93).

While the authors acknowledge that economic policy mistakes were made during the 1970s in relation to the West which exacerbated the external disequilibrium, they do not believe imports were excessive. Instead, they maintain that if figures for the entire decade are looked at, imports from the West hardly exceed the growth rate of national income. In addition, they believe that no matter what the intended policy was during this time, there was (and is) simply no alternative to increasing imports from the West. They cite three reasons for this:

1) Hungary is dependent upon the import of particular commodities and if its CMEA supply is restricted then it simply must go elsewhere. The authors argue that this would be the case even if there was a limited growth policy and a rational restructuring in the domestic

economy. The commodities they refer to are not only traditional commodities of raw materials and energy, but also imported goods of 'varying modernity and complexity' (Koves and Oblath, 1983:95) which cannot be acquired with the CMEA due to the slowdown in growth and increasing economic tensions.

2) Hungary buys not only machinery and equipment from the West but also intermediate products. This is due not only to problems in the domestic economy, but also due to problems in intra-CMEA cooperation, where semi-finished products are one of its weakest links. They do not consider the import of intermediate products to be superfluous, for the above mentioned reasons as well as for the benefit they yield in the context of export specialization and development. They do recognize however that it was not necessarily the case that Hungary imported the most appropriate products to serve its export potential during this time.⁹

3) Finally, as Hungary increased its exports to the CMEA countries, an ever-increasing share of the export content was dominated by Western imports which included the processing of Western raw materials and parts into finished products to satisfy the end-product

⁹As Inotai suggests "Imports were contained mechanistically. The savings were being achieved decisively by a reduction of so called development imports (including machines, equipment, components improving efficiency and exportability techniques, etc. While the imports of material type products, semi-manufactures and raw materials accounting for a very high share by international standards of Hungarian conventional and convertible currency imports were not contained commensurately...thereby imports on their own, served as an artificial maintenance of the old production pattern which could not stimulate a structural renewal" (1987:10).

character of intra-CMEA trade (Koves and Oblath, 1983:96).

The authors argue therefore that the increasing trade imbalance and subsequent indebtedness to the West was precipitated by two main factors. While on the one hand imports from the West increased to solve the problems of reduced opportunities within the CMEA, on the other hand they also increased in order to support Hungary's increased export deliveries to the CMEA, necessitated by the large deterioration in its terms of trade with this USSR.

The significance of the failure to recognize the consequences of the serious problems within the CMEA is highlighted by the authors who state: "adjustment to the problems in the region was just as necessary as adjustment to the changing price and demand-supply conditions on the world market and..this failure thus exacerbated problems encountered with the West and failed to create the conditions under which long-term solutions can be formulated (1983:101).

In conclusion, it has been suggested that it was not excessive imports from the West which caused the widening external trade disequilibrium. Rather, the reality was more complex. Hungary's rapidly changing relations with its primary trading partner, the Soviet Union, must also be considered.

PROBLEMS OF STRUCTURAL ADJUSTMENT

While Koves argues for the necessity of imports from the West for continual economic development, Kadar looks at the question of Hungary's exports in an effort to understand what were the causes in the 1970s of Hungary's structurally weak export sector. While external factors certainly affected this sector Kadar considers Hungary's

failure to adjust to world market demand to be the single most important reason for the weakness in this sector and the continuation of low exports even today.

One of the basic concerns of economists regarding Hungary's external economic performance has been its loss of ground in the world economy and the lasting and extensive deterioration of relative positions vis a vis the rest of the world. The importance of this loss in position is highlighted by Hungary's strong dependence on export performance and given its small size, the degree to which it is foreign-trade sensitive. According to Kadar, while Hungary's share in world trade amounted to 0.65% in 1938, 0.7% in 1970 and 0.5% in 1980, it hardly achieved 0.4% in 1985. Of greater concern is the fact that in the international industrial division of labour the loss in ground has been particularly extensive. Hungary's share in world industrial exports was 0.9% in 1960, 0.8% in 1970, 0.5% in 1980 and 0.4% in 1985. Finally, in trade in manufactures, the loss of position was experienced across the board. Hungary's share in total CMEA imports of manufactures was 7.6% in 1965 and 4% in 1984. With the developing countries Hungary's share reached a maximum in 1960 of 0.45% decreasing to 0.31% by 1984. With the developed countries, its share totalled 0.27% in 1955, 0.30% in 1970, 0.23% in 1980 and 0.19% in 1983.

This section will look at some of the reasons that Kadar identifies as causes for Hungary's loss of position in the world economy.* These include his concepts of the 'structural vicious

*I have relied on a variety of articles by Kadar in this section. Kadar is Hungary's foremost theorist on global structural transformation.

circle', 'double structural outflanking' and other issues.

Structural vicious circle. Hungary's industry is characterized as a structural vicious circle according to Kadar. He points to a destructive economic policy since the early 1960s which promoted a structural reversal away from machine building to a highly material - (and hence import-intensive) and energy-intensive activities. The reasons for the shift had to do with factors in intra-CMEA cooperation as well as the promotion of industries by the state which were more conducive to administration by central control. He considers this to have been a major set-back which resulted in an industrial structure which emphasizes metallurgy, heavy chemicals, textiles and (within the machinery sector) vehicle production, all of which have become lagging industries in the 1980s. See Table 4.1 for data on Hungary's industrial structure.

Even within Hungary's most successful industrial export industries such as chemicals and metallurgy she faces additional problems owing to the fact that these are based mainly on imported iron ore, coke and hydrocarbons. (The exception to this is in the aluminum industry where Hungary has large deposits of bauxite). In light industry also, the ratio of imported raw materials is very high. The food processing industry is the only industrial branch which is supported by a major domestic raw material base.

Thus more than half of Hungary's industrial production belongs to sectors which do not take advantage of domestic conditions and inputs, but instead, run with imported materials, sources of energy and

TABLE 4.1
Branch Structure of Hungary Industry
by Gross Production

	<u>1975</u>	<u>1985</u>
Mining	7.1 %	5.7 %
Electric energy industry	3.8	4.5
Metallurgy	11.2	9.0
Engineering	23.0	24.6
Machine, Machinery	5.4	5.2
Und. for vehicles	6.6	6.7
Elect. Engineering	3.2	3.4
Telecom., vacuum engineering	2.9	4.3
Precision eng.	1.7	2.4
Metall. mass prod.	3.2	2.3
Building material indust.	3.2	3.0
Chemical industry	17.0	19.5
Heavy industry.....	65.3	66.3
Light Industry	14.8	13.5
Wood processing	2.2	2.0
Paper industry	1.2	1.4
Printing	0.8	1.1
Textile	5.0	4.5
Leather, fur, shoe	3.0	2.3
Clothing	1.8	1.5
Handi/home crafts	0.8	0.7
Miscellaneous industry.....	1.3	1.3
Industry excluding food ...	81.4	81.1
Food industry	18.6	18.9
Total	<u>100.0</u>	<u>100.0</u>

Source: Statistical Yearbook 1985, Hungarian Statistical Office, 1987, p. 111

equipment (1985:249). In addition, the preponderance of these industries in its industrial structure has meant that until the early 1980s there was an ever increasing material intensity of industry.

The viciousness of the circle is such that given the import dependence of its industrial structure, Hungary is required to maintain, if not increase, imports - even during times of difficulty in the world economy. At the same time, it is not concentrating its energies on those industries in which it does hold a comparative advantage.

Kadar notes additional problems with this type of industrial structure. The high capital intensity of the structure has meant that already scarce investment funds (which might be better utilized elsewhere) must be diverted to it. In addition, as a result of the primacy of end-product industrialization which is characteristic of this type of industrial structure, Hungary became, and has continued to be, relatively backward in areas such as packaging, storage and after service sales - all of which inhibit its ability to compete in the international environment.

Double-structural outflanking. Kadar considers the declining primary (agricultural) character of Hungary's exports since 1974 to be one of its greatest achievements. Thus, since 1974, industrial products have represented the majority of Hungary's exports to the OECD. Kadar points out, however, that Hungary's main problem in marketing industrial exports (which consist mostly of finished and semi-finished products of light industry) is not that they are outdated nor is it due to insufficiency of external demand. Instead,

it is a result of changes in international supply due to increased exports by the developing countries in sectors such as textiles and clothing, metallurgy and household machinery - exactly those industrial sectors which Hungary has specialized in since the 1960s. As the market shares of these other countries grow, Hungary will be unable to compete with them due to their comparative advantage in these branches as well as the tariff preferences they receive from the Common Market.

Kadar shows that Hungary has not been successful in "upgrading" its export products. Its terms of trade has deteriorated with the OECD as a result of its weakening competitiveness in manufactures. He compares Hungary with many of the OECD countries which, during the 1970s also experienced a worsening terms of trade. He notes however that these countries responded by transforming their production and export structures. Thus, the volume of OECD imports increased by 12% between 1973-1976 and a further 15% between 1976-1979. Countries like Japan, the FRG, the Netherlands and some semi-industrialized countries successfully adopted "vigorous and elastic foreign trade and structural policies, exploiting a difficult market situation which aimed at increasing their export volume and strengthening their positions in the OECD markets" (1984:246). While Hungary increased its exports into the OECD by 18% between 1973-1979, the Netherlands achieved a 21% increase, the FRG 28%, Austria 34% Japan 44% and Korea 82% - while all facing the same difficult international environment (1984:246).

Kadar refers to double structural outflanking as a two-fold process. On the one hand, Hungary faces an endangered market position

from the side of the structurally backward, labour intensive, light industrial products as a result of the expanding supply from the developing countries and Southern Europe. On the other hand, new competition threatens to appear on the part of some structurally advanced countries as a result of the free trade area for industrial products extending over the countries of the Common Market and EFTA. Kadar believes that this gives advantages to countries at a similar or higher level of development than Hungary which sell high quality light industrial products and consumer durables (1984:248).

Other issues. Kadar points as well to other issues which contribute to Hungary's difficulties in structural adjustment. First is the increased international significance of the service sector. By the mid-1980s the Hungarian export ratio of services to goods hardly attained 1/3 of the world average. Thus, with the exception of the development of tourism, the service sector has remained inadequate and has consequently placed a heavy burden on the export of goods for earnings of foreign exchange (Kadar, 1986d:212).

Another problem is that Hungary's trading relationship with her three main partner groups necessitates a strategy comparable to that of a military strategy of 'three-front warfare'. This is due to the significantly different commodity structures, quality requirements, technical levels and organizational forms which distinguish Hungary's relationships with the CMEA, OECD and developing countries. Kadar maintains that the necessity to respond to the diversity of these three markets means that these trading partners play a "significant role in shaping the problem of Hungary's structural weakness" (Kadar,

1986d:218).

Finally, an additional concern which is consistently raised, not only by Kadar but other economists as well is an "increasing geographical shift of the centers of growth" (Kadar, 1986c:88). While for the first 25 years after World War II the momentum of growth in East and West Europe surpassed the world average, the 1970s and 1980s have seen a deterioration of growth in both these regions, so that Europe has lost ground as the centers of growth have shifted to the Pacific region - defined as the Western part of the American continent, Japan, the Far Eastern developing countries, China, the South Sea Islands and the Soviet Far East.

Why is the geographical shift so crucial for Hungary? Table 4.2 shows Hungary's reliance on Western Europe as a trading partner. While OECD countries totalled 34.8% of Hungary's export trade in 1984, 31.2% was to the Western European countries. Not only has Hungary's trade been concentrated on the slower growing regions (OECD-West Europe and CMEA) but its greatest trade surpluses have been generated from the Soviet Union (due to an export surplus in dollar-account trade) and the Middle East - yet these trade surpluses are unlikely to be sustained. Kadar cites two reasons for this: 1) the foreign trade and foreign exchange positions of the oil exporting countries are getting weaker, while their export expansion and efforts at balancing are getting stronger, and 2) the foreign exchange receipts of the Soviet Union from exports of energy are declining, while its efforts at an agricultural self-sufficiency are getting more intensive (1986c:90). Moreover, developing links with the Pacific countries is not an easy task for

TABLE 4.2
Hungary's Country Pattern of Foreign Trade
(Percent)

	<u>Exports</u>			<u>Imports</u>		
	<u>1975</u>	<u>1981</u>	<u>1984</u>	<u>1975</u>	<u>1981</u>	<u>1984</u>
A. Socialist Countries	72.5	58.1	53.8	65.7	51.5	53.1
CMEA	68.5	54.4	49.6	63.5	48.0	48.6
B. OECD Countries	21.8	30.2	34.8	27.4	40.2	34.9
OECD Europe	20.6	27.9	31.2	24.1	35.7	30.5
Non-Europe	1.2	2.3	3.6	3.3	4.5	4.4
USA	0.6	1.6	2.7	1.9	2.2	1.7
Japan	0.2	0.3	0.4	0.8	1.3	1.1
C. Developing Countries	6.0	11.7	11.4	6.9	8.3	12.0
Total A+B+C ^{\$}	100.0	100.0	100.0	100.0	100.0	100.0

^{\$}Totals may not exactly add to 100% due to rounding.

Source: "Business Herald", 1986/1, p. 14

Hungary given the absence of historical economic ties, geographic distance and cultural and institutionally dissimilarities (Kadar, 1986c:89).

THE LACK OF AN EXPORT STRATEGY

In Chapter 3 it was argued that Hungary experienced and responded to the change in epoch in much the same way as the other CMEA Six. While a policy of import substitution was initially implemented, it was followed by a policy of import restriction. The import restrictive policy helped to solve the external imbalance, but it did not solve the problem of structural adjustment. Hungary distinguished itself from these other economies with the adoption of the NEM in 1968 and in its continuing commitment to reform in the post-1978 period. A fundamental question which emerges is why, in the case of Hungary, didn't the reform process help solve the adjustment to structural change?

Hungarian economists answer this question by citing major policy mistakes. First, the policy of import restriction served its purpose in correcting the external imbalance in the early 1980s, but it did so at the expense of both the domestic growth and the development of an appropriate export sector. Second, it was not preceded by an explicit export promotion strategy in the late 1970s. Without such a strategy, the reforms that were initiated and might have played an increasingly positive role in the export sector were severely inhibited by the import restrictive policy itself.

Bognar explains how critical exports are to Hungary's total economy in a recent article (1985:214):

"the Hungarian economy has become an economy to be guided

(and to be made more dynamic) by exports and the decisive motive power of growth is the expansion of exports. The social aims of the economy and those closely linked to the economy, requiring considerable material input, can only be achieved in the case of successful and increasing exports".

According to Andras Inotai (1987:11), during the late 1970s and early 1980s, the export sector was seen as contributing to the restoration of the equilibrium "to a smaller extent" than import restrictions. As a result, the industrial structure, which was material, energy and capital intensive was maintained and strengthened. The lobbying power of the state enterprises in these sectors grew as it became clear that they were providing necessary exports in the absence of any new structure. The problem was that they were doing so inefficiently, at a high cost, and were siphoning off scarce capital by the withdrawal of funds from well-managed enterprises.

The investment policy of the government also had a key role to play in inhibiting the development of the export sector. According to Bela Balassa (1986:16), the "Fall in investment, particularly in the investment shares in which Hungary has a comparative advantage has not permitted the transformation of the structure of exports and the upgrading of their technological level. Greater profitability and less risk vis a vis the CMEA markets has exacerbated this".

Balassa notes that gross fixed investment fell by 1/5 while industry's share fell from 36.9% to 33.2%, in constant prices. The declines were concentrated in engineering (whose share dropped from 18.6% to a 12.1%) and in light industry (10.1% to a 6.1%). Balassa argues that it is precisely these industries in which Hungary has a comparative advantage in by reason of the availability of relatively

low cost skilled labour. The simultaneous restrictions on the import of machinery from the West has furthered the decline in the technological level of Hungary's engineering and light industries. Finally, Balassa points out that this problem is further exacerbated in the 1986-1990 Five Year Plan, where the investment emphasis continues in the traditional sectors. In this plan the share of mining and electrical energy is projected to increase from a 27% share of investment funds in 1976-1980 and a 38% share in 1981-1985 to a 42% share in 1986-1990 (1986:16, 17).

The import-restrictive policy necessitates centralized control over import licenses and foreign exchange. On a micro level this restricts enterprise autonomy. On a macro level, the state's maintenance of an artificially high international value of the currency has inhibited exports. According to Balassa, Hungary's competitiveness has deteriorated between 1978-1985 because the forint appreciated in real terms by 18%. He argues that this is contrary to reports from the Ministry of Trade which have stated that the forint has been devalued by 27% during this period. Balassa attributes this to inappropriate weighting of foreign currencies in Hungary's currency basket, with a much greater weight given to the U.S. dollar than is warranted by its importance in Hungary's trade (1985:354).

Andras Inotai, in a fairly radical analysis, argues that the reform process never included the external economy. "It was not present as an organic constituent but as an external condition, as a solid but passive factor designed to guarantee the success of the reform process" (1987:14). While he contends that it may have been plausible to

consider the external sector a passive factor at the time of the initiation of the NEM in 1968 when the world economy was calm, it was inappropriate to continue considering it as such during the turbulent 1970s.

CONCLUSION

Foreign economic policy in Hungary in the post-1978 period has been marked by debate and conflict. Policy was initially subordinated to the immediate crisis to correct for the external disequilibrium. Most economists agreed at the time with actions taken by the government to restrict imports as a means for achieving a trade balance and in order to prevent Hungarian insolvency. Where opinions diverged however was in over the future direction of foreign economic policy. For those who agreed with Kozma, the cause of the crisis was the openness of the economy to the West. While room for further East-West cooperation existed, such cooperation was to be advocated only as a method to further Hungarian economic development and only as it could contribute to opportunities for further CMEA economic integration.

For those who agreed with Koves, Kadar and Inotai, the cause of the crisis was more complex. It included the failure to recognize the limits to CMEA interdependence as members countries (particularly the Soviet Union, Hungary's largest trading partner) faced economic decline, as well as the failure to initiate structural adjustment to the changing world market. Thus, while Hungary overcompensated for problems within the CMEA it did so at the expense of promoting more efficient production in sectors demanded by the West. Furthermore, while the import restrictions adopted by the government to solve the

crisis were expected to be only short term measures - it became the long-term policy without the government ever adopting an appropriate export promotion policy. Had an export policy been initiated it would likely have helped solve the external disequilibrium and thereby reduce the need for import restrictions.

While it is clear that the government did not adopt an outward looking foreign economic strategy during this period it did however move ahead on reform of its system - and this meant that in the foreign trade sector changes were gradually introduced. These changes - slow to come and introduced only incrementally have nonetheless wrested more and more control of foreign trade away from the state at the macro level and into the hands of the enterprises at the micro level. These reforms, particularly since 1985 and with the ousting of Kadar in mid-1988 have set the stage for the next period when a more explicit outward looking foreign economic policy is expected to be launched.

Chapter 5

JOINT VENTURE PROMOTION IN HUNGARY

This chapter begins with a discussion of East-West industrial cooperation (EWIC) in Hungary and how joint venture policy has emerged from this framework.¹ Next, joint venture policy in Hungary is reviewed by analyzing four distinct points in time when significant changes were made to joint venture regulations. These points are 1972, 1978, 1982 and 1986². Each period includes a discussion of: the changes made to the original Decree of 1972; the political and ideological issues which were at stake; and the effects of these changes on the number, size of investment and type of joint ventures established. Before starting however, a brief overview of the period 1972-1987 is provided.

OVERVIEW

Hungary's interest in joint ventures dates back to the mid-1960s when it was recognized that the economy had to shift from extensive to intensive development and that it was therefore necessary to import technology from the West. It was also a time when the reform movement

¹EWIC is a term used to refer to East-West industrial cooperation. While it includes joint venture arrangements, they have been only a small proportion of all types of industrial cooperation. In this paper industrial cooperation refers to non-joint venture, (i.e. non-equity) types of cooperation. Non-equity EWIC has been to a large extent a precursor to joint ventures and thus it is important to examine for what it shows about the advantages and disadvantages of forms of East-West economic relations that are more complex than trade.

²An Order was included in 1979 on the implementation of Decree No 28/1972. It provides clarifications on the Decree such as what type of foreign partner would be recognized by the Hungarian government and the number of Hungarian firms which could be involved in the joint venture. See "Joint Ventures in Hungary", Review of Socialist Law, 1987 No. 4.

was strong in Hungary and when the New Economic Mechanism was launched.

However propitious these times were for the implementation of a joint venture policy from the standpoint of economic rationale, this type of policy was nevertheless constrained by factors which were of a political and ideological nature. This is not surprising considering the fact that a successful joint venture policy would challenge some of the traditional tenets of socialist ideology. The most fundamental challenges were to the principle of state ownership of the means of production, the practice of CMEA autarchy and self-sufficiency and to the state's control over all aspects of the economy. Moreover, by launching the NEM, Hungary was already engaged in a significant experiment in the domestic arena which sought to reform the traditional economic mechanism of the socialist economies. At the time it was uncertain whether the NEM would be allowed to proceed without the intervention of both anti-reform proponents within Hungary, but more importantly, without direct intervention from the Soviet Union. To launch a wide-ranging joint venture policy which would involved intensive relations with the capitalist world at an unprecedented level was farther afield than the reformers felt able to go.

While East-West non-equity industrial cooperation became the standard method for implementing the transfer of Western technology (in addition to the massive import of technology which had severe ramifications on the balance of payments and stock of debt), in 1972 Hungary did introduce a Decree by the Ministry of Finance which permitted the 'establishment of joint economic associations with foreigners'. The Decree however was extremely limited and allowed for

such associations only in the sphere of services.³ The late 1970s also saw the amendment to the original joint venture Decree to allow for such associations in the production sphere. Hungary recognized that political and ideological constraints regarding had to be loosened if the joint venture policy was to be successful.

During the early 1980s, thanks to the persistence of Hungarian economists, many state policy-makers came to recognize that Hungary's development potential is affected by the world economy and that it is therefore necessary to participate actively in it. As a result, and as a consequence of the declining interest in EWIC by Western partners, Hungary's joint venture regulations have undergone considerable revisions.

EWIC

East-West industrial cooperation has been an important area of economic relations between East and West since the mid-1960s. While there is no generally agreed upon definition of this phenomena, the Economic Commission of Europe of the United Nations defines it as:

"the economic relationships and activities arising from contracts extending over a number of years between partners belonging to different economic systems which go beyond the straight-forward sale or purchase of goods and services and

³The Decree by the Ministry of Finance has never been enacted into law. In principle therefore, a higher body could circumvent this Decree if it wanted to. Peter Naray (personal communication, February 1988), in the Ministry of Foreign Trade pointed out that since the government is strongly in support of joint ventures this would be unlikely to occur. Enacting the Decree however into law would nevertheless reinforce the government's intent to fully support the joint venture process. Throughout the course of this thesis the words legislation, regulations and Decree will be used interchangeably even though legally, it has not been enacted into law.

includes a set of complimentary or reciprocally matching operations in production, in the development and transfer of technology, in marketing" (UN ECE, 1973:2).

It is cooperation through contracts, which, for the most part, do not involve Western equity participation.

INTEREST IN EWIC

Eastern perspective. EWIC was to play an important role in their economies, facilitating the shift from extensive to intensive growth. It was (and still is) seen as a way to gain access to Western technology, including the appropriate production know-how. With this technology the Eastern countries expected to increase their production capacity, efficiency, technical level and hence, quality of output.

Moreover, EWIC was expected to contribute to the export potential of the East European countries - a most important expectation as these countries faced increasingly large balance of payment problems. Thus, it was expected that EWIC would provide access to Western marketing networks as well as teach Hungarian managers the necessary marketing skills- which as a result of their shortage economies, is sorely lacking.

Finally, EWIC arrangements were expected to be self-financing. This has been accomplished by provisions in the agreements for payments in resultant products. This provision has enabled the Eastern European countries to acquire technology which would otherwise be prohibitively expensive.

Western perspective. While EWIC agreements have largely been a result of the Eastern European countries' initiatives, the Western countries did recognize the potential for a profitable outcome in these

arrangements. From their perspective the most important consideration has been the access into the Eastern European market (or keeping a presence in such a market) with the hope of reaching the CMEA market at large. EWIC has been seen as an opportunity for the Western partner to make the necessary Eastern contacts which will stimulate further sales, particularly in products which are obsolete on the Western market (Weinert, 1986:286).

EWIC DATA AND ANALYSIS

Carl McMillan, in a study at Carleton University, categorized EWIC activities by their level of complexity. Level I consists of general framework agreements with Western firms which are general protocol agreements - or the intention to cooperate. Level II consists of substantive, non-equity cooperation agreements with Western firms which include a broad range of activities and sectors but are mainly directed toward the 'utilization, modernization and/or expansion of industry in the Eastern partner countries'. Level III includes agreements for joint projects in third countries (mostly developing countries) which consist primarily of turnkey and other capital projects and Level IV includes the operation of joint companies distinguished by location - either in the East or the West. These companies are in the form of joint equity ventures with a broad range of economic purposes (McMillan, 1981:58,59). According to McMillan, joint ventures can be distinguished from other forms of EWIC in that they are:

"a contractual arrangement between East and West enterprises under which an identifiable organization entity is established specifically for the purpose of joint production,

marketing or related activities such as research and development. Within this organizational framework, the parties to a joint venture contract to pool their productive resources, to manage operations jointly and to share associated risks" (McMillan, 1974:1).

According to McMillan's study which was last updated at the end of 1980, (among the Eastern European countries and the Soviet Union) accounted for 8% of Level I agreements (48 agreements). Both the Soviet Union and Poland had greater shares, 64% and 9% respectively. Hungary concluded, among the CMEA, the highest percentage of both Level II (33%) or 455 agreements and Level III (30%) or 76 agreements. In Level IV - joint ventures - only Hungary, Romania, Poland and Bulgaria permitted foreign equity investment in the East and as a percentage Hungary held 47% (8) of the total joint ventures, the same share as Romania. In terms of joint ventures in the West, Hungary's share was 16% (51 ventures) while both Poland and the USSR shares were greater (McMillan, 1981:58).

From McMillan's study it can be seen that Hungary has held a leading position among the CMEA countries in terms of the number of agreements signed in levels II and III. The reason for the low level of joint ventures in Hungary will be analyzed in the following section. Suffice it to say at this point that while Hungary was among the first of the socialist countries to allow joint ventures (Yugoslavia and Romania having initiated them first), its results were not substantial and as a proportion of its total EWIC agreements, can be considered relatively insignificant.

DECLINE IN INTEREST IN EWIC

According to a Bela Kadar (1983) and Klaus Bolz, (1984) EWIC in

Hungary has stagnated since the early 1980s. Klaus Bolz suggests that the turning point may be considered as of the end of 1982. His figures show that while in 1982 72 agreements were concluded, the number of agreements actually in existence between 1981 and 1982 increased by only 4. Therefore, while a number of former agreements expired each year, by 1982 the number of expiries must have almost been as high as the number of new agreements (Bolz, 1984:244).

Both Kadar and Bolz mention a number of reasons for the stagnation. Some of the most important are noted below:

Hungarian factors for decline in ENIC.

Exports: The lack of breakthrough in achieving a sizeable and stable export base in convertible currencies. From tables 5.1 and 5.2 it can be seen that a) exports have grown relatively slowly and have not significantly outpaced imports and b) while the annual balance of exports to imports has been in surplus overall it has been a result of FRG turnover compensating for many of the deficits incurred with the other partners.

Restriction of market access: The restriction of Western market access imposed on the Eastern countries by the Western partner - owing to the latter's stated fear of competition - has meant that the Eastern European country has had little success in developing convertible currency export markets.

Limitations of technology transfer: Hungary's ability to compete in the international arena has not been advanced as a result of ENIC because the Western partner has transferred only second or third rate technology.

TABLE 5.1
Development of the Total Number
of Hungarian Cooperation Agreements and
Cooperation-related Trade

<u>Year</u>	<u>Imports</u> <u>Million</u> <u>Forint</u>	<u>% of</u> <u>Prev.</u> <u>Year</u>	<u>Exports</u> <u>Million</u> <u>Forint</u>	<u>% of</u> <u>Prev.</u> <u>Year</u>	<u>No. of</u> <u>Agreements</u>	
1978	4,546.1		5,149.7		363	
1979	4,615.3	101.5	6,559.1	127.4	390	107.4
1980	4,310.5	93.4	6,421.9	97.9	451	115.6
1981	5,606.7	130.1	6,469.8	100.7	504	111.8
1982	5,454.2	97.3	7,057.6	109.1	508	100.8

Taken from Bols, Klaus page 245.

TABLE 5.2
Hungary's Cooperation Linked Turnover with its
Principal Partner Nations in Convertible
Currency - 1982
(Million Forints)

<u>Country</u>	<u>Imports</u>	<u>Exports</u>
Yugoslavia	2,048.7	1,835.8
FRG	1,305.1	2,410.4
France	394.1	470.1
USA	448.1	386.1
Sweden	379.7	389.6
U.K.	369.1	296.5
Austria	210.3	332.3
Italy	71.5	379.6

Taken from page 245, Bols, Klaus.

Characteristics of the economic management system: The enterprise demand for structural change (technological development) is not high as a result of the centrally planned economy. Also, an interest in EWIC may only be a means to acquire missing inputs and technologies from Western sources which will enable the enterprise to sell to the CMEA market. If the input necessary for EWIC can only be furnished by a Western supplier however and this input(s) is costly - the more difficulties there are for the Hungarian enterprise and the less likely it will be interested in EWIC.

Western factors for decline in EWIC

Political sphere: 'Sensitivity to politics' is mentioned by Kadar who notes that the policies of the left-centre or social democratic governments in the OECD countries who have been committed to trade unions and job protection have constrained EWIC relations. In addition, as a result of world economic conditions, there has been less interest in more risky undertakings, particularly with the socialist countries. Finally, superpower tensions and the Polish crisis in the early 1980s has inhibited Western interest in Eastern Europe.

Hungarian economy: Problems of growth, debt and import restrictions have adversely affected Western interest in industrial cooperation. Moreover, access to the CMEA market has not been satisfactory.

World economic processes: According to Kadar (1983:17), as technical development has been increasingly concentrated due to higher research and development costs, larger initial investment outlays and the heightened riskiness of such ventures owing to the uncertain world

economic situation, "the movement of technologies are increasingly intertwined with movements of capital" (Kadar, 1983:17). This intertwining has meant that the bargaining power of the technology exporter has been strengthened over time.

While in the late 1960s and early 1970s capital exporters were concerned with nationalizations and expropriations - and hence many preferred to separate ownership of capital and technology transfer - after 1975 these same capital exporters, whose bargaining position had grown stronger, began to transfer the most advanced technologies only "in closer forms involving ownership, in the framework of cooperation involving equity participation, since this form ensures the larger volume of profit linked to the volume of manufacture, and also opportunities for control over the utilization of the new technology" (Kadar, 1983:18).

While Western interest in ENIC was promising in the late 1960s and early 1970s, the conclusion of agreements was mostly dependent on the Western partner's willingness to accept economic relationships which did not include the issue of ownership rights. This willingness has been weakened as world economic processes have affected technical development and in fact, many MNCs now want to link technology transfer to equity participation.

It is Kadar's opinion that there is a direct correlation between those medium and developing countries which liberalized their importing of capital regulations in the 1970s and their current successful integration in the international division of labour. Those countries

which did not liberalize their regulations however have found themselves lagging behind both in technical development and structural change (Kadar, 1983:18).

In short, during the 1970s an interfacing of interests between Hungary and the West resulted in the expansion of economic cooperation through inter-enterprise industrial cooperation. In the 1980s however, interest in ENIC began to wane due to both domestic reconsideration and world economic processes. In order to modernize the economy and expand convertible currency exports, Hungary has been forced to initiate new ways in which these goals can be achieved. It is in this context that joint venture promotion has, in the 1980s, become a vital part of Hungary's foreign economic policy.

JOINT VENTURE PROMOTION

In this section of the chapter, the evolution of joint venture promotion will be examined. While joint ventures were initiated in 1972, in the subsequent 16 years Hungarian policy-makers were compelled, due to changes in the world economy, to liberalize the regulations in order for the policy to succeed.

1972 DECREE

LEGISLATIVE ENVIRONMENT

As a result of discussions initiated in 1968 concerning the viability of foreign direct investment in Hungary, the Hungarian Presidential Council in December 1970 passed a resolution in support of East-West joint ventures. This resolution in turn authorized the Ministry of Finance to establish appropriate joint venture rules. In October 1972 Decree No. 28 was issued by the Ministry of Finance

determining the parameters within which joint venture arrangements were to be conducted. The Decree was comprehensive in nature, providing a seemingly transparent and propitious framework for the establishment of joint ventures. The fact is, however, that the Decree was quite restrictive in nature and thus greatly limited the possibilities for a successful strategy.

Goals of the 1972 Joint Venture Policy: The goals of the policy were, according to Toldy-Osz to:

"increase the technical and economic standard...the development of commercial relations and to bring profit. Additional secondary considerations included the better catering for home markets and a higher level of performance of deliveries under foreign contracts" (1974:15).

Access to Western technology therefore was the primary motivation. The technology transfer included both embodied and disembodied technology. In his 1974 study of joint ventures in Eastern Europe McMillan identified two additional and fundamental objectives underlying the above-mentioned aims: to ease balance of payments problems with the West, and in the long run, to ensure that the development of the Hungarian economy proceeds apace with the world economy (1974:17).⁴

Finally, it is important to note how the possibility of joint ventures provided additional opportunities than those available in previously existing forms of industrial cooperation agreements.

According to McMillan that was to be accomplished by:

⁴According to Toldy-Osz it would be wrong to assume that a primary aim of the Decree was to obtain foreign capital. As he points out, Hungary was able to get loans at cheaper rates of interest than the foreign partner usually wanted to secure as profit in the case of association. Therefore "what Hungary aims at with the engagement of foreign capital is primarily joint financial interest" (1974:16).

"Vesting the Western partner with a direct interest in the successful application of his technology by giving him a share in profits and losses. It was felt that this commitment, together with the continuing contacts afforded by shared operational control offers the best guarantees that Eastern participants will receive the most up-to-date technology, gain the full market advantages of Western sales networks and have the most direct access to Western managerial know-how" (1974:18).

Basic conditions: The establishment of joint economic associations with foreigners was primarily oriented to sales, commercial, research and development activities. Only under exceptional cases, requiring the full consent of the Council of Ministers were joint associations allowed to be directly involved in production activities. It was felt that since the primary purpose of the joint associations was to improve the existing technical level it did not need to be directly involved in the production process. This basic condition was in fact one of the most restrictive aspects of the entire Decree. Western partners were thus expected to be content with not being partial owners of productive facilities, but rather contracting (in the name of the joint venture) with domestic enterprises, usually the Hungarian's parent enterprise, for production under joint-venture determined specification and quality control.

According to McMillan:

"In effect, the foreign firm established in association with the Hungarian enterprise an on-the-spot liaison office for contract manufacturing, subcontracting and other forms of cooperation. The major incentive for the Western firm in such an arrangement is the possibility, through a direct presence in Hungary and closer working relations with the Hungarian enterprise, of acquiring greater control over production and a more effective say in marketing operation in Hungary and elsewhere in Eastern Europe" (1974:62).

Joint-ventures were expected to export to convertible currency

markets. They were not therefore, allowed to affect the balance of payments adversely but rather, were expected to improve it. They were expected to earn sufficient convertible currencies to pay for required purchases of equipment, components and supplies from the West and also for the repatriation of their profits and assets.

While there was no minimum level of participation by the foreign partner specified in general, a foreign partner's equity share was limited to 49% holding. In reference to the joint-venture's legal form McMillan considered them to be an unusual hybrid. In his view:

"Their complex legal form reflects an attempt to reconcile the need to attract private Western capital and technology with the public ownership principles of a socialist society. They are essentially contractual in nature, with the equity relationship between the partners established in a basic contract. While they may also take the form of 'joint stock company' with equity shares formally created, the restrictions on disposal of such shares makes this latter variant of doubtful practical significance" (1974:2).

In general, the Western partner's voice in management is not limited by its equity share. The partner relationship is negotiated prior to establishing the joint venture and, subject to the approval of the Ministry of Finance. After the deduction of nominal expenses, depreciation and allocations to a "risk fund (mandatory), and an "employee participation fund" (optional), the remaining profits were taxed at a rate of 40% on profit up to 20% of the association's net assets and 60% on additional profit. Partial refunds were provided in the case of the joint-venture reinvesting its profit.

POLITICAL ENVIRONMENT FOR JOINT VENTURES

One would have expected Hungary to launch a strong promotional campaign to advertise its new regulations. After all, the only

possibility for success with joint ventures was to provide the potential Western partner with sufficient information on which it could make its decision. According to McMillan, the Hungarians did just the opposite however, and generally tended to play down the joint venture possibility. He cites two examples in reference to this point: 1) although it was decided in 1970 to allow joint economic associations, it was not until 1972 that a formal Decree was actually issued and, 2) unlike Romania and Yugoslavia, which looked for any occasion to publicize their new joint venture laws, the Hungarians were quiet.

Thus McMillan notes:

"in an interview on Hungarian cooperation arrangements with the West held a few months after the Decree was issued...the Hungarian Deputy Trade Minister made no reference to the possibilities of joint ventures in Hungary" (1974:24).

McMillan argues that the reason for this reticence probably had to do with Hungary's generally conservative foreign policy stance. Thus, while in the domestic sphere the NEM was taking hold, directly challenging some basic tenets of the Stalinist economic model, Hungary was not willing to openly challenge its assumptions regarding economic relations with the capitalist world. Allowing direct foreign investment in Hungary was such a challenge.

It can be assumed therefore, that limiting joint ownership to the non-productive sphere could be justified without having to directly confront, at the level of ideology, the notion of socialist ownership. In addition, as Andras Rajki commented,

"1972 was a difficult period. Some people in the government and in the Party wanted to go ahead with opening up towards the world economy and some wanted to orient the economy more the East. Even the joint-venture legislation could be

considered as a battle between the two factions" (Andras Rajki, personal communication, January 1988).

RESULTS OF THE 1972 DECREE

Prior to the Decree, and despite the lack of publicity, by 1972 eleven concrete proposals were received from foreign partners (Marer, 1986:120). Two of these would have required a substantial dollar investment (over 100 million U.S. dollars) and were involved in joint production of ball bearings and joint assembly of automobiles. These proposals however were rejected by the Ministry of Finance because of Hungary's resistance to joint ventures in the production sphere (1986:130).

Between 1972 and 1978 (when regulations were liberalized), a total of three joint ventures were established with a total of \$2,507,000 original capital invested. The foreign share in the registered capital was less than 50% in each case. Of the three, 1 was in the production sector - in the pharmaceutical industry, 1 was in both the production and service sector in primarily the computer and electronics industry and 1 was in the service sector in the form of trade representation (although it had originally been founded for the purposes of production). See Table 5.3 and 5.4 on pages 156A-D. It is important to note that the production oriented joint ventures were not direct producing joint ventures.

1978 AMENDMENTS

LEGISLATIVE ENVIRONMENT

Goals of the joint venture policy: The goals of the joint venture policy did not change. Authorities continued to lay emphasis on

technological development and increased convertible currency export earnings - or in certain cases, convertible currency import savings. As in 1972 it was also expected that joint ventures would make a profit (at least after initial difficulties) and would enable the Hungarian enterprise to achieve its economic goals (Toldy-Osz, 1979:22).

Basic conditions: In May 1977, revisions to Decree 28/1972 were made (officially adopted as of 1978). The Decree was amended to allow the establishment of direct producing joint ventures. In addition, while foreign capital shares could not exceed 49% in general, in those ventures established in the financial (banking) and service sectors, this percentage could be higher. The financial sector therefore was not considered a protected sector. Also the high rates of taxation were eased to 40%.

Reasons for the changes in the legislation: The decision to allow the establishment of direct producing joint ventures was made because the 1972 Decree was not getting results. According to Andras Rajki (personal communication, January 1988), "It turned out that the 1972 law didn't make sense, it didn't attract investors. So it meant some rethinking. In 1977 some government and Party officials who wanted to put the break on reform gave the green light". According to Toldy-Osz, policy-makers identified a number of reasons for the failure. First, they understood that the Western partner's interest and willingness to use its intellectual knowledge was greater in the case of direct production and that therefore the goals of a joint production company could be realized more consistently than otherwise. Also,

better results could be achieved if the Western partner played a greater role in the direct management of the operation rather than simply contracting a Hungarian enterprise to undertake the production. Second, the policy-makers felt that joint ventures which only established simple cooperation relations were not maximizing the potential offered than if entirely common interests in both production and marketing were allowed (Toldy-Osz, 1979:24).

Moreover, Hungary faced increasing difficulties in her balance of payments as well as the dramatic growth in the stock of her debt. Given this situation it seems likely that the authorities felt compelled to create a more satisfactory environment within which to attract direct foreign investment than had previously been the case. The intent of the investment was not the importing of foreign capital per say, but rather in order to acquire the technology (both embodied and disembodied) necessary for technical development and increasing convertible currency export earnings.

POLITICAL ENVIRONMENT

In 1978 the strategic role of joint ventures was discussed in a high level government meeting. According to Marer, as a result of this meeting the council concluded that:

"joint ventures should be considered a viable alternative form of cooperation with Western firms, that the rules and possibilities should be publicized and promoted and that the relevant ministries should provide financial support for worthwhile ventures" (1986:130).

It is difficult however to determine exactly how the authorities justified, in ideological terms, the break from their previous cautious stance. In fact, when this question was raised in numerous interviews

the response was invariably that ideology as such was not an issue, but rather the debates were focused on whether such a policy could effectively solve some of Hungary's economic problems. If this was indeed the case, a number of additional points are worth mentioning. First, the pro-reform movement was beginning to gain momentum at this time after the anti-reform hiatus. By 1977 such an amendment would have seemed the only plausible solution to encourage Western direct investment. Second, it hardly could be argued that this amendment would threaten the socialist state productive sector, particularly given the paucity of Western funds that were in fact invested between 1972-1976. Third, by 1977 in the environment of detente and the successful completion of the Helsinki Accords, the space in the realm of foreign economic policy in which Hungary felt it could manoeuvre independently of the Soviet Union had likely increased.

RESULTS OF THE 1978 AMENDMENTS

From 1978 until 1982 eight joint ventures were established. The capital invested totalled \$27,960,000 (US). While the figure is not large it greatly exceeds the 1972 period figure of \$2,507,000 (US). The majority of the investment total however, that is, 20 million US\$ was for the purposes of the CIB (banking) joint venture established in 1979. The CIB was the first joint venture where the Western partner was the majority (66%) shareholder, where a joint venture was established in a custom free zone and where a joint venture was authorized in the financial sector. Of the three other joint ventures established during this period, two were located in the production sector (1 of which was in the pharmaceutical industry) and the

remaining one in the service sector in a custom free zone - in the tourism and trade representation industries. The percent of foreign control in each of these was less than 50%. See Tables 5.3 and 5.4 page 113A-D.

1982 REGULATION

LEGISLATIVE ENVIRONMENT

Goals of joint venture policy: No change.

Basic conditions: At the end of 1982 a Decree issued jointly by the Minister of Finance and the Minister of Foreign Trade approved the establishment of joint ventures (and wholly owned subsidiaries) in custom free zones. In Hungary, there is no designated free-zone, rather any real estate site can be chosen (with the approval of the Minister of Finance) as long as the property can be fenced in and the movement of people and goods can be controlled by the customs authority. Thus, no new real estate or infrastructural development was needed to implement this regulation.

The off-shore companies qualify as foreign entities for the purpose of most Hungarian rules. They are exempt from most Hungarian foreign-currency and foreign trade rules and from restrictions governing Hungarian enterprises. These firms keep their accounts in convertible currencies, they can keep their reserves in foreign banks and can contract loans abroad without a permit from the foreign exchange authority (Gabor, 1987:11). As off-shore companies they are able to import their needed materials custom free, but if they wish to sell their products in Hungary they are liable to a customs duty. In addition, they can only export to those enterprises which have foreign

trade rights. It is expected therefore that the main purpose of the companies is the reexport of their production.

Reasons for the legislation: In a recent article McMillan summed up the East European policy dilemma of reconciling foreign private investment with the principle of state ownership and national planning in the following way:

"Too great an integration of foreign investment into the host system may increasingly undermine those valued attributes (while also serving to discourage potential investors who fear the uncertainty created by the interventionism of the system). On the other hand, too great a separation through special regulatory treatment of foreign owned firms, places at serious risk the desired, competitive and other, spillover effects from foreign investment" (1986:269).

In the case of Hungary, the establishment of a customs free zone was not motivated by such a policy dilemma (which McMillan acknowledges in the article), but rather as a means by which to provide further incentives to Western partners interested in establishing joint ventures in Hungary. In addition to customs savings and tax incentives, the Western partner does not have to abide by most Hungarian statutory rules which are contrary to customary Western business practices. Examples of this would be pricing of products and the setting of wages (both of which are relatively controlled by state authorities in Hungary).

Hungary, unlike some of the other Eastern European countries, did not create the custom free zone to separate Western practices from the host system. The purpose was not intended to create an "enclave" of foreign investments to be kept in isolation of the domestic economy. McMillan's point, however, more generally raises the question as to the

potential effectiveness of a joint venture in terms of competition and spill over effects when it operates in a separate regulated environment. This question does apply to Hungary, and as he point out later in his article, it is the perfect place within which to test the impact of the "enclave" approach since not all the joint ventures operate within the regulatory zone.

POLITICAL ENVIRONMENT

During this period, according to those interviewed, ideological considerations were not an issue. The initiation of a custom free zone did not significantly alter the existent joint venture policy. Rather, it was implemented in an effort to determine the most effective way to attract foreign investment.

RESULTS OF THE DECREE

Between 1982 and 1986 39 joint ventures were established. Of interest is that only three of these were in a custom free zone. The total original capital invested during this time was \$65,586,000 (U.S.). This figure is more than double the total of the two previous periods combined. Of these joint ventures there were six instances where the Hungarian enterprise was not the majority share holder. The joint ventures vary in type of function with 20 in production, 16 in services and three in both. Twenty-eight of these were established in the following sectors: financial (2), computers (3), trade representation (3), tourism (4), pharmaceuticals (4), clothing (1), construction (4), agriculture (6) and electronic (1). The FRG was the single most frequent partner, establishing 11 joint ventures while Austria and Switzerland both established 6. See Tables 5.3 and 5.4 page 113A-D.

TABLE 5.3 (Continued)

				INDUSTRY	
				SECTOR	
				P R O D U C T I O N	
				F I N A N C I A L	
				T R A D I N G	
				C O N S T R U C T I O N	
				C H E M I C A L	
				M E T A L L U R G I C A L	
				M A C H I N E R Y	
				E L E C T R I C I T Y	
				T R A N S P O R T A T I O N	
				C O M M U N I C A T I O N	
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Source: Kulfoldi Reszveteli Vegyesvállalatok Magyarországon Című, Magyar Gazdasági Kamara, 1988
 Joint Ventures in Hungary with Foreign Participation (Register), Hungarian Chamber of Commerce, 1987
 "Joint Ventures-a Complete List", Hungarian Trade Journal, 1988
 East-West Joint Ventures, Economic Commission for Europe, United Nations 1988

Note: U.S. dollars figures calculated with the use of the relevant exchange rates listed in:
 I.M.F. International Financial Statistics and in Hungary: A Decade of Economic
 Reform, (Radice, Swain, eds) page 173 (see Bibliography for full citation).

TABLE 5.4
Joint Ventures in Hungary
Breakdown by Period

			INDUSTRY										
			F I N A N C I A L	C O M M U N I T Y	T R A D E	T O U R I S M	P R O P E R T Y	C O N S T R U C T I O N	A G R I C U L T U R E	E N E R G Y	D O M E S T I C A N		
ORIGINAL CAPITAL INVESTED IN US\$ (000's)			SECTOR TOTAL										
Breakdown by Sector													
1972-1977	Production	591	1	0	0	0	0	1	0	0	0	0	
	Service	270	1	0	0	1	0	0	0	0	0	0	
	Both	1,646	1	0	0	0	0	0	0	0	0	0	
	Total	2,507	3	0	0	1	0	1	0	0	0	0	
1978-1981	Production	5,198	2	0	0	0	0	1	0	0	0	0	
	Service	22,762	2	1	0	1	1	0	0	0	0	0	
	Both	0	0	0	0	0	0	0	0	0	0	0	
	Total	27,960	4	1	0	1	1	1	0	0	0	0	
1982-1985	Production	25,524	20	0	1	0	0	3	2	2	6	1	
	Service	25,295	16	2	3	2	3	0	0	0	0	0	
	Both	14,768	3	0	0	0	1	0	0	2	0	0	
	Total	65,586	39	2	4	2	4	3	2	4	6	1	
1986-1987	Production	71,831	44	0	1	0	0	2	10	3	4	3	
	Service	32,581	17	1	6	2	3	0	1	3	1	0	
	Both	0	0	0	0	0	0	0	0	0	0	0	
	Total	104,413	61	1	7	2	3	2	11	6	5	3	
TOTAL ALL YEARS			200,466	107	4	11	6	8	7	13	10	11	4
1987	Production	60348	35	0	1	0	0	2	8	1	3	3	
	Service	7258	8	0	3	1	2	0	0	1	1	0	
	Both	0	0	0	0	0	0	0	0	0	0	0	
	Total	67606	43	0	4	1	2	2	8	2	4	3	

Source: See previous table

1986 AMENDMENTS

LEGISLATIVE ENVIRONMENT

Goals of policy: According to Laszlo Borbely, Director General, Ministry of Finance the following is expected in the second half of the 1980s from the establishment of joint companies and the 'livening of this activity':

"We expect first of all that it should further the raising of the technical standard of the economy by the inflow of advanced technologies. An important condition for this is that cooperation with the foreign partner should be lasting and should rely on mutual interest. The business success of the joint company is also inseparable from that by its management and operation it should contribute to the learning and spreading of modern management and organization techniques, a higher production culture.

It is an unchanged goal that the joint companies should contribute to the export capacities of the economy, primarily to the increase of convertible currency exports. This is obviously the common interest of the partners in order that their venture should be profitable. At the same time the establishment of joint companies offers an opportunity to obtain foreign capital, to expand the sources for development in a way which at the same time does not increase foreign obligations, and the import of which can be realized, due to the inflow of capital represents a surplus from the aspect of the balance of payments" (1986:9).

It can be seen then that the goals of the joint venture regulations have remained consistent throughout the 1972-1987 period.

Basic conditions: Overall, the conditions dramatically improved for joint ventures as a result of the 1986 measures. The most important changes were the introduction of tax concessions for joint ventures established in priority areas and the streamlining of the authorization procedures.

Tax rate: The tax rate is generally 40% of taxable profit. However in the following cases the tax rate is reduced:

-Providing that the corporation's paid up capital exceeds 25 million Hungarian forints and foreign capital participation exceeds 30% of the total stock and,
-if it carries out productive activity or builds and operates a hotel, it will pay 20% taxes on profit for the first 5 years and 30% thereafter, or
-if the association carries out 'outstandingly important' activity from the point of view of the Hungarian economy it will be exempt from taxes the first 5 years and from the 6th year the corporate tax will be 20%. The list of activities is quite large and is summarized in Chapter 6.

A rebate of corporate taxes is provided on already paid taxes (upon request) to the extent of 50%, if at least 50% of that year's after tax profit has been reinvested (if not less than 5 million forints). If the amount reinvested is equivalent to 100% of the previous year's profit after taxation (at least 10 million forints) then the refund will be 75% of the previously paid corporate tax. Finally, double taxation agreements have been made with most industrially developed countries for the elimination of double taxation.

Authorization: A Hungarian enterprise can begin preliminary negotiations with a Western partner on its own accord, advising the Ministry of Finance only at the 'commencement of substantial negotiations'. This is a change from previous practice when the Hungarian enterprise had to inform the Ministry at the outset of any negotiations. Upon the conclusion of substantial negotiations, the Hungarian partner must submit an application requesting permission for foundation along with the Deed of Association, Memorandum of Association and any amendments thereof. The Memorandum of Association becomes effective with the approval of the Minister of Finance. The Ministerial decision must be made within 60 days - after having

consulted with the Inter-Department Expert Commission on Joint Ventures.

Reasons for the changes: The reason for further liberalization in joint venture conditions, especially through the introduction of sizeable tax concession was to create a more favorable environment in which to attract foreign investors. As noted previously, economists had argued that the legislation was too restrictive. Indeed, between 1972-1986 the total amount of foreign capital invested in Hungary amounted to approximately 50 million US\$, of which 20 million US\$ was as a result of the CIB. Moreover, while the total number of joint ventures had risen to 45, considering their small size, little effective impact on the economy could be expected. If the goals of the joint venture policy were to be taken seriously, it was clear to the government that changes in the legislative environment had to be made. Laszlo Borbely summing up this period comments:

"In the first years after 1972, Hungarian regulation was characterized by exaggerated caution and - as is usually the case - by over-regulation. This was less attractive to foreign investors...Later, when the rigidities and the superfluous limitations of regulations were mostly already removed, the domestic investment situation was already characterized by retrenchment, and this did not favor the Hungarian companies investing their available means of development into joint ventures. In the unfavorable world economic situation, the foreign companies too, usually engaged less frequently than earlier in the investment of capital abroad for the purpose of production (1986:9).

It must also be noted that the desire for the joint venture policy to succeed is due to Hungary's urgent need to restructure her economy or drop further behind in the international arena. As a growing awareness of this necessity emerged in Party and government circles,

(as a result of the work by economists who have been arguing this point for some time) the greater the willingness has been to liberalize the environment for joint ventures. It is in this context that Csikos-Nagy noted that the Seventh Five-Year Plan (1986-1990) "connected the putting of the economy on a new course of growth with the direct capital import".² He sums up the attitudes towards joint ventures in the following way:

"In the 1970s we oversimplified the issue of capital supply by considering it as one of capital scarcity which can be compensated with foreign credits. It was assumed that the import of new technologies would bring about the increase of export potential and in this way the equilibrium would be restored at a higher level of development, by meeting the debt service we could manage to keep our international liquidity".

Now however, direct capital import "...is a better alternative than taking foreign credits...the partner who contributes capital to the development of means of production wants to obtain a guarantee for the movement of foreign capital...in the case of capital investment the foreign partner shares in risk taking" (1986:10).

POLITICAL ENVIRONMENT

As has been noted in the previous sections, since 1978, government approval of the import of foreign capital has been openly acknowledged and promotion of joint ventures encouraged. The liberalization of rules concerning joint ventures and adequate incentives offered to Western partners has been slow to emerge during this period however. It is fair to conclude that the government's caution stemmed from both

²This includes , first of all, the possibilities offered within the CMEA for international capital relations, in addition to direct capital import from the West. Csikos-Nagy, until his recent retirement, held the position of Secretary of State and President of the National Materials and Prices Office and was later President of the Council of Industrial Policy.

internal opposition which had not yet been resolved and a continued cautious approach to not move too far afield from acceptable Soviet foreign economic policy.

During 1982-1983 an important debate surfaced in Hungary regarding the possibilities of cooperation with Western firms - a debate which established more explicitly a general consensus on the benefits of joint ventures, which, in turn, contributed to policy-makers' increasingly positive attitudes towards them - culminating in the tax concessions in 1986. This debate also occurred at the time when economists recognized that EWIC was in decline and had not yet sufficiently provided the Hungarian economy with the necessary tools for technical development. The debate was prompted by an article written by two economists on the subject of cooperation with Western firms and involved published responses by a total of 15 people: 7 scientific researchers, 3 working in ministries, 2 in education, 2 in central economic institutes and 1 in a bank. In addition, a public debate was held on this issue, sponsored by a research group.*

The central concerns of the debate focused on the "imperative necessity of choosing an economic strategy and within this the requirement of changing the Hungarian policy regarding the import of functioning capital followed up to now" (Rejto, 1983:327). The context of the debate was considered within the framework of two interrelated economic problems which Hungary faced - "indebtedness to the Western

*See Zoltan Krasznai and Mihaly Laki, "Conditions and Possibilities for Cooperation in Production and Trade with Western Firms in Hungary", Acta Oeconomica, Vol 29 (1-2), pp. 149-166, 1982.

world and the other, the growing inflexibility of the production structure and their lag behind the worldwide development of technology", (Rejto, 1983:327) and therefore the necessity to adjust to the world economy in order to solve these problems. (Emphasis in original).

A sampling of excerpts from an article summarizing the debate sheds light on how positively economists and others were viewing joint ventures in the early 1980s:

"The involvement of foreign capital does not emerge in itself but closely with the new economic strategy. Owing to the increasing problems of the Hungarian economy, the decline in international competitiveness, the well known limitations to boosting the volume of exports, the very slow improvement of the export structure far from being free from contradictions - as has been indicated by a growing number of signs for years - choosing this economic strategy can no longer be delayed and, its well-considered, at the same time as far as possible, rapid introduction is a more urging necessity than ever" (Andras Inotai, 1983:328). (Emphasis in original).

Addressing the benefits from the import of functioning capital Tamas Becskai argues:

"Capital investment from the viewpoint of the receiver means a final grant, in opposition to a credit charged with the burden of repayment in installments. The charges of enterprise debts are in general depending on the terms and interest rate of the credit - higher than those of the profit transfer proportional to the capital participation. This is especially valid for the 1980s. According to the other consideration, the direct common risks and common interest in profit develop such forms of behaviors with the foreign investor which are favorable for the recipient enterprise and country in respect of technology, management and foreign marketing" (1983:329).

Denying the inherent danger of dependence as a result of Western foreign direct investment Inotai argues:

"It cannot be decided in itself, which foreign financial resource entails more favorable effects (functioning capital

versus credit capital)). But it can fairly unambiguously be stated on the basis of international experience so far that both credit capital and functioning capital adapted themselves to the economic policy of the recipient country, i.e., brought about favorable or unfavorable effects depending on the implemented economic policy" (1983:330).

Peter Margittai argues something similar in terms of technological dependency:

"It does not make much sense to expect everything from the foreign investments until we do not possess an economy much more open than the current one, responsive to the innovations many-sidedly subject to and thus acknowledged by the world market...With a genuine transfer of technology a technological dependence will not come about either, for the transferred technology changes into technological innovation capacity. Thus, the secondary impact of technology are not at all an automatic result and can be asserted solely by adequate control of reception and development policy" (1983:330).

Responding to why functioning capital is not functioning in Hungary, and by implication why a further modification of the laws to make them more conducive to joint ventures is necessary:

"But why should foreign capital come with open arms to Hungary when it can make investments elsewhere under more favorable conditions" (Inotai, 1986:333), and according to Jeno Barsony "the export of capital would be mostly motivated by the extension of the market but the reality of this is dubious, too, for on behalf of Hungary we can hardly offer any new market, what is more, it is rather we who expect the mixed ventures to increase and promote the Hungarian exports" (1983:333).

Mr. G. Rejto (1983, 336) summarized the views of the respondents on the disinterestedness of the Hungarian firms in the following way:

"The enterprise behavior, aimed at security and at keeping reserves, complemented with the low level of profits, with the over-centralized taxing away of incomes and with unsatisfactory internal flow of capital result in that the enterprises have no assets to be lastingly engaged, e.g. for joint ventures. Not to mention the lack of motivation to a risk-taking entrepreneurial type of managing behavior" (Rejto, 1983:336).

According to Mr. Rejto, only one writer expressed reservations about further liberalization of the joint venture environment because he felt that ENIC had not yet been fully exploited.

The debate is significant for two reasons. First, it is clear that the respondents were generally interested in clarifying the thinking regarding this important issue and in some way setting the record straight on the possibility of cooperation with Western firms. Second, while it is difficult to ascertain precisely the impact this debate would have had on policy makers, at least 3 economists who were interviewed and had personally taken part in the debate felt that the debates favorably impacted on the future decisions of policy-makers. Although policy-makers had indicated a certain level of acceptance of joint ventures in the measures taken in 1972 and 1977, it seems likely that this public debate enhanced their support for joint ventures, contributed to the recognition that existing legislation was too restrictive and to subsequent steps being taken to improve conditions.

With the liberalization of the joint venture environment in January 1986, it must be asked whether ideological and/or political consideration had finally been laid to rest. For some of the economists, this seems to be the case, while others would disagree.

For those who have argued that ideological considerations are no longer a factor in joint venture promotion different points have been raised. Tamas Sugar, a consultant on joint ventures at the Hungarian Chamber of Commerce insists that no such ideological concerns are present. He notes that he was on the committee in the early 1980s to

draw up recommendations to the government on regulations and all of the committee's recommendations were accepted by the government (Tamas Sugar, personal communication, March, 1988). In Gyorgy Varga's viewpoint (editor of Figyele, a major economic newsjournal), "development in the domestic market in terms of its economic and social life have moved farther ahead intellectually and ideologically than the specific regulations concerning joint ventures". He was referring to the new corporate law, passed in the autumn of 1988, as an example of this. He believes that "ideology today is not a real problem - maybe 4-5 years ago this could be relevant but no longer" (Gyorgy Varga, personal communication, January 1988). Finally, there are those, such as Miklos Gabor who, by expressing a general satisfaction with the current regulations, particularly as they reflect an acceptable international standard, suggest that the ideological questions have been resolved (Miklos Gabor, personal communication, January, 1988).

On the other hand, there are those that argue that ideological considerations and the reluctance to give up old structures continue to play a strong role not only in joint venture policy but in the economic reform process overall. According to Andras Rajki (who raises the strongest critique of this issue) the following points are raised. First, he argues that what has been done up to the present is characteristic of a policy that is not farsighted but rather ad-hoc. It cannot be considered a watershed. Thus, while the environment has opened a little, he believes it has come too late. In his opinion, the current measures are out-of-date and are no longer competitive. All countries give tax holiday and something more. Tax benefits are now

only considered a secondary question. Second, he believes that the reason the policy makers have taken only ad-hoc steps is because they are waiting to see what will happen in the Soviet Union.

"Now many people are in doubt whether the Gorbachev line will stay and whether the Soviet Union will be able to open up (convertible ruble, real foreign trade, etc.). If everything goes right Hungary could profit from these steps. But if they don't (if something like a counter revolution occurs) then Hungary would loose much of her initiative. That's why they don't want to hurry - they are waiting. Nobody dares to go ahead of the Soviet Union" (Andras Rajki, personal communication, February 1988).

Finally, Inotai argues a similar point in a different way. In his opinion "the government is more willing to give up ideological issues than give up old and outdated structures. This then becomes the main problem of economic reform which applies to the economy as a whole, with its impact on all policies including that of joint ventures". In his view, economic reforms have only been taken to a point - but not to where they jeopardize the old structure. Thus, "the real interest groups and lobbies are not in the ideological front - but in the real economy" (Andras Inotai, personal communication, January 1988).

A final resolution of this issue is not possible. It is important to note however, in more concrete terms, some evidence which would indicate that the political environment for joint ventures, since 1986, has dramatically improved. The most significant evidence is that top government officials have made more and more public references to the necessity of creating a favorable environment for joint ventures. One example is Borbely's comments cited earlier. Another such example is from a speech by then Prime Minister Grosz (currently he is General Secretary) at the Autumn Session of the National Assembly in September

1987 who noted that, "An important possibility for achieving our goals is to further develop international economic cooperation...in this spirit we would like to encourage the increased involvement of foreign capital by further improving the conditions this requires" (Grosz, 1987:16).

Second, the extent of promotion of joint venture opportunities has also significantly increased. There are many multi-language publications which explain the specific regulations and list all joint ventures now in existence. There have been lectures and "Hungarian Days Abroad" where these opportunities have been promoted. A joint venture club has been established under the auspices of the Hungarian Chamber to help expedite problems faced by those joint ventures now operating in Hungary. Finally, the Chamber expects to establish in the fall of 1988 an agency promoting the investment of foreign capital. It is important to note however that according to Tamas Beck, President of the Chamber, for the agency's successful functioning "...an authorization is needed to ensure its trouble free cooperation with the state administration - and this is still outstanding" (1985:5).

RESULTS OF THE 1986 REGULATIONS

Between 1986 and 1987 61 new joint ventures were founded. The total original capital invested was \$104,413,000 (US). This figure, invested during a two year period, is approximately equivalent to the total invested during the entire preceding 14 year period. Moreover, more than half of this total (64%) was invested during 1987. The percent of foreign ownership is equal in 14 of these, and is greater

than 50% in 10. Thirteen have been established in a custom free zone. Of the 61, 44 were in production and 17 in the service sectors. In the production sector 25 of the joint ventures are located in the following industries: computers (1), pharmaceutical (2), clothing (10), construction (3), agriculture (4), and electronics (3). In the service sector the 17 joint ventures are located in the following industries: financial (1), computers (6), trade representation (2), tourism (3), clothing (1), construction (3), and agriculture (1). See Tables 5.3 and 5.4 page 113A-D. It is interesting to note that despite the significant increase in joint ventures during this period, it is expected that only about 20 will really begin to function in the first half of 1988 (Toldy-Osz personal communication, May 1988).

CONCLUSION

This chapter has examined the evolution of joint venture policy from the first steps taken in 1972 through 1986 when the current policy was initiated. Figures for the number of joint ventures established - broken down by period and then by various features such as the capital invested, % foreign controlled and breakdown by sector and industry was given. Each stage in the process witnessed a growing willingness by the authorities to take the necessary steps to favorably alter the Hungarian environment to Western interests. While in hindsight it is easy to argue that the initial Decree in 1972 was so restrictive that is proved of little value, it must also be recognized that the very fact that such legislation existed at all, no matter how limited, was in itself a major accomplishment. Hungary thus created for herself a space, albeit an extremely small one in 1972, which while being careful

not to directly challenge some of the basic tenets of the Stalinist model, nor go beyond the Soviet Union's foreign economic policy, did provide the possibility to establish intensive economic relations with the Western world based on joint equity participation. While EWIC had already gained momentum by the early 1970s it was the equity participation which placed the joint venture policy outside of previously established behavior.

With the recognition that the 1972 Decree confining joint association to the services sphere was of little interest to Western partners (only 3 joint ventures were established during this period) and facing her own severe crisis in her external economic performance prompted by the change in epoch, in 1978 Hungary adopted regulations to allow joint ventures in the productive sphere. Thus, she was able to further expand the space within which to develop more intensive economic relations with the Western world. During this period 4 joint ventures were established increasing the total number to 7. In 1982, again faced with both limited success and a crisis in her external economy she adopted regulation to allow for joint ventures in custom free zones. During this period 39 joint ventures were established - a significant increase from the previous two period. Finally, in 1986 Hungary decided to expand her space far more significantly by choosing to adopt tax concessions which would make her environment competitive within the international arena. This step was taken at the same time there was a growing recognition within Hungary that she must restructure her economy and adjust to the world economy or face an ever increasing economic decline. Between 1986 and the end of 1987 61 joint

ventures were established and \$104,413,000 (US) was invested. During these two years both the total number of joint ventures and the dollars invested exceeded the cumulative totals of the preceding 14 years. By the end of 1987 a total of 107 joint ventures had been founded in Hungary and \$200,466,000 (US) invested. While the current political attitude and legislative environment can be considered the most open to date, it is generally acknowledged that further liberalizing trends must continue. The new debate therefore focuses on how big a step to take and how soon to take it.

Chapter 6

EVALUATION OF THE JOINT VENTURE POLICY

This chapter sets out to analyze the economic effects of the joint venture policy to date. An evaluation of this kind is extremely difficult. One reason is that the establishment of joint ventures began to take off only after 1982, with the majority of them being founded between 1986-1987. This has resulted in a limited time within which to provide a suitable framework for analysis, and as consequence, few studies have been undertaken.¹

A second factor, and probably more important, is that many of the potentially favorable economic effects of joint ventures are difficult to measure. Had the policy been successful in attracting sizeable sums of capital, resulting in large undertakings and the consequent modernization of at least some sector(s) of the economy, the task of evaluating the policy would, of course, be easier. Conversely, had Hungary failed to liberalize the regulations over the course of the 1970s and 1980s such that only a handful of joint ventures existed, this would result in a quick negative evaluation. But Hungary's reality is far more complex. While the size of the capital invested is small (@200 million US\$), the 107 existing joint ventures are not insignificant and they have begun to have noticeable effects on the

¹The most comprehensive study on joint ventures to date, by a Hungarian source, was conducted by the Institute for Industrial Economics. This study was expected to be published only in Hungarian in the summer of 1988. Another study, conducted by Germans for the Bonn administration by the Friedrich Ebert Foundation assesses the operation of Hungarian-West German joint ventures. This study is in German and Hungarian.

domestic economy.

There is a third reason why an evaluation of this kind is difficult. The joint venture policy is only one (quite small) policy functioning with a much larger environment of economic reform. Thus, in the 1980s, economic reform of the system itself has taken place at an accelerated pace. These reforms, by modifying or replacing old economic structures have impacted on the domestic environment and hence the environment in which the joint ventures find themselves. In addition, as the need to adapt the Hungarian economy to the world economy has become increasingly recognized, a new economic strategy is slowly emerging which stresses a selective export oriented development. This in turn affects government priorities in restructuring, in relations with the CMEA, etc., which also have repercussions on joint ventures.

A fourth reason is that it has been increasingly recognized that the economic reforms cannot substantially move ahead unless these are matched with political reforms. These political reforms will require the state to confine its activities more and more to the macro sphere, leaving the micro sphere to market forces. The point is that joint ventures currently in operation are not operating in an environment where their effects can be easily isolated out from a normal functioning of the economy. The entire economy, by virtue of the reform process, is in a state of dynamic flux, which both impacts on joint venture policy and which is simultaneously impacted by it.

Taking these factors into account, an evaluation of the economic effects of the joint venture policy is nevertheless imperative. This

chapter, like the preceding ones, is based on the Hungarian perspective on the evaluation of the joint venture policy. It will first look at the strength of the response to the joint venture promotion as measured by the dollar value invested in Hungary as of the end of 1987 and identify those reasons for the low level of investment. Second, (taking into account this small amount of investment), an evaluation is made on whether or not the joint ventures now in existence have met the stated objectives of this policy, that is a) has it improved the export balance of the economy and b) improved the technical development of the economy.

STRENGTH OF RESPONSE TO JOINT VENTURE PROMOTION

How successful has Hungary been in attracting foreign direct investment? Between 1972-1987 (end) the total original foreign capital invested totalled \$200,466,000 (US). This total is extremely low for the number of years involved and it can therefore be concluded that Hungary has not been successful in attracting foreign direct investment. If one looks at the years 1986 and 1987 however (1986 being the initiation of the tax concessions) the total amount invested was \$104,413,000 (US). In these two years alone, foreign capital investment was about equal to the entire previous 14 years. From this perspective, while still not a large figure if compared at an international level, it does suggest that Hungary's policy since 1986 has begun to produce better results.

Tamas Beck at the Hungarian Chamber analyzes the low level of investment in international comparison. According to his calculations, (1987:5) by looking at the per capita gross capital inflow in other

countries in light of their GDP, the following can be observed:

- in groups of countries with low GDP (\$800 US per capita), gross capital inflow is \$0.3 US/capita)
- in countries with low-medium GDP (\$1,000 US per capita), gross capital inflow is \$7.3 US/capita
- in countries with medium GDP (\$1,000-2,000 US per capita) gross capital inflow is \$17.5 US/capita
- in advanced countries with high GDP (\$2,000 US/Capita) gross capital inflow is \$37 US/Capita

Hungary's GDP per capita (\$1,929 US) is equivalent to countries with medium GDP. Her gross capital inflow in 1985 was \$40,609,000 (US). Her gross capital inflow per capita was \$3.81.² It was therefore 4.5 times smaller than countries at comparable levels of development!

Beck points out that the world's stock of functioning capital doubled during the last ten years to attain a level of 600 billion US\$. Direct investments amounted to 7% of this yearly sum. From the total of 600 billion, 10 billion US\$ was allocated outside the OECD. In this context, Hungary's 100 million for 16 years must be considered highly insignificant in world terms. Beck also examines the regional distribution of the FRG's investment abroad. The FRG's capital flows are important to Hungary given the countries' close proximity, the strong trade ties that already exist between them and because of Germany's economic strength. Of the 130 billion DM which the FRG invested abroad during the first half of 1986, 59.3 billion DM were invested in Europe, and 18.1 DM were invested in European countries outside the EEC. When speaking about the 18.1 billion "the

²This is based on calculations from the 1985 Hungarian Statistical Yearbook using 1985 figures for GDP, population and the exchange rate. For source of Hungarian gross capital inflow see Table 5.3 in Chapter 5.

Bundesverband der Deutschen Industrie did not find the CMEA countries worthy of mention at all" (1987:6).

REACTION TO THE LOW LEVEL OF INVESTMENT

For many economists (outside the government), the fact that the total investment in Hungary is so low has meant that analyzing joint ventures is of little interest to them. This is further justified by the fact that between 1986-1987 foreign direct investment was .88% of gross domestic investment.³ Thus, it is considered by many a marginal phenomenon existing outside of the real economic processes. If nothing else, it has reinforced for some, a skepticism towards the potential for Western cooperation at the inter-enterprise level. In fact, outside of the government and the Chamber only 4 senior economists were found to be actively engaged in research on this subject.⁴

One of these economists, Peter Margittai, is active in pushing for further reforms to the joint venture legislation. He argues that on a world level the largest portion of foreign direct investment is accounted for in mergers and takeovers of existing companies. If Hungary does not succeed in allowing for such possibilities, in addition to the possibility for wholly owned subsidiaries, he believes that foreign direct investment in Hungary will never amount to a large sum. This is confirmed by Bela Kadar who notes, "It is a world-wide

³ These figures were calculated from Table 5.4 Chapter 5 and Magyar statisztikai zsebkönyv (Hungarian Statistical Pocketbook), 1987, p. 100 and 214.

⁴This is based on information I was given - and to whom I was referred. I have been told however that there is considerable interest in this subject by students at the Karl Marx University of Economics.

tendency that a growing proportion of the international flows of capital - at present more than two-thirds of them - are associated with a partner joining an existing company, and with a partial buying or full buying up of companies" (1986:20). Furthermore, Margittai argues that Hungary is in need of establishing a share market where international capital would be allowed to participate. He expects that reforms of this nature will be implemented in the next few years, and indeed a well publicized conference in setting up a stock exchange took place in March 1988, with the participation of Western experts (Peter Margittai, personal communication, February, 1988).

Government officials on the other hand have had over-optimistic reactions, despite the low level of direct foreign investment. The desire for increasing capital flows into Hungary led some government officials to propose that the 1986-1990 Five Year Plan should include a five year target figure for the level of foreign direct investment. This sum was to be 1 billion US\$, equivalent to 200 million a year - a sum equivalent to what has thus far been achieved during the entire preceding 15 years! While the national planning office rejected the inclusion of such a figure they still voiced an expectation that a 500 million US\$ target should be reached (Andras Inotai, personal communication, January 1988).

REASONS IDENTIFIED FOR THE LOW LEVEL OF INVESTMENT

WESTERN PARTNER LACK OF INTEREST

It is difficult to identify any one overriding reason why so little investment has been achieved. In evaluating the shortcomings of

their own program however, Hungarians mention the following reasons²:

-As mentioned previously, the slow liberalization of the regulations up until 1986 - and since then, the fact that Hungary does not allow for foreign direct investment in already existing enterprises, nor the possibility for mergers or takeovers. In addition, foreigners are not allowed to set up wholly owned subsidiaries (Peter Margittai, personal communication, January 1988).

-Due to the fact that Hungary is not a member of any free trade association, the joint venture faces both custom barriers in its exports and custom duties on its imports. As a result, Hungarian production costs must be 15% cheaper to make exports competitive behind tariff barriers. In addition, non tariff barriers are also faced by those Hungarian enterprises wishing to penetrate European and EFTA markets (Andras Inotai, personal communication, January, 1988).

-The infrastructure of the country is not well developed, and due to budget difficulties it cannot be modernized quickly (Miklos Gabor, personal communication, January 1988).

-The market problem involving 3 markets: the home market which is relatively small, the convertible currency markets which must be exported to - at least to earn enough foreign currency to meet their transfer liabilities and pay for their required imports for production, and the rouble markets. While the rouble market is of primary interest to the Western partner, Hungary is unable to offer any guarantee as a

²These limitations assume a generally elastic interest by Western partners as they become influenced by the overriding political climate - largely determined by the Superpowers.

bridgehead into this market. (See next section for more discussion of this point).

-While Hungary's comparative advantages are in the relatively low price level of services, the relative abundance of highly qualified labour which can be used for research and development as well as service intensive activities and the relatively low cost level overall (relative to Western Europe), these advantages are not necessarily more favorable than what investors can find in South East Asia. Thus, there is not one, outstanding advantage that Hungary can offer to its potential investors (Tamas Benedek, personal communication, March 1988).

-Finally, the fact that in the last couple of years the Hungary's economy has been faced with low or negative growth rates and increasing debt. Also, the reform process is in flux, contributing to a general sense of uncertainty. Moreover, the socialist economic mechanism is still unfamiliar to foreign investors, limiting in some measure, their willingness to expend time and resources in order to accommodate the difference.

HUNGARIAN PARTNER LACK OF INTEREST

Hungarian enterprises have not been enthusiastic about entering into joint ventures. A number of reasons are mentioned for this lack of interest:

-According to some experts, Hungarian enterprises do not receive any special benefits from setting up joint ventures (Andras Inotai, personal communication, January 1988). Others however have mentioned that they can receive preferential loans with low interest rates

(Miklos Gabor, personal communication, January 1988), while still others have argued that capital is so tight in the domestic markets that such loans are not really available (Andras Rajki, personal communication, January, 1988).

-Domestic enterprises, involved in joint ventures, can potentially benefit from Hungary's double taxation legislation. Tax rates for joint ventures are far more favorable than they are for the Hungarian enterprise. While the maximum tax rate for joint ventures is 40%, the tax rate in preferential areas is much lower. For Hungarian enterprises, the rate was 90% of their profits in 1985, while in 1988 it has been reduced to approximately 70-75% (Tamas Sugar, personal communication, March 1988). Thus, if a Hungarian enterprise establishes a joint venture, the joint-venture's profits can be repatriated to the parent without the parent having to pay additional taxes on this profit. The benefits to the Hungarian parent enterprise however are realizable only if the joint venture makes sizeable profits and doesn't invest these profits in the joint venture. While it can be argued that this may be considered a long term advantage to the Hungarian parent company, it is unconvincing as a sufficient incentive to entice Hungarian enterprises to enter into such association. It assumes a level of risk-taking and entrepreneurship which is not the characteristic qualities of Hungarian management. (See below).

-Lack of entrepreneurial spirit is often cited as a reason for the low level of interest in joint ventures by enterprise managers. Managers under the traditional system in Hungary are successful if they carry out the instructions of their superiors in the Party (government)

hierarchy. The skills therefore associated with Western style management - which are required by joint ventures - such as risk taking, initiative, and rapid response to market signals, are sorely lacking. Hungarian managers tend to be less interested than their Western counterparts in experimenting with new forms of enterprises such as the joint venture.

-Wages. Hungarian enterprises have little control over the level of wages and in turn, wages have little relation to the productivity of the worker. Joint ventures however, are free to determine the salaries of their workers and are able to link them to performance criteria. It was noted by Miklos Gabor (personal communication, January 1988) that this situation negatively affects the Hungarian enterprise's disposition towards joint ventures. Why should a Hungarian enterprise establish a joint venture and watch the joint venture management receive higher salaries than that of the parent managers? In addition, Hungary has traditionally faced problems of labour shortages. Joint ventures have attracted labour away from the Hungarian enterprises by offering higher salaries. This disadvantage may not be so prevalent in the current period of increasing unemployment however.

-Superficial interest. In this situation the Hungarian enterprise decides it is worth its while to get involved in the joint venture process. The reasons for doing so however do not stem from an 'entrepreneurial' desire to participate in such a process but for other reasons. These reasons include: the government and Party are promoting this activity and so it is the best way to stay in their favor; joint ventures have easier access to imports and given the difficulties in

acquiring foreign exchange, it will provide the opportunity to acquire the imports an enterprise has needed; third, whereas EWIC used to provide the transfer of more up to date technology, now the joint venture process can be ensure this. These interests, while not altogether "negative", nevertheless place the joint venture in the framework of getting around the old way of doing things without breaking out of these old ways. For the joint venture to be successful however, the old ways will not suffice - a new approach altogether is needed (Andras Inotai, personal communication, January 1988).*

-CMEA production. The stable niche many Hungarian enterprises hold due to their production for CMEA markets has meant that they have little interest in the joint venture process. They do not see the need to change their production practices, adopt Western management methods, nor take on additional burdens. It is a hypothesis of one economist, that this is one of the reasons why only 1 or 2 joint ventures have been established in the engineering sector. In this sector, more than many others, production is guaranteed to go to the CMEA market. As the CMEA market changes however, and as it demands a larger high-tech component in the engineering products it receives from Hungary, the managers of these Hungarian enterprises will be compelled to take an

*It is interesting to note that according to Rajki, the possibility that the enterprise will use the joint venture policy as a way to satisfy pent up demand is a major reason why the authorities will not do away with the joint venture expectation that all imports must be balanced with export earnings. The concern over this import demand predominates even when this balance expectation is considered to both limit the attractiveness of Hungary's current legislation to Western partners as well as the fact that this expectation has hardly been met by those joint ventures now in existence (see next section).

interest in joint ventures. Thus, in order for them to maintain their market in the CMEA they will have to produce internationally competitive goods and for this they need both embodied and disembodied technology from the West (Gyorgy Varga, personal communication, January 1988).

-In addition to the regulations however, economists argue that domestic reforms, both economic and political, must be accelerated in order to enhance the role of the market and free the enterprise manager from central intervention. This will in turn compel the enterprise managers both to adopt more efficient (and Western) production methods and respond to signals from both the domestic and international markets.

In sum, it has been suggested that while the total sum of foreign direct investment in Hungary is quite small, it was achieved in a generally less than satisfactory environment. Since 1986, with the liberalization of the regulations and with the likelihood that additional amendments to the regulations will be made in an all out effort to attract larger levels of investment, the long-run prospects for the import of functioning capital seem to be more favorable. What will influence this long-run trend considerably, in many economists estimation, is how soon these amendments take place and how bold they will be. If they are not implemented soon, many believe that Hungary will miss her chance to participate in the new international division of labour emerging as a result of the process of structural change taking place in the world economy.

EXPORT PROMOTION

"It is an unchanged goal that the joint companies should contribute to the export capacities of the economy, primarily to the increase of convertible currency exports". (Borbely, 1986:10)

It is clear why this goal is considered a fundamental component⁴ of the joint venture policy. First, Hungary does not want to incur any negative effects on her balance of payments as a result of joint ventures. Thus, the venture is expected to acquire at least enough foreign exchange (via exports) to pay for the necessary imports for production as well as the transfer of profits (and/or income) to the partner's home country. Second, the goal is expected to help achieve an improvement in Hungary's external balance by improving its participation in the international division of labour as a result of obtaining modern technology and access to the convertible currency networks of the Western partner.⁵ This section will look at these two objectives separately.

BALANCING IMPORTS WITH EXPORTS

It is important to clarify how the goals of "not incurring any negative effects on Hungary's balance of payments" is manifested in the actual joint venture regulations. According to Toldy-Osz (personal communication, January 1988):

"In the Decree, it is only said that the aim on the Hungarian part is to ameliorate the balance in convertible currency through the foundation of joint ventures. That is the aim, among other aims. That is all you find in the Decree.

⁴Another reason, as mentioned previously, is that without such restrictions, authorities fear that joint ventures will be misused to simply satisfy pent up import demand.

However, when evaluating the necessity of a joint venture and before giving the approval for its foundation, the Ministry of Finance seeks to determine whether the joint venture balance will be favorable or not. So it is an expectation that is taken into consideration at the occasion of the approval of the joint venture.

But when speaking about the balance, I always add that if the joint venture produces such a product which is necessitated in the country and would have been imported up until now, or should be imported from now, then it is also taken into account in the balance of foreign currency. I should add that not all of the Hungarian authorities have the same opinion as to the substitution of imports, but the Minister of Finance, who has the last word on the approval and foundation of the joint venture is of this opinion".

When Mr. Toldy-Osz was asked to his knowledge, how many firms were actually involved in exporting he stated:

"Really all are involved in exporting. Without promising exports at the occasion of the foundation, it is impossible to get an approval. It is another question whether the joint venture promises to export after 3 or 5 years time. This is another thing. If you would ask whether now, all of the joint ventures export or not, my answer would be 70-80% do really export now. From the other remaining 20-30% it is also expected that after 1 or 2 years they should export too".

Thus, it is clear that the export potential of the joint venture (the minimum being to achieve a balance in foreign exchange transactions) is integral to the approval process.

There are some however, who feel that this goal is not without its contradictions. According to Andras Inotai (personal communication, January 1986), such an aim, which expects that from the first moment a balance is to be achieved has the following results - it means that the joint venture is practically obliged to achieve gains and profits in the first year. This creates three unfavorable effects :

"First, it deters those interested in establishing large joint ventures because gains cannot be expected in the first

year. Thus, it is counterproductive to Hungary's desire to increase the size of the joint ventures established. Second, it means that those who do found joint ventures are more likely to enter sectors where they can get quick money. Their interests are therefore only short term. Third, in regard to Hungarian enterprises, it does little to encourage them to enter into the joint venture process. They fear not being able to get the necessary imports for production because they do not have the necessary foreign exchange. They also fear the uncertainty of the future environment - what the future conditions will be both for credits and for imports, and thus, do not have confidence that they will be able to meet the balance requirements in the years ahead".

Inotai blames the narrow-mindedness of the bureaucrats for insisting on such a balance. It assumes that the only way to evaluate the success of a joint venture is by the direct effects - in this case whether or not it impacts favorably (or at least not adversely) on the balance of payments. He argues that in addition to direct effects there are indirect effects which must be considered in any such evaluation and which may in fact be more beneficial. Many economists interviewed were of a similar opinion.

Unfortunately it is difficult to find any data which confirms one way or another whether the joint ventures now in existence have contributed to Hungary's external balance. Almost all those interviewed, with the exception of Toldy-Osz felt that the joint ventures, if anything produced a negative balance, possibly about even, but certainly not positive. The only actual study that was referred to was one done by Toldy-Osz.* Here however only 30 joint ventures, out

*In interviews with 3 joint venture managers, 2 noted that while their imports and exports have been pretty much balanced, they have never received any intervention by the Hungarian authorities either voicing dissatisfaction when they haven't been balanced, or insistence that they provide a more positive one.

of 100 solicited, responded to his questionnaire. These 30 enterprises exported 2 billion forints (or approximately 40 million US\$) in 1986. This includes both direct exports (exported directly by the joint venture or a foreign trade enterprise) and indirect exports (the joint venture produced a component which was used by another enterprise for a different exported product). If the 30 enterprises are taken together, they achieved a positive balance earning more than enough foreign exchange to pay for both imports needed for production and for the repatriation of profit. Toldy-Osz argues that this positive balance would be even greater if the import savings due to substitution of joint venture products was also taken into account (Toldy-Osz, personal communication, January 1986).

The fact is, for many of the joint ventures, in particular those in the service sector, coming up with an export product is not necessarily an easy task. The case of FOTEX illustrates this point. According to both Tamas Sugar and Andras Rajki (personal communications, January 1988) this is what occurred there: Fotex is a joint venture in the service sector - it processes film. It imports the necessary supplies for the process. Seeing that it does not produce a product which can be exported it looked around for an appropriate item. It decided on carved wooden statues for which it claimed there was a convertible currency market. They contracted a Hungarian enterprise to produce the product. They apparently had problems exporting this product successfully and called the Chamber (to Sugar) looking for possible solutions. They even proposed paying the Hungarian National Bank the equivalent hard currency to balance their

imports. Something was worked out with the Ministry. Currently, FOTEX is exporting contact lenses to Western Europe and is, according to Sugar, doing quite well.

Another example is McDonald's who signed a joint venture contract and expected to import food products which were also produced in Hungary. The opening of the store was delayed due to this problem - i.e., it would incur import debts but did not have a product to export in order to maintain a balance. The problem was solved when McDonald's decided to rely on Hungarian suppliers for these products rather than import them (Andras Rajki, personal communication, May, 1988).

While it is understandable why the government continues to expect that joint ventures will not create a negative impact on the balance of payments, it is an expectation which dissuades Western businessmen from entering into such partnerships.

PARTICIPATION IN THE INTERNATIONAL DIVISION OF LABOUR

The fundamental goal of the joint venture policy is to substantially improve Hungary's export balance by participating in the international division of labour. The possibility of this occurring is generally connected with developing links with the large multinational corporation. (See Chapter 2). Authors Krasznai and Laki (1982:156), two Hungarian economists who have analyzed the impact of Western inter-enterprise cooperation in Hungary, have the following views on how the international division of labour has become increasingly divided into core and periphery over the 1970,

"The core is a sector of the international division of labour characterized by lasting transfer relations and interpenetration of capital between enterprises that may be

called central with good reason because the trade in products, technologies know-how as well as connected commercial and non-commercial services representing the most advanced technological level and stimulating for technical and economic development precisely on this account is realized in its framework. On the other hand, the periphery is characterized by traditional commercial transaction and contractual relations (not leading to any international penetration of capital) i.e. various types of cooperation...Western enterprises are not interested in handing over the most advanced technologies to their partners with whom they are in peripheric relations. They are interested in the transfer of technologies already in the descending branch of the life cycle in order to maximize their receipts per unit costs of research and development".

It is clear from the total size of investment and the average size of investment per venture (approximately 500,000 US\$), that the interpenetration of capital between Hungarian and Western enterprises has not occurred. In addition, for the majority of the joint ventures established, the Western parent company is either a medium - but more likely, relatively small corporation. Of the 107 joint ventures, only approximately 5% can be considered to be established with a truly large multinational corporation while an additional 10% are considered large in their own country but not well known internationally (Toldy-Osz, personal communication, January, 1988). Furthermore, it would be wrong to assume that those large multinationals which are represented in Hungarian joint ventures are indeed transferring advanced technologies and by doing so helping Hungary carve out a niche for herself in the world market. Andras Rajki (personal communication, May 1988) gives an example which illustrates this point.

Siemens AG and the Hungarian firm Intercooperation Co. Ltd. established the first joint venture in 1974. It is called SICONCONTACT. The original intent was to promote cooperation between Siemens AG and

Hungarian enterprises and to provide for the servicing and maintenance of the six Siemens computers then in Hungary. The joint venture also began to produce some technological items for the computers which did result in the transfer of some technology. Now however, while SICONCONTACT is making these same products it has nothing to do with technology transfer. Siemens, which is one of the leaders in Europe in computer technology, does not give anything to Hungary except servicing and agents.

Most Hungarian economists agree that the large multinational corporations do not want to come to Hungary. They argue that one of the most important reasons for this is the policy of the multinationals to establish primarily subsidiaries and not joint ventures. In Hungary, the only exception to this lack of interest has been the establishment of joint ventures in the banking sector - but the banks do not directly help Hungary develop its place within the international division of labour. Some economists believe that short of the multinational being allowed to set up subsidiaries they will resort to similar practices which were encountered in EWIC relations. That is, the multinational will limit the joint venture's access to their convertible currency export network - justifying this on the basis of fear of increased competition the joint venture may cause, or will only transfer second rate technologies which while potentially useful for the domestic market, will mean that products produced by the joint venture will be no more competitive than other products already produced on the world market and/or are already exported to the West.

Whether these tendencies will hold true for joint ventures is

difficult to say at present. Andras Inotai (personal communication, January 1988) however, argues that it will not necessarily hold true because if it were true, it would also have to apply to South East Asia as well. He asks "why are Japan and the United States and Western European companies going to South East Asia, producing there and then importing to their home country?". In his opinion, "if the country has an export oriented policy then the foreign capital will adjust to this export oriented environment. The problem is that Hungary currently does not have such a policy - we are in the process of speaking about it. Instead, we have only forced exports in some sectors". As discussed in Chapters 4 and 5, many economists believe it is the implementation of such a policy that is critical to Hungary's future well being.

It is clear that joint venture policy to date has not been able to meet the government's own stated objective of increasing Hungarian exports to convertible currency markets, nor has the policy been successful in securing Hungary a niche within the international division of labour.

EXPORT PROMOTION TO THE CMEA

While Hungary's objectives have been to obtain access to convertible currency markets it has also had to recognize that contrarily, much of the potential Western partner interest in locating in Hungary has had to do with the possibility of access to the largely untapped CMEA market and not to the convertible currency markets. In fact, this contradictory view over the direction of the export orientation is one of the major areas where Hungarian and foreign

interests clash.

It is first of all important to analyze the motivation on the Western part to gain access to the CMEA market. It is generally acknowledged that among the main considerations (none mutually exclusive) which motivate foreign investors in general, the single most important motive is the desire to penetrate local or regional markets. This market penetration motive may be expansionary, that is a wish to open up new markets to satisfy management's desire for growth of sales, market share and profits, or defensive - to protect foreign markets traditionally served through exports if access is threatened by protectionism.

In the case of Hungary, the motivation for direct investment would be expansionary. Given her limited market size of approximately 10.5 million however, it is not surprising that the foreign partner attaches even greater importance to gaining access to the larger CMEA market. There are two points here that are important to make. First, as pointed out by Andras Inotai (personal communication, January 1988), the Hungarian market itself should not be underestimated. He assesses that in terms of purchasing power there are approximately 8-8.5 million people able to buy, which is considerably larger than in countries in South East Asia and Latin America. Second, while the interest in the larger CMEA market is of concern to the large multinational corporations, this should not be overstated - at least as small investors are concerned. The fact is that 107 joint venture now exist in Hungary.

What then was the foreign partner's motivation for entering into

the joint venture process such that 107 now exist in Hungary? Andras Rajki (personal communication, May, 1988) sums up the evidence based on a study conducted by the Industry Economic Research Institute. The first reason: in about 1/2 of the cases either someone on the Board of Directors or a businessman is of Hungarian descent. This accounts for the bulk of the small, (500,000 US\$) investors. Second, the companies think sooner or later the CMEA countries will open up. He believes this is why Citibank came and why some larger multinational corporations are beginning to show interest.

For those Western firms interested in Hungary's joint venture process as a means to gain access to the larger CMEA market, Hungary currently can not be the bridge into this market (despite her attempts to do so).⁹ This is due to a number of interrelated and complex problems which constitute CMEA relations which are manifested in the

⁹This is not an unreasonable expectation given current changes in the USSR. Additional comments on this subject are of interest.

According to Dr. Gero Biro, editor of the Hungarian Business Herald:

"Foreign interest in setting up joint ventures in Hungary would sizably increase if a capital outlay would simultaneously enable the foreign partner to export to other CMEA countries and the Soviet Union in particular. This is, however, practically impossible at present, due to the method of settlement with the CMEA" (1986, 2:2).

According to Miklos Gabor of the Foreign Trade Bank:

"Trade between the CMEA countries is still mostly carried out on a bilateral basis. The range and volume of exported/imported goods are fixed in inter-governmental agreements. As long as this state exists and until some kind of multilateral settlement can be introduced, this will mean an impediment to exports by joint ventures to socialist countries. Recent phenomena, however, indicate that such a development may not be long in coming. As it is, the Soviet Union too, has started to encourage the establishment of joint ventures and the foundation of the first Hungarian-Soviet joint venture not based on an intergovernmental agreement represents a milestone in this direction" (1987:14).

long-term bilateral and inter-governmental character of the relations (i.e. limited relations at the inter-enterprise level), and in the severely limited and inadequate intra-CMEA monetary relations, including the lack of a convertible currency and unified exchange rates as well as an antiquated pricing mechanism. Thus, without reform of the entire CMEA system, the forging of a bridge between the Hungarian and CMEA market is no simple task, even given the stated determination of the current Soviet leadership to begin this process.

The following comments give an indication of both the attempt to acknowledge the desires on the side of the Western partner to penetrate this large market and the fact that Hungary does not have any foolproof method to do so. According to Laszlo Borbely:

"Told frankly, the linking of the different market conditions is today still unsolved for the joint companies operating in Hungary. But it is justified to expect that Hungary's experience with socialist integration and her practice in relations with the Western countries will bridge this problem on the basis of mutual interest" (1985:15).

Beck at the Chamber presents an even more optimistic viewpoint:

"If the type of the production or the economy of scale justify it, the State is ready to assist the mixed company in providing a good basis for its permanent presence on the transferable rouble market. I think that this task, with the timely, realistic and necessary unification of rates of exchange, prices and accounting methods, will be increasingly easy to meet" (1987:7)

Finally, for the viewpoint outside of the government and public sphere, Andras Inotai's comments (personal communication, January, 1988) are interesting to note:

"We must find some special regulation so that the joint venture settled in Hungary can enter into the CMEA market in financial terms which would at least, not be disadvantageous to Hungary. Possibilities exist because almost of the CMEA

countries need technologically up-to-date products. Some are so important for the Soviet Union that they cannot do without them. In that case the Soviet Union would probably be willing to pay in convertible currency or in some materials which could be marketed directly to Western markets or further elaborated in Hungary - and in its new form exported again, b) although the Soviet Union is in a more serious balance of payments situation than some years ago, it is still a solvent country - and if takes into account the internal pressure for consumer goods and since the current leadership wants to maintain stability and the support of the population then it must consider how to allow the population access to consumer goods".

The fact is however, according to Rajki, that only 1 joint venture has been established which had, at its foundation a guarantee from the Hungarian authorities that it would gain access to the Soviet market.

"The Swiss multinational Eli Lilly SA was convinced somehow to come to Hungary because of the Soviet market. But first of all they had to convince the Hungarian authorities that they had to be guaranteed sales in the Soviet market. Their product was a special chemical product concerning chicken and hog digestion which facilitates the activities of the stomach. The Hungarian authorities worked out a sales plan with the Soviet Union. The joint venture went ahead with buying a huge lot in Northern Hungary where they were to set up a factory. The joint venture was established and the permits in place - but in between, on account of the bureaucracy and I am not sure what else - three to four years elapsed. New products emerged on the world market and the Soviet Union reneged on its side and told the Hungarian authorities that it no longer wanted the product - it would buy something on the world market. The joint venture still exists - they have an office - but they aren't producing anything. It is not clear what they are doing to occupy themselves all day long" (Andras Rajki, personal communication, January, 1988).

While it is clear that no short-term solutions have been identified to solve this problem, long-term possibilities do exist as Gorbachev's reforms are implemented in the Soviet Union, and as intra-CMEA relations are reformed. Ironically, while reform of the Soviet

Union is considered essential to the well-being and further development of the CMEA countries, one economist mentioned his concern that as the Soviet Union allows for joint ventures, foreign direct investment in Hungary will become further marginalized in the eyes of the Western partner since it will no longer provide the bridge (albeit currently illusory bridge) with the CMEA. A practical solution to this potential problem is offered by Beck however:

"In addition, it is important to rethink the conditions and terms of the functioning of the joint ventures. These were formulated before it became fashionable to establish joint ventures in other socialist countries. In order to make Hungary an attractive country for investment, competitiveness must be ensured in this too" (1988:5).

In sum, the joint venture policy has not been successful in achieving its objectives of export promotion. Hungary has failed to attract partners who can help it establish a niche within the international division of labour. Even in the promotion of exports to the CMEA, while not an objective of the policy per se but would nevertheless provide Hungary with a unique comparative advantage with which to attract further investment, it has also been unsuccessful in securing a bridge into the market.

TECHNICAL DEVELOPMENT

A fundamental goal of the joint venture policy since its emergence in 1972 has been to increase the technical development of the economy. What does the concept technical development include? It is clear that in the 1970s, Hungary referred to it as the modernizing of the productive forces and increasing the level of productivity - both necessary conditions in order for Hungary to move from extensive to

intensive growth. In the 1980s however, Hungary has increasingly recognized that technical development must also aim to restructure the economy in order to adjust to world market changes and it must strive for the development of managerial know-how of enterprises if it is to be successful. Joint venture policy in the 1980s therefore seeks to facilitate the technical development of the economy in this general sense. Bela Kadar sums this point up in the following way:

"Hungarian capital import is to carry out the technological and structural modernization of the economy, to improve its productive ability and to further world-economic integration on the national-economic and company level. In addition to the growing interaction of the international flows of up-to-date products, technologies and expertise as well as of financial resources, it is the import of capital for investments that can best facilitate the adoption of high technology and advanced methods of production, organization, management and marketing" (1986:19).

How successful then has the joint venture policy been in improving the technical development of the economy? If an evaluation is based only on the amount invested as well as the size of the foreign partner (as discussed in the previous sections) it can be argued (as many Hungarian economists do) that no major technology transfer and hence technical development has taken place. However, 107 joint ventures do exist and they must have effected Hungary's technical development in some way or other. There are many problems however in trying to make an evaluation of this type. First, is the fact that while 36% of all joint ventures now in existence were established in 1982-1985, the majority - 57% - were established between 1986-1987.¹⁰ While large

¹⁰There is all the more reason to argue this when according to Toldy-Osz of the 61 joint ventures established from 1986-1987 only about 20 will be in operation as of mid-1988.

sums have never been invested in Hungary, since the 1980s there has been an increase in these sums - there was a 83% increase in the sum invested between 1986 and 1987. Furthermore, while during the 1982-1985 period 51% of the joint ventures established were in the production sector, in the 1986-1987 period, 72% were in this sector - 66% of all production joint ventures established. Thus, it has been only in the recent period, particularly after 1986, that it is possible to begin to raise questions such as the kind of impact joint ventures have had on Hungary's technical development. Even still, given the time needed for those established to be fully functioning before a determination of productivity gains, etc. can be made - it must be argued that it is premature at this time to evaluate the extent to which those in existence have succeeded in improving the technical development of the economy.

Given these limitations it is possible however to look at some examples of the kind of technology that is being transferred in the joint venture process. Also it is possible to evaluate whether or not the joint ventures now in existence will aid in restructuring the economy. This can be evaluated by looking at the sector and industries in which the joint ventures are located and by comparing them to the priority areas determined by the government. Finally, it is important to consider some of the indirect effects the joint ventures have had on the economy. In this section these issues will be addressed in turn.

SOME EXAMPLES OF TECHNOLOGY TRANSFER

While it is impossible to generalize about the types of technology transferred the following examples can provide at least some insight

into this process.

1) Walton, Computers Co. Ltd., was established in 1984. This joint venture is with a British firm - Walters International Microsystem Ltd. and the Hungarian partner Videoton Electronic Works (the major electronic producer in Hungary). The original capital invested was 25,000,000 forints. While information provided by the Hungarian Chamber reports that this joint venture is for the production of matrix printers - the reality is that the joint venture only assembles the printers. The Hungarian parent company, Videoton uses Walter's manufacturing licence (obtained through the joint venture) and components are either produced or imported by Videoton. The joint venture is responsible for the assembly (at Videoton facilities) and the sale of them - either back to Walters in the U.K. or bought by Videoton for domestic use. The main advantage of the joint venture has not been in obtaining the manufacturing licence - Videoton could have acquired this by itself - but rather in the fact that the Hungarian parent of the joint venture (Videoton) is guaranteed the necessary imports for its production, something which it is not guaranteed as a solely Hungarian enterprise. The joint venture considers the contact with Walters International not more than a good business contact. Although Walters International provides up-to date licenses, the joint venture itself has had difficulty in maintaining an up to date product due to problems in obtaining up to date information from Western subcontractors. While it exports approximately 15% of its product to the West (to Walter's) it does not believe it can increase its export due to international competition. It cannot export to the CMEA because

it does not have the appropriate export licence. This licence is in the hands of its parent company (Mr. Tamas Folgar, personal communication, May 1988).

2) Another joint venture, APV-Ungaro Limited Liability Co. is a joint venture established in 1984 between APV International Ltd. Great Britain, APV Paracal Ltd., Great Britain and three Hungarian partners. Original capital invested was 5,000,000 forints. According to reports from the Hungarian Chamber the joint venture manufactures and commissions food-processing machinery and equipment. The reality however is similar to the previous example. The joint venture at this time assembles (and markets) a compressor - it purchased the license from APV International and imports 50-60% of the components from them while the remaining component production is subcontracted to Hungarian companies. The joint venture also provides engineering services for the food processing industry - providing complete plants (technology) to its customers in the Third World. While it would like to move into manufacturing, it does not do so at this point. (Ms. Julia Grexa, personal communication, May 1988).

3) Kemipur Polyurethane System Ltd. is another joint venture established in 1984 between Elastogran GmbH (BASF Gruppe), FRG and two Hungarian firms. Here, consistent with the Hungarian Chamber's report, the joint venture has been producing and selling polyurethane foam systems. It is significant to note however that it took two years after the establishment of the company to start production. Original capital invested was 100,000,000 forints. In this joint venture the German partner supplied equipment, know-how and has undertaken to

continually update this in line with the demand in Hungary. The German manager is responsible for production, technology and control while the Hungarian partner is responsible for management, sales and finances. It is expected that within five years the German manager will sufficiently train the existing personnel to no longer be needed. At this time all raw materials are imported although it is anticipated that by 1995 Hungarian firms may produce some of the materials. The joint venture does not operate directly abroad, rather it services only the Hungarian market. It is guaranteed however that BASF-Elastrogan, (the German parent) sells up to 20% of the joint venture's production through its own sales organization (Hungarian Business Herald, 1988/1:23).

4) A final joint venture example is Sphero-EVIG which is reported and does in fact produce and sell circulating pumps with spherical engines for heating and utility warm water equipment. It was established in 1981 with 3 Hungarian firms and two small German companies. Original capital invested was 125,600,000 forints. The German partners had no previous business experience in Hungary before this joint venture. Rather the inventor of the product had been seeking a partner with sufficient technical and production experience for the utilization of his patent and Hungary was interested, believing the technology to be useful for the domestic market. In addition it was felt that export sales would be possible and so the licensor stopped producing (in its own facilities) the products under license to the Hungarian joint-venture. After initial difficulties in the first 18 months - when the joint venture was granted loans by the Hungarian

parent, the company has now stabilized and the profit/sales ratio has been increasing annually. (Hungarian Business Herald, 1988/2:9).

As these few examples show, the reality of the joint ventures are, at times, different than the expressed intention at the time of foundation. The actual technology transferred is generally small although the joint venture product can be useful for the domestic market. It is clear that the Western interest is to obtain market access. The interest of the Hungarian partner is not necessarily the development of a viable joint venture, but may be to get around domestic enterprise import restrictions. Moreover, the intensity of the relationship between partners in the joint venture varies, with no norm established.

SECTORS WHERE THE JOINT VENTURES ARE FOUND

Restructuring of the economy is a fundamental goal of the current 1986-1990 Five Year Plan. This is pointed out by Lajos Faluvegi, Deputy Prime Minister and President of the National Planning Office who, when discussing the current plan comments:

"In the forthcoming plan period our development depends basically on whether we can meet the requirement of adjusting better to the world economy in quality and up-to-datedness. Far-reaching structural changes are taking place in the world economy and we are bound to lose ground in the world unless the Hungarian economy can adapt to these changes as quickly as possible" (1985:3).

While the fundamental development goal of the plan is to generate a higher volume of net product, it is to be achieved by "the acceleration of export oriented development, which itself is dependent upon the medium and long term restructuring of the enterprises in order for them to achieve international competitiveness". According to the

plan, a "differentiated development of the manufacturing industry, agriculture and food industry is to be facilitated by increased investments...as well as investments in production-related infrastructure." (Kardos, 1986:8).

It is significant that contrary to prior years where investment policy was not linked to restructuring nor an explicit export-oriented policy, it is the intent of the present plan to do so. In addition, central economic development programmes have been launched which are expected to contribute to a general improvement in the modernization and competitive structure of production. The central programmes promote:

"a moderation of specific energy use, the development and spreading of material and energy efficient technologies, the utilization of wastes and secondary raw materials, a society-wide economic application of electronics, including an expansion of the manufacture of electronic components and sub assemblies, and the development of the manufacture of pharmaceuticals, pesticides and intermediate products" (Kardos, 1986:8).

The link between these priorities and joint venture promotion can be found in the 1986 regulations where sizeable tax concessions were granted in priority areas determined by the government. The current list includes those areas mentioned in the plan, among others. Below is a summarized version of the list.¹¹

- Electronics and electronization
- Production of vehicle component parts in cooperation
- Agricultural and food-processing machinery and equipment
- Production of components for the engineering industry
- Development of packaging technology

¹¹The range of activities having an outstanding importance of the Hungarian economy is determined in a Bulletin by the President of the National Planning Office in accordance with the Minister of Finance.

- Production of pharmaceuticals: plant protective agents
- Development of the production of high technology for textile and clothing materials
- Investment projects for highly processed industrial products
- Supply industry developments in the agricultural sector and the food industry for promoting exports or substituting for convertible currency imports
- Development of the domestic protein bases
- Production and sales of propagation and breeding materials
- Technical development - material and power saving
- Tourism

How successful has the joint venture policy been in attracting investment into priority areas determined by the government? In Table 6.1, we have grouped joint ventures corresponding to the above-mentioned priority areas.¹² While this type of categorization is difficult at best, it is particularly true in this case as the information available about the activities of the joint venture is limited and many of the categories overlap. Despite this, the table can still shed some light on the general direction of the joint ventures vis a vis the priority areas for structural adjustment.

As the table shows, in 1986-1987 when the priorities were determined (and tax concessions given) and in 1982-1985 when they were not yet established, approximately two-thirds of the joint ventures were founded in the priority areas. Given the generality of the categories and the comprehensive nature of them, this may not be surprising. However it does suggest at the least, that the type of joint ventures being founded (while small in terms of capital

¹²It is interesting to note that according to Rajki, 20% of all joint ventures are dormant - they have not closed up but are now not working. Only 1 has actually closed up its entire operation because it had accumulated huge losses.

TABLE 6.1
Breakdown of Joint Ventures
by Priority Area

PRIORITY AREA	1966-67	1982-1985
Electronics and electronization	7	4
Production of vehicle components	0	0
Agricultural and food processing machinery and equipment	1	1
Production of components for the engineering industry	7	1
Development of packaging technology	5	2
Production of pharmaceuticals: plant protective agents and intermediaries	1	0
Development of the production of high technology for textile/clothing materials	7	2
Investment projects for highly processed industrial products	0	0
Supply industry developments in the agricultural sector and the food industry for promoting exports or substituting for convertible currency imports	4	5
The development of the domestic protein bases	0	0
Production and sales of propagation and breeding materials	1	1
Technical development - material and power saving	5	1
Tourism	3	4
 TOTAL	 41	 21
 Other (not designated as priority areas)	 20	 16
 GRAND TOTAL	 61	 39

invested), has the potential for aiding the structural adjustment of the economy. Moreover, with the 56% increase in the number of joint ventures between the two periods, and the fact that while dollars invested in production and the service sector were nearly equal in the 1982-1985 period, in the 1986-1987 period the total amount invested in the production sector was over twice the total invested in the service sector, it can be concluded that the tax concessions prove to have been an effective way to stimulate interest in these areas. Of note is the fact that production of vehicle components is the only category that is completely unrepresented, as the two other categories with zeroes - investments projects for highly processed industrial products and the development of the domestic protein bases overlap with other areas.

In what activities have the other one third of the joint ventures been established? According to the tables in the previous chapter, the other sectors in 1986-1987 were: construction (6); agriculture* (5); clothing* (4); trade representation (2); pharmaceuticals - health care (2); and financial (1). In the 1982-1985 period other sectors included: construction (4); trade representation (2); pharmaceutical - health related (3); financial (2); computer* (1); and miscellaneous (6). (*These are listed as the same category as in the priority area but for various reasons -such as the level of technology- are not included as priorities.) The joint ventures in this group (excluding financial and trade representation) are more likely to be consumer goods - in demand by the population and largely for domestic use or in for the development of the construction industry, particularly domestic housing products.

In sum, despite the qualifications one must make for the lack of adequate information on exactly what each joint venture is actually doing at this time, and despite the small sum invested overall, it does appear that the policy has been effective in promoting development in priority areas designated by the government.

MANAGEMENT AND PRODUCTION KNOW-HOW

The transfer of disembodied technology is considered by all the economists interviewed as the predominant form of joint venture technology transfer. It is in the area such as the organization of the production processes, the division of labour established on the shop floor, the quality control procedures, marketing, advertising and after sales services where Hungarian know-how is fundamentally weak. Furthermore, Western management culture, which emphasizes entrepreneurship including risk taking, initiative, incentives, etc., are all methods which need to be learned by Hungarian managers if they expect to operate in a market environment. Thus, as further reforms of decentralization are introduced into the economy, the Hungarian managers will need to utilize these entrepreneurial skills. Conversely, as they acquire these skills they will be less tolerant of central interventions - thus pushing the reform ahead. Alfred Sinkovitz (personal communication, January, 1988) sums up the usefulness of the type of technology transfer in the following way:

"Hungary has a deficit in management sciences capital. It is badly formed. Managers have little knowledge about the modern world economy. We have developed bureaucratic managers who are concerned more with Party relations than with general management. Their knowledge of the West is faulty. This is a source of underdevelopment - it is not only a technical question but here - a spiritual capital

deficit. so if we can learn modern management in the framework of a joint venture, if the Western world would participate in the formation of the young managers, then it would be more effective than only changing our capital structure*.

While the effects of this type of technology transfer are difficult to measure, a few examples are worth noting for they aptly highlight some of the most desirable effects it can have on the economy as a whole. A number of anecdotes have been related by economists on the theme of competition. Here is one such case. FOTEX (as described earlier) is a joint venture providing the processing of film. Using the same machinery that already exists in Hungary it provides the consumer with the completion of film processing in 2-3 hours. It also gives discounts to those purchasing its film. It enjoys great popularity because previously the Hungarian state enterprise processed the film in 4-5 weeks. The reason for this was administrative, not technical. The state enterprise complained to the government that FOTEX constituted unfair competition and that administrative methods should be used to enhance the state enterprise's position. The government decided not to intervene. Soon afterwards, the state enterprise started to offer the consumer 1 day film processing (Miklos Gabor, personal communication, January 1988).

Another anecdote will illustrate the point concerning quality. The joint enterprise is Sancell-Hungary Co. Ltd., the Western partner is Swedish. The joint venture produces sanitary articles, primarily disposable diapers and sanitary napkins for women. Not only does it have a reputation for excellent quality but it is also recognized for its attractive packaging and its prominent advertising. Needless to

say, the product is very popular in Hungary. The Hungarian state enterprise traditionally involved in this production complained to the government when faced with the competition from the joint venture. The government decided not to intervene. Now it is reported that the state enterprise has improved both the quality and the advertising of its product to remain competitive. (Personal communication with Gyorgy Varga and Andras Rajki, January, 1988).

Management culture impacts in other ways as well. The joint venture more often than not will contract with another Hungarian enterprise for the production of a particular component or product. While the joint venture must supply the Hungarian enterprise with the necessary license, it is expected that in return, the enterprise must ensure that the product will be produced on time and meet the stricter quality standards than the enterprise has previously met. Andras Koves (personal communication, February, 1988) analyzes these effects in the following way:

"Even if it is difficult to think that the macro-economic effects of joint ventures would be very high in the foreseeable future (i.e. in terms of low capital investment, low convertible currency exports), the improving market (domestic) situation is important in showing the possibilities of technological innovation to Hungarian enterprises - there is a demonstration effect for products to be produced. In addition, the best experts in the country want to work for these enterprises and this makes other enterprises realize it is important to give technology, education and money to its employees".

While this form of technology transfer may be where Hungary can be expected to gain the most advantage given its current regulations, it is significant to note that as of 1988, out of 67 joint ventures which are members of the joint venture club, only 17 Western managers can be

considered stable managers - that is, that they live in Hungary, have a work permit etc. Approximately 20 managers come three or 4 times a year, staying a couple of days. In the majority of cases, the managers come only 1 time a year - at the time of the Board meeting - for determination of profits, business plans, etc. (Toldy-Osz, personal communication, January, 1988).

CONCLUSION

This chapter has evaluated the success of the joint venture policy to date. Taking into consideration various reasons why such an evaluation is difficult, it proceeded to look at different criteria for making an overall assessment. Of central importance in such a determination is an evaluation of the strength of the response to the joint venture promotion itself. Here it was found that the total capital invested was extremely small and of marginal significance when compared internationally. Notwithstanding the fact that since 1986, due to a more favorable investment climate, direct investment has doubled over the preceding 14 years, an overall conclusion must be drawn that Hungary's joint venture policy has not created a sufficiently satisfactory environment within which to attract foreign capital. Thus, while Hungarian economists and officials point to a variety of reasons why both Western and Hungarian partners are less than enthusiastic about establishing joint ventures, their overriding concern is with further liberalization the regulations.

The value of the total investment is the single most important criterion or it determines the extent to which the policy objectives can be achieved. Once this is taken into account however, it is

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possible to evaluate the success of the policy based on whether it has met its objectives for the joint ventures that do exist. In the section on export promotion it was found that although specific data is sparse, the general sense is that not only do most joint ventures not meet the export-import balance requisites but furthermore, there are no examples of joint ventures which have helped Hungary develop a niche within the international division of labour. In addition, in the area of CMEA exports - while not being an objective of the policy but rather a special interest of Western partners - it has been found that Hungary has been unable to build a bridge into this market.

In the section on technical development it was found that since 1986 it has been the government's objective to entice joint venture investment into those areas of the economy that it has targeted for structural change - and this effort has in fact been successful. That is, approximately two-thirds of the joint ventures founded during 1986-1987 have been in these areas. The tax concessions in this period served to stimulate growth in the total number of joint ventures established. What is hindering the full development of this objective however is the small size of the investments. Finally, in the area of technology transfer of disembodied technology it was found that the objectives of the policy have indeed been meeting success. Western management culture and production know-how are effectively being put to use in some joint ventures and have impacted the domestic economy by stimulating competition and other indirect effects.

A final assessment must distinguish between policy and the

objectives. The policy itself is good, however the objectives were overly ambitious. Not having met the hoped for goals however is not in itself a reason to condemn the policy. In a technologically underdeveloped and capital scarce country enticing direct foreign investment has the potential for benefiting the home country. As it was shown in preceding chapters, the ideological factors which have inhibited the expansion of this type of activity have become less important over time as concerns over economic development have taken priority. One cannot condemn the policy by simply pointing to the paucity of investment. Attracting foreign investors is in fact, attainable - however it depends on the environment established. It is clear that once Hungary made her environment more attractive so that it was competitive with other world sites, more interest arose from Western partners and it resulted in a substantial increase in the number of joint ventures founded.

At this point however, Hungary is at a crossroads in defining her joint venture objectives. It is clear that if she maintains the current environment without major changes to it, it is most likely that she will not attract the larger multinational corporation and will continue to find it difficult to develop her export potential and establish a niche in the international division of labour. This however does not seem tenable for her long run interests. If however she seriously wants to pursue her joint venture objectives, then it is clear that it will be necessary to change the environment in which the joint venture policy functions. This means the continuation of the reform process in general, but also, more specifically, it means

changes in the regulations for joint ventures.

For many economists there is no question of which option the government should chose. Moreover, they speak about this with a sense of urgency - the implementation of new regulations should happen immediately - for if it is not already too late, in the near future, no doubt it will be. For them, a selective export-oriented development strategy is of vital importance for the future of Hungary and an appropriate joint venture policy is an important policy (among others) which can be put into place to make the overall strategy a success.

Chapter 7

HUNGARIAN JOINT VENTURE PROMOTION 1972-1987: A RESPONSE TO CHANGES IN THE WORLD ECONOMY

It is now time to return to the original question raised at the outset of this thesis. How have changes in the world economy influenced Hungary to actively promote joint ventures in the 1980s? In order to answer this two additional questions were posed: how do Hungarian economists analyze the impact of changes in the world economy on Hungary's economic performance (addressed in chapters 2,3 and 4) and what is the Hungarian evaluation of joint ventures and of their actual and potential contribution to the solution of Hungary's economic problems (addressed in chapters 5 and 6)?

Chapter 2 begins with an analysis of Hungarian views on the world economy. It was found that they consider the world economy to be an organism encompassing capitalist, socialist and third world countries creating its own processes and logic to which individual states are subordinate. There is no global power structure which rationally organizes these processes however, and as a result, there is an increasing polarization in levels of development throughout the world - a polarization which is fraught with serious consequences both for individual countries and the global community overall.

According to many Hungarian economists, the 1970s were a unique period in history which saw the ushering in of a new epoch. This epoch emerged with the oil price shocks of the early 1970s, an event which - although its roots were present earlier - nevertheless fundamentally altered the future course of economic development. While the oil

crisis raised the specter of global scarcity for the first time, it more importantly, altered many countries' terms of trade and spurred the rise in global debt. It also accelerated the pace of the scientific and technological revolution as new energy saving technologies were necessitated.

Chapter 3 indicated how the new epoch affected the economies of the CMEA in general and Hungary in particular. Most important was the recognition that the socialist economic system had failed to move from extensive to intensive development and that as a result their economies were lagging behind the West. The solution found to remedy this situation was to import technology from the West. This new desire for Western technology helped open up the doors of detente and contributed to the improvement in East-West relations. The improvement in relations was negotiated between the superpowers however, and the opportunity for the CMEA Six to gain access to the technology was in no small part influenced by the volatile nature of the superpower relationship.

The oil crisis was another factor which had an impact on the CMEA Six's development strategies. One consequence of the oil shocks and the subsequent world-wide recession was the increased interest on the part of the Western world, particularly Western Europe to renew trade relations with their counterparts in the East. Second, was the fact that borrowing on the international capital market was easy as a result of the influx of petrodollars. These two factors meant that the CMEA Six could proceed with the economic strategy of import substitution as a means to develop intensively. They were not constrained by the lack of hard currency nor by the lack of appropriate exportable goods for

the Western market. The reality of excessive borrowing however meant by the mid-1970s their collective convertible currency debt rose to an unprecedented level and problems in the balance of payments became chronic. In response, the CMEA Six replaced the policy of import substitution with a new economic policy which severely restricted imports.

A third factor which affected these countries' development strategy was the intra-CMEA relationship. Owing to the particular pricing policies within the CMEA and the fact that these were not based on world market prices, the CMEA countries found themselves obtaining oil from the Soviet Union at below market prices at the time oil prices hit the roof in the West. While the intra-CMEA pricing policy changed in 1975 in order to align itself more closely with world market prices, prices still did not change quickly. As the rest of the world was developing new energy saving technologies in response to the oil crisis, the CMEA Six continued to maintain those industries and technologies which were energy intensive and inefficient. They were not compelled to structurally adjust to the demands of the new epoch.

Hungary's response to the changes in the world economy was not much different from that of the other CMEA countries. Where it did diverge however was in initiating the NEM in 1968. The reform movement in Hungary was curtailed in the early 1970s however and was revitalized only in the post-1978 period. Since 1985, as the reform movement has finally gained momentum and as many small steps initiated by the reform process over the years have begun to build upon each other, Hungary find itself poised to reap the benefits from its commitment to economic

reform.

The reforms adopted in Hungary's foreign trade sector are a testament to both the slowness of the reform process but also to the extent to which Hungary is increasingly ready to face the world market. While small changes throughout the early 1970s and early 1980s have been made in the organization of foreign trade, in the reduction of foreign trade planning, in the financial regulators and in foreign direct investment in Hungary, it is only in the post-1985 period that the system has been substantially altered such that control over foreign trade decisions has been wrested from the Ministry of Foreign Trade and its trade organization into the hands of the enterprises at the micro level. Despite the gains however, the foreign trade sector is still constrained by excessive control over financial regulators - particularly in the area of state control over all foreign exchange as well as by the legacy of the over centralized past.

In Chapter 4, Hungary's foreign economic policy debates were discussed in order to identify Hungary's options as it faced the world economy in the 1980s. The debates responded to a question posed by many Hungarian economists: what led to the Hungary's economic decline in the late 1970s and why had the decline persisted in the 1980s? On one side of the debate are those who believe that Hungary had opened its economy excessively to the world economy in the 1970s and that this was at the root of its current problems. Thus, while East-West economic cooperation can help develop the socialist economies, such cooperation can only be subordinate and complimentary to the development of fuller intra-CMEA integration. On the other side of the debate

are those who believe that opening to the West is the only possible solution to Hungary's economic woes and that it was the failure to do so sufficiently, which led to Hungary's crisis. This openness should not be to the exclusion of developing further ties within the CMEA, but on the contrary, must be seen as a prerequisite to maintain mutually beneficial intra-CMEA relations.

Hungary's failure to structurally adjust to world market demand has meant that its industrial structure does not complement its comparative advantage and as a result, Hungary is faced with increasing competition from both third world countries who are able to better exploit their comparative advantage as well as by countries who are being given preferential treatment within the EEC. Thus, Hungary, as a heavily trade dependent economy, must either initiate a successful export strategy or face further decline in its economic development.

Chapters 5 and 6 answer the second question of this thesis. Chapter 5 reviewed the history and political environment of joint venture legislation as well as the number, size of investment and type of joint ventures established during the 1972-1987 period as the policy evolved. Four key turning points in the policy's history were addressed.

The first period was in 1972 when the CMEA countries decided to acquire Western technology as a means for achieving intensive economic development. While the CMEA moved to increase imports from the West for such purposes so too did they attempt to establish more intensive relations - known more generally as EWIC. The joint venture policy instituted by Hungary at this time was yet another effort to achieve

these ends. The joint venture policy met with little success for two reasons. First, it emerged virtually unpromoted and unacknowledged by the Hungarian government due to both strong ideological resistance to accepting Western equity participation in the economy (as it directly challenged the concept of state ownership of the means of production) and because the Hungarian government did not want to step too far afield of existent Soviet foreign economic policy. Second, the policy was unsuccessful because it was too restrictive, (limiting joint ventures to the service sector) and as a result, failed to interest Western partners.

In the second period, starting in 1978, the regulations were amended to allow for joint ventures in both the service and production sectors. This change came at a time when Hungary had only just begun to address its mounting economic problems, particularly in the area of convertible currency debt and balance of payment deficits. Economists realized that Western partners would only be interested in participating in joint ventures if they were permitted to develop intensive relations at the enterprise level and were able to have control over the ventures in which they invested. Moreover, the ideological concerns over private ownership receded as the foreign investment remained at a low level and Hungary became more concerned with whether it could relieve itself of its debt burden.

In 1982, a third period in joint venture promotion emerged as measures were adopted which allowed for joint ventures in custom free zones. Such a measure hoped to further entice Western partners to

Hungary. Taken together, the three periods, while achieving some results - during the first period 3 joint ventures were established, in the second period 4 were founded and the third period 39 with a combined value for all three periods of \$96,053,000 (US) - still failed to achieve any sizeable influx of foreign direct investment.

It was in the course of the post-1982 period that more serious attention was finally given to the joint venture policy. This was a result of analyses by reform economists finally being acknowledged by policy makers. These analyses, as described in Chapter 2 of the thesis, pointed out that the potential for future economic development lay in structurally adjusting to the world market and that such adjustment involved becoming integrated into the international division of labour; that capital markets were constrained in the 1980s and that the MNC had gained prominence as an international actor - such that in the 1980s countries were competing for its attention. Whereas - Hungary's attitude had previously been one of what can the Western partner do for it, Hungary has had to recognize that it must either adapt its environment to entice the Western partner or find itself without such partners. Finally, it was recognized that EWIC itself (that is non-equity cooperation) had been losing ground as the world wide competition for Western partners increased.

In 1986, as a result of such analyses, the government adopted its most liberal regulation for joint ventures. The essential component of the new regulation was a major tax concession for joint ventures established in priority areas of the economy. These priority areas were determined in conjunction with those sectors considered essential

to Hungary's efforts at structural adjustment. In response to these tax concessions, 61 new joint ventures were established in just two years. The total value of original capital invested totalled \$104,413,000 (US). While the level of investment in the two year period is not high in terms of international comparison, it was a major advance for Hungary. It proved that if Hungary is willing to make changes to its regulations consistent with international norms, it has every potential for enticing foreign direct investment.

While Chapter 5 showed that the number of joint ventures increased as changes were made to the regulations, Chapter 6 evaluated whether the objectives of the joint venture policy were met. The two primary objectives of the policy were export promotion and the technical development of the economy. If achieved, they could help solve some of Hungary's economic problems. Chapter 6 begins with an evaluation of the strength of response to joint venture promotion. This is essential because the extent to which the policy objectives can be met is contingent primarily upon the value of the total invested. As it was shown, the total level of investment is very small. It was noted however that the level of investment during the 1986-1987 period improved considerably and points to a potentially promising future.

Despite the low levels of investment an evaluation in terms of the success of the objectives is still possible. In the area of export promotion it was found that the joint venture objective has yet to be met. Joint ventures are primarily serving the domestic market and while all joint ventures are founded on the expectation that they will export to the convertible currency markets, this expectation is not met

in reality. Many firms in an effort to meet the requirement of balancing their imports with exports have developed contrived exportable commodities, while others have simply let the balance lapse. While some firms have succeeded in exporting, the volume of exports is not high and there are no specific examples where a joint venture has promoted Hungary's acceleration into the international division of labour. There are many economists who feel that the expectation to export to the Western market is an impediment to many potential foreign investors. Moreover, the overriding interest of Western partners is the possibility to penetrate the larger CMEA market and here Hungary has been unable to secure a bridge.

In an evaluation of whether or not Hungary has succeeded in improving the technical balance of the economy Chapter 6 points out that such an assessment would be premature given that the majority of the joint ventures were founded in the post-1982 period and most of these were founded as of 1986. In fact, as a small sampling of the joint ventures show - there is at times a discrepancy between the stated intentions of the joint venture and what they are in reality doing. Thus, while some state that they are established for the production of a certain commodity they are in fact only assembling the product. Moreover, Hungarian enterprise interest in joint ventures was shown to be less for the venture itself than as a means for acquiring imports that would be unavailable to a solely domestic enterprise. On the other hand, there are examples where the joint venture is in fact producing an up-to-date product, where the technology for the production has been transferred by the Western partner and where the technol-

ogy has clearly contributed in such an instance (albeit in a small way), to the technical development of the economy.

Chapter 6 found that joint ventures have succeeded in contributing to the process of structural adjustment as defined by Hungarian policy-makers. During 1986-1987, at least two-thirds of the joint ventures were founded in these priority areas. Thus, while the priority areas are defined broadly and it is difficult to determine the precise activities of the joint ventures, it can nevertheless be concluded that the joint venture policy has been effective, particularly in the 1986-1987 period in enticing associations in important areas of the economy.

Finally, the chapter reviews the benefits associated with joint ventures in the area of management and production know-how. It is in this area that Hungarian economists concur that the joint venture policy has proven to be successful. Not only has the Western partner imparted management know-how to the benefit of the joint venture itself, but owing to Western quality control requirements, marketing and advertising skills and after-service sales practices, formerly complacent Hungarian state enterprises are facing increasing competition from the joint ventures. Thus, domestic enterprises have found themselves having to adapt their practices to Western norms and have begun to realize that their market share is no longer guaranteed. In this way the spill over effects of the joint ventures have benefited the domestic economy.

Joint venture promotion has been slow to evolve. This has resulted in a less than favorable atmosphere during the majority of the

years the policy has been in existence. While politics and ideology played an important role in the initial years of restrictive regulations, as Hungary was forced to respond to changes in the world economy its regulations have been liberalized. While it can easily be argued that such regulations were too long in coming and that they still do not provide a satisfactory environment in which to entice Western partners, it cannot be forgotten that Hungary was constrained throughout the entire period by its socialist principles and institutions and by its alliance relations. Thus, in this light, Hungary's achievements should not be underestimated. Although the results have not matched policy-makers' overly optimistic hopes, a number of important economic benefits have resulted. More importantly however is that, compared to the other CMEA countries, Hungary, as a result of having undergone the painful process of reform, is now poised to take even bolder steps in the reform process and in the joint venture arena.

APPENDIX 1INTERVIEWS CONDUCTED

Renedek, Tamas. Economist, Industry Economic Research Institute.

Gara, Ivan. Executive Director, UNICBANK.

Grexa, Julia. Commercial Director, APV Ungaro, Kft.

Hertzen, Hannu von. Lawyer, Trade Division, Economic Commission for Europe.

Inotai, Andras. Economist, Head of Department, Institute of World Economy.

Koves, Andras. Economist, Director, KOPINT.

Losoncz, Miklos. Economist, Foreign Trade, Institute for Planning.

Margittai, Peter. Economist, KOPINT.

Miklos, Gabor. Economist, Head of Department, Foreign Trade Bank of Hungary.

Naray, Peter. Lawyer, Official, Ministry of Foreign Trade.

Folgar, Tamas. General Manager, Walton Computers Ltd.

Rajki, Andras. Economist, Adjunct Professor, Karl Marx University of Economics.

Sinkovits, Alfred. Economist, Institute of Economics.

Sugar, Tamas. Consultant, Hungarian Chamber of Commerce.

Toldy-Osz, Ivan. Chartered Accountant, Professor, Vice President of the Joint Venture Club - Hungarian Chamber of Commerce.

Varga, Gyorgy. Editor, Figyelo. (Hungarian Economic Newsjournal)..

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