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## THE ECONOMIC TRANSFORMATION IN HUNGARY – DETOUR OR IMPASSE?

### ABSTRACT

The economic transition took place in the Central and Eastern European region almost at the same time. The reasons and the process of economic transition are similar. However, the Hungarian case had a special importance in the change of the regime, as it was followed by a political transformation. The New Economic Mechanism from 1968 brought irreversible changes in macroeconomy and in the attitude towards entrepreneurship. The reforms were stopped because of several reasons. However, the spirit survived. While focusing on the transformation, it is also essential to examine the historical and political background of Hungary to answer the question whether the socialist economy can be considered a “detour” or “impasse”. Using the different statistical data about the Hungarian convergency towards the developed Western European region, it can be said that the relative backwardness is rooted in the historical past and apart from the fact that several efforts were carried out in order to reduce or at least to stop the growing differences, these attempts failed partly because of several inappropriate political decisions.

**Keywords:** economy, transformation, reforms, convergency

*This war is not as in the past; whoever occupies a territory also imposes on it his own social system. Everyone imposes his own system as far as his army can reach. It cannot be otherwise. If now there is not a communist government in Paris, the cause of this is Russia has no army that can reach Paris in 1945.*

Stalin's speech from April, 1945<sup>1</sup>

<sup>1</sup> It was called the “Stalinn doctrine”. *The Stalin Doctrine*, Grand Strategy: The View from Oregon, 22 January 2011, at <<http://geopolicraticus.wordpress.com/2011/01/22/the-stalin-doctrine/>>.

*When forces that are hostile to socialism try to turn the development of some socialist country towards capitalism, it becomes not only a problem of the country concerned, but a common problem and concern of all socialist countries.*

Quotation from Breznev's Doctrine, 1968<sup>2</sup>

*The fall of the Berlin Wall in 1989 opened a new historical phase for Eastern Europe. But it also marked a turning point at the heart of neo-liberal globalisation and European construction.*

Catherine Samary<sup>3</sup>

## PREFACE – THE DIVISION OF EUROPE

The aim of this paper is to describe the economic transition in Hungary within the Central and Eastern European region, its features, historical background, aims and consequences. After the Second World War, Hungary became the member of a bloc of states within the Soviet Union's sphere of influence called the socialist bloc, therefore it is reasonable to give an overview of the consequences of this group to focus to the Central and Eastern European region as a whole. According to Berend,<sup>4</sup> the transformation of Central and Eastern Europe after the half-century communist experiment is one of the most important historical events of turn-of-the-century Europe and the emerging new world order. The transformation is a complex phenomenon with far-reaching political, social, cultural and economic aspects.

When we examine the economic transformation, it is essential to concentrate on the geopolitical, historical, political and economic background as a whole. A huge amount of books and essays deals with the aspects and consequences of the division of the European continent, the gap as an effect of the iron curtain. It would be a hopeless task to list the authors and their works; however it would be reasonable to introduce at least a part of the Hungarian works focusing on the economic transition and Hungary's role within Europe and its convergence towards the developed Western European core region.

It is a part of historical legacy that the European continent cannot be considered a homogeneous entity; there are cleavages which are either cultural or economic. It is

<sup>2</sup> Quotation from the Brezhnev doctrine. J. Taranto, 'Leonid Brezhnev Lives', *The Wall Street Journal*, 30 March 2012, at <<http://online.wsj.com/article/SB10001424052702303404704577313750705052134.html>>.

<sup>3</sup> C. Samary, 'East Europe Faced with the Crises of the System'.

<sup>4</sup> T. Iván Berend is a Hungarian historian focusing on the economic history of the Central and Eastern European region in the 19<sup>th</sup> and 20<sup>th</sup> centuries. In many of his works, he explains the problems of convergence and divergence of the Central and Eastern European region to the more developed Western European states. His concise summary of the construction of the Soviet bloc can be read in: *Central and Eastern Europe, 1944-1993. Detour from the Periphery to the Periphery*, New York 1998, *Cambridge Studies in Modern Economic History*, 1.

not surprising that these cleavages are located more or less at the same places.<sup>5</sup> Among others, the Wallerstein's model<sup>6</sup> that characterised the triple-divided construction was accepted by the Hungarian historians as well. His construction was extended by Jenő Szűts. According to their opinion, the gap between the more developed West and the periphery can be explained by several historical and economic factors. They both found a so-called semi-periphery which can be referred to as the Central and Eastern European region.

If we keep in mind the regional differences as a reason and at the same time the consequence, the distinctions of the European continent are essential. According to Jacobs's interpretation, Europe can be identified as a concept as well as a continent and the borders oscillate widely.<sup>7</sup> Following this standpoint, "Europe" became virtually synonymous with Christendom in the Middle Ages. A relatively recent and generally unaccepted theory sees Europe spanning half the globe, from Iceland to Bering Strait, nearly touching Alaska. During the Cold War, however, the opposite tendency triumphed more often: All of the Soviet Union, including Vilnius, Riga and other cities that today lie within the European Union, were excluded from Europe entirely. At times even the Soviet satellite states in the Warsaw Pact were left out as well, so much had "Europe" come to be synonymous with "the West" and its associated political values. According to Jacobs, their Europeanness of the countries of the former Eastern Bloc was confirmed with the transition and the European integration. The change of the regime brought the remapping of the European continent as the post-socialist states also expressed their claim for acknowledgment as the full members of Europe. European integration was the final proof of the fact that the borders of Europe are not equal with the line of the iron curtain, however several doubts arose in connection this issue.

## THE ECONOMIC TRANSFORMATION IN CENTRAL AND EASTERN EUROPE

There can be several reasons of the collapse of socialism; of why it happened, whether there were external reasons or it was a consequence of several political and economic coincidences. It can be assumed that the agony of the socialist economy was a long-lasting process. However, taking account the statistical data, we must not forget about

<sup>5</sup> It is very popular to deal with the division of Europe. The core and periphery theory by Wallerstein is based on the same ideology that was also described by the Hungarian historian Jenő Szűts in his work: 'Vázlat Európa három történeti régiójáról', *Történelmi Szemle*, No. 3 (1981), pp. 313-359. The importance of this essay – apart from the intention to write a synthesis comparing the different regions of Europe – was its delicate timing. The essay was published in the early 1980s and claimed that there was no homogenous Eastern Europe.

<sup>6</sup> I. Wallerstein, *A modern világgazdasági rendszer kialakulása. A tőkés mezőgazdaság és az európai világ-gazdaság eredete a XVI. században*, Budapest 1983.

<sup>7</sup> F. Jacobs, *Where is Europe?*, Opiniator, at <<http://opinionator.blogs.nytimes.com/2012/01/09/where-is-europe/>>.

the fact that in the first half of the 1950s, the Central and Eastern European region was the most dynamic region of the world reaching the greatest increase in the annual national product. There were times when the West did not feel totally assured about its superior economic and military force and communist brush fire in poor parts of the world was feared. The whole region followed the same scenario as the Soviet view of communism was the prescribed model everywhere in the Soviet bloc and only a limited level of divergence was accepted. This perception underwent a remarkable change after the 1956 events in Poland and the collapse of revolution and war of independence in Hungary. Strict elements of Stalinism disappeared and never returned, however it did not mean a dynamic change in the socialist world, only moderate changes were recognisable. In case of Poland, farming largely remained in private hands and dissidents met with more tolerance than in other East European countries. Hungary was also allowed to embark on a more relaxed economic policy which included incentives for workers and greater freedom for middle management in agriculture and industry. Thanks to the higher level of consumption, it also became the most individualist society of Europe. But when Czechoslovakia seemed to be heading towards the dismantling of single-party rule in 1968 and to the espousal of other "bourgeois democratic" heresies, Soviet and Warsaw Pact troops marched in and restored communist order. A month later, the so-called Brezhnev doctrine described precisely the limits of the divergence within the socialist world however it concentrated mostly on the political issue neglecting the economic issue.

It was pointless to speak about the socialist region as politically homogeneous, but economic and social differences particularly emerged right in the late 1940s. According to several views, the reason of the collapse of communism can also be explained by this unequal heritage and development. Communism failed because it was based on a model, in some sense inappropriate, or the particular Soviet incarnation was at fault. The model served not too badly in special circumstances, such as the economic take-off in the terminology of Rostow, but it failed hopelessly in a mature economy. It was widely recognisable in the case of Czechoslovakia that, thanks to its historical and geographical background, it can be characterised as the most industrialised and most urbanised state within the Communist bloc. That is a special question whether enforced industrialisation had such painful consequences as the decline of the standards of living, the fall of real wages, fall of consumption that could lead to the political opposition against Soviet Union after the death of Stalin. The features of communist rule were inherited from the tsarist Russia; the centralisation of power and the need for ideology, the key role of the military and the imperial aspirations.

When we examine the issue of the economic transformation, the road to the change of the regime from the perspective of the transformation of economy, the historical heritage also has to be kept in mind. This division survived for centuries. The historical heritage remained in Europe in a dual structure.<sup>8</sup> The difference can discerned in the

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<sup>8</sup> If we look at the difference between the East and the West, semi-periphery can refer to the East as well.

following issues: nation state versus global governance, representation of the local or global interests, federalism or strong nation state. The revival of the nation state after transition was very often accompanied by strong centralisation efforts which resulted in the total absence or a weakness of the decentralised institutional system and autonomies of the region. The judgement of the events of 1989, or the transition process itself differs according to the judges. It can be described as the “*annus mirabilis*” when a great political and economic transformation appeared without violence.<sup>9</sup>

At the turn of millennium, more optimistic views became widespread according to the success or failure of the transition. The model created by Iván Szelényi<sup>10</sup> distinguished three different types of transition models from which two “belong to” the post-Socialist European states. He estimated the outer-directed capitalism as the better scenario from the two European models with the limited possibility of transition crisis and a relatively short time frame. However, the crisis that reached Europe in late 2008 showed that the deeper a country is involved with foreign capital and foreign direct investment, the greater vulnerability it has to sustain.

Types of Transition by Szelényi

Transition types	Outer-directed capitalism	Top-down directed capitalism	Building capitalism from below (bottom)
Type of Capitalism	Liberal system (New EU-8 members in CEECs)	Patrimonial system; Politically controlled capitalism (Russia, Ukraine, Bulgaria)	Hybrid system (China, Vietnam)
Political strategy of transition (conflicts within elites)	Victory of the technocracy over bureaucracy; collaboration with intelligentsia for the hegemony	Bureaucracy preserved its power, using it for the acquisition of private wealth	Coalition of bureaucracy with the new national bourgeoisie; Bureaucracy preserved its political power
Foreign capital	Predominant	Little	Growing portion of TNCs; many small investors
Political system	Multi-party democratic system	Multiparty system with authoritarianism	Mono-party system
Transition crises	Deep, relatively short period (4-5 years)	Shallow at the beginning, but long lasted (10 years <)	No crises

Source: I. Szelényi, ‘Kapitalizmusok szocializmusok után’, *Egyenlítő*, No. 4 (2004), edited by the author.

According to Kornai, the transitions of the Central and Eastern European Region are unprecedented. In his 2005<sup>11</sup> essay, when he compares the transition models he

<sup>9</sup> This phenomenon appears in Kornai’s and Berend’s works. Berend describes 1989 as an “*annus mirabilis*” partly because of the speed of the events as almost every regime collapsed within a year, and on the other hand because of the peaceful nature of transformation. As it took part without greater violence. János Kornai, the famous Hungarian retired professor of Harvard University also uses this terminology to describe the chain of the events in 1989.

<sup>10</sup> I. Szelényi, ‘Kapitalizmusok szocializmusok után’, *Egyenlítő*, No. 4 (2004), pp. 2-11.

<sup>11</sup> J. Kornai, ‘Közép-Kelet-Európa nagy átalakulása – siker és csalódás’, *Közgazdasági Szemle*, Vol. 52, No. 12 (2005).

came to the conclusion that the CEE region transformations were realised according to the following criteria. The transition itself affected all spheres of the economy and the political institutions.

Transition Models according to Kornai

Characteristics	CEE region	Transformation of the Soviet Union from Socialism into Capitalism	Hungary: Horthy restoration Chile: Pinochet restoration	China: transformation after Mao	West Germany: transformation after WW2	The great historical transformation in Europe: from the Middle Ages into modernity, from pre-capitalism into capitalism
In the main direction of the development of the economic system?	Yes	No	Yes	Yes	Yes	Yes
In the main direction of the development of the political system?	Yes	No	No	No	Yes	Yes
Parallel in all spheres?	Yes	Yes	Yes	No	No	Yes
Without violence?	Yes	No	No	No	No	No
Without foreign military occupation?	Yes	Yes	Yes	Yes	No	No

Source: J. Kornai, 'Közép-Kelet-Európa nagy átalakulása – siker és csalódás', *Közgazdasági Szemle*, Vol. 52, No. 12 (2005), edited by the author.

By accepting Kornai's statement, we can agree that the change was so rapid and covered all spheres so it can be rather described as a revolution. Kornai's definition can be also disputable if it is compared with two types of perception which are also well known in this region. One of them relates to Habermas who writes about "repairing revolution" instead of regenerative revolution.<sup>12</sup> However, there is a different phenomenon which is frequently used to characterise this region. In the assistance of the state, the government is determinative because the initiatives usually come from the above. The word is "refolution", which is a composition of two words – reform and revolution blended

<sup>12</sup> Nachholende Revolution. It refers to the fact that the reason of these revolutions was the return to the democratic legal state and the norms of the developed capitalist Western European region. According to Habermas's theory, bureaucratic Socialism could not be identified as an alternative version of organised Capitalism. It is rather a backward formation of Capitalism. This is why the revolutions of 1989 can be called as "repairing revolutions". This definition implies that this type of revolution does not have any importance or lesson for the developed Western world.

together. This word refers to Ash and it referred at first to the role of the participants in the process of transition. Ash states that the initiators of the reforms were rather the Communists in late Socialism and the ideas of the “inhabitants”, the role of the newly-organised or reorganised civil society was not so decisive. As it is visible, the state, the “upper level” got an enormously great role inherited from previous centuries.<sup>13</sup>

The relationship between the state and society, the question of the initiator is a consequence of the historical heritage. Examining the reasons of the economic backwardness or lag is a very complex issue. It cannot be declared that Eastern European backwardness is a mere consequence of the planned economy and state socialism. If this case, it would be enough “to return to normality” by introducing the Western type of market economy by bold and radical reforms. There is some kind of contradiction between Berend and Kornai. When Berend describes the age of socialism as a “detour” in his book published in 1998<sup>14</sup>, Kornai prefers to use the symbol of “impasse” to get this model from the traffic signs.<sup>15</sup> Both authors mention that socialism cannot be a natural consequence of the events and the features of the economy inherited from the inter-war period. However, there is a slight difference between the two approaches. If we use the word “detour”, we accept a type of linear progression and this detour is just a moderate bending of the main direction. However the “impasse” is rather a feeling of experience that we did not choose the right way, we have to go back to the starting point and to launch a new progress.

Transition can be characterised by the collapse of state socialism. In most cases, the change of the regime was quite peaceful since the Soviet Union gave up the control of the area and the communist elite lost its self-confidence and hope to be able to solve the towering economic problems. A stormy and spectacular transformation began and characterised the entire period of the 1990s. The economic and political transition of the 1990's across the Central and Eastern Europe was simultaneous with the faster expansion of globalisation in Europe. The change of the regimes brought to life several scenarios in connection with economic transition. From the very beginning, several hundreds of recommendations, studies and critical analyses became worked out by the newly appointed governments, scholars and experts of various international institutions. A broadly accepted set of criteria for a reform programme, the so-called Washington Consensus of 1989, originally applied to less developed, crisis-ridden Latin American countries, was offered as a blueprint for the process of Central and Eastern European economic transformation. The acceptance of the initiative of the Washington consen-

<sup>13</sup> It also has got a Hungarian version: “reforradalom” that is also the composition of the two words into one. There is another description, the so-called “velvet revolution” which also refers the fact that the events took place mostly without violence. As Ash remarks, the symbol of the new type of revolution is the “round table” instead of guillotine that represents the possibility of agreement instead of terrorism (T. G. Ash, *The Magic Lantern. The Revolution of '89 witnessed in Warsaw, Budapest, Berlin, and Prague*, New York 1990; A. Schmidt, *Törésvonalak és területfejlesztés Lengyelországban; adottságok, szereplők, intézmények, perspektívák*, Doctoral thesis, Pécs 2010).

<sup>14</sup> I. Berend, *Central and Eastern Europe, 1944-1993...*

<sup>15</sup> He used this example first time in 2005 at his public lecture after receiving Doctor H.C. title at the University of Pécs. The lecture was published in J. Kornai, ‘Közép-Kelet-Európa nagy átalakulása...’



sus concentrated mainly on macroeconomic stabilisation of the post-socialist states; it tried to help reduce the inflation and indebtedness. It rewrote, among other things, the role of the state, the share of the redistribution of resources, the liberalisation of trade, the monetary system and the importance of privatisation, the growing importance of the private sector focusing on the manufacturing industry. New institutions were to be built and the legalisation of the market economy was also essential. It also incorporated the price and trade liberalisation. This prescription was offered for former state socialist countries by the International Monetary Fund, World Bank and the American administration. As Jeffrey Sachs declared, *the economic reforms will set in motion a sustained process of economic restructuring. ... Once market forces... should be a strong pull of resources into the previously neglected service sectors.*<sup>16</sup> On the other hand, such a great restructuring process was expected from the agricultural and industrial sectors as well. As in the Socialist regime the importance of the energy-intensive heavy industry was unquestionable, with the transformation the labour-intensive and skill-intensive industries became emphasised. Its role was to increase the competitiveness of this sector in order to make it an important factor on the world market.

However, this tabula rasa process dominated by the Chicago school version of laissez-faire ideology, or market fundamentalism with disregard of social values and the seeking of supremacy of the market values was already in the scenarios of the Reagan's and Thatcher's governments and became the most important principles of the economic transformation in Central and Eastern Europe.<sup>17</sup>

During the economic transition, the following principles were kept in mind.

1. The transition to market economy was accompanied with the urgent demand of adaptation to a completely different environment of world economy.
2. There was an inappropriate development trend of economy based on depressing structure of obsolete industry and stagnating service sector.
3. There was a significant deficiency in domestic capital funds with high foreign debts.<sup>18</sup>

## THE HUNGARIAN TRANSFORMATION – ITS PRELUDE AND THE REFORMS THAT WERE UNDERTAKEN

The Hungarian economic and political transformation was based mostly on the principles of the debt trap. However, it is worth to examine the reasons why the debt trap became so typical in the Soviet bloc and why it obtained such a determining influ-

<sup>16</sup> I. Berend, *The Economic History of Twentieth-Century Europe. Economic Regimes from Laissez-faire to Globalization*, New York 2006, pp. 174-175.

<sup>17</sup> A. Schmidt, 'The Consequence of the EU Enlargement – the New Borders of the European Union' in I. Tarrósy, S. Milford (eds.), *Challenges for the European Union in the Next Decade. A View from the Danube Region*, Pécs 2013, pp. 63-68.

<sup>18</sup> Gál and Rácz write about this in Z. Gál, Sz. Rácz (eds.), *Socio-Economic Analysis of the Carpathian Area*, Pécs 2008, pp. 4-7, *Discussion Papers Centre for Regional Studies, Hungarian Academy of Sciences*.



ence, reason and consequence in the Hungarian economy. Naturally, it can be explained by several ways. Among others things, it was a consequence of the reaction of the Hungarian political elite after the revolution and war of independence. They tried to avoid any violence after the collapse of the 1956 revolution and war of independence. It was much easier to concentrate on consumption and if there was lack of inner resources, it was the easiest way to ask for a loan from the banks. From the mid 1960s, there was a compromise between the political sphere and the Hungarian society. The so-called "Kadarism" was not glorified by the society, as it was rather considered as an acceptable agreement based on the attempt from the state to meet the needs of the nation and to limit the level of the dictatorship in political aspect and in the cultural sphere. If there was anything that could threaten the balance, the danger of losing legitimacy emerged.<sup>19</sup>

In the 1960s, the world was still far enough from the oil crisis. However, some kind of adjustment was required in Hungary. Thus, it is essential to examine the reasons and the historical background of the peculiarity of the Hungarian economic policy. If we were to begin such an analysis, it would be advisable to deepen oneself in the observation of the facts and data of the historical past, beginning with the facts and consequences of the Hungarian economy after the dissolution of the Habsburg Monarchy. It can be stated that the existing economic unity of the two state bodies in the second half of the 19<sup>th</sup> century was interrupted and Hungary was suffering from the negative consequences of the lost World War I. Instead of an economic cohesion, the new independent Hungarian state found itself cut from its previous industrial centres. A great shock was caused by the area and population loss, but the earlier functioning markets networks and logistic units also disappeared. Until the twilight of the Habsburg Monarchy, the Hungarian economy was functioning as a part of an economic integration and common currency zone.<sup>20</sup> Since 1920, as a consequence of the birth of the independent but truncated state, the Hungarian economy transformed from the status of a part of an empire into a small and internationally open economy that brought about a significant dependency on the trade partners both in export and import activities. That was the reason why it was essential for the Hungarian economy to find adequate international trade partners, even if it meant the opening towards the fascist Italian economy or the sympathy towards the German *Grossraumwirtschaft* or later, after 1945, the thrust towards the Comecom. This latter sympathy resulted in an unilateral dependence on the Soviet Union that gradually became less and less tolerable.

Although there are several views concerning the level of the development of the Hungarian economy and the roots and reasons of the relative backwardness, it is gener-

<sup>19</sup> As Romsics explains it in his essay dealing with the threats of the Hungarian political legitimacy. In: I. Romsics, 'A Kádár-rendszer legitimitásvesztése az 1980-as években', *Rubicon*, No. 7-8 (2009).

<sup>20</sup> However, there were several attempts to create the Hungarian monetary independence it became realistic only once, when the Hungarian prime minister and minister of finance, Sándor Wekerle hindered the attempt that would have led to the leaving of the common currency and economic zone (A. Vígvári, 'Reform és rendszerváltás Magyarországon', *Rubicon*, No. 2-3 (2008)).

ally accepted that as the Hungarian state belonged to the so-called semi-peripheral region, its economic and social standards were far from the European core region. It was also generally assumed that if there was anything that could help in the process of modernisation, it definitely had to come from the outside, and thanks to the geographical and cultural position of Hungary, mostly either from Germany or, at least by German intermediation. As it was typical in the entire 20<sup>th</sup> century, the states of Central and Eastern European region were forced to adapt the Western type of modernisation and – apart from a short period from the early 1950s – no intention was noticeable to receive any results or influence of the Socialist Soviet Union.

There is a lively discussion among historians about the level of convergence towards the more developed Western region. The roots of this debate are based in the question whether the data represent more accurately the level of the productivity of the Hungarian economy versus the core region in past and present. As the evaluation of these data is not the aim of this present essay in which I summarise different statements, it is generally accepted that in the past two hundred years Hungary was only hardly successful in catching up to the Western region. It is still close to the reality that the reasons of this disadvantageous position can be explained with historical, political and social problems as well.

The idea of the viable market economy was a result of a set of slight reforms. It began with the policy of the “new course” announced by the prime minister Imre Nagy in 1953. The revolution and the execution of the leaders of the revolution and war of independence prevented the continuation of the reforms, but from the mid-1960s, a new phase of reforms emerged. The greatest obstacle was the question to what extent the Soviet Union would tolerate the divergence from the Soviet type of socialist economy. It can be proven by data and events that the Hungarian society was among the least tolerable towards the regime and the aims of Socialism. The most spectacular expression of this behaviour was recognisable in October 1956, when within 48 hours the previous political regime became replaced by new and renascent political actors. If it could happen once it could not be guaranteed that it would not happen again. The Kádár regime was the exceptional one that finally chose the reconciliation with the enemy in several aspects.<sup>21</sup> One of them was the decision about amnesty in 1962/63, when a great part of the participants of the 1956 October revolution were released. It also meant the official acceptance of the Kádár regime.<sup>22</sup>

The other attempt was the involvement of the prominent actors of the coalition era with the political elite. There were several experts who did not show any attempt to accept the party membership, but their experience and knowledge seemed to be beneficial. Finally, a slight change in the Socialist economy was decided. The Hungarian

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<sup>21</sup> L. Csaba, ‘Hadigazdaságtól a piaczgazdaságig, 1945-1990’, *Rubicon*, No. 3 (2001).

<sup>22</sup> The discussion on the 1956 events, the participation of the Soviet troops, the neglecting attitude of the Western powers was stopped. There was no longer debate on this issue at the sessions of General Assembly of the United Nations in New York. It was the end of the Hungarian isolation on the international stage.

New Economic Mechanism<sup>23</sup> (NEM) was a chain in the concatenation of the several reforms and patches made by the Hungarian government. In the 1960s, the Hungarian representatives were in negotiations with the IMF,<sup>24</sup> several representatives of the past coalition parties, or at least experts belonging to the sympathisers of the once-existing parties were invited to different expert committees. These gradual reforms and facilitations did not have great influence on the macroeconomic level, but it made the inhabitants' life enviable, especially comparing with the surrounding socialist states. It also questioned the policy of the Hungarian Socialist Workers Party. In order to face the problems and to react for the traumas of the potential economic troubles, a new course emerged in the programme of the state party as well. The initiative was borrowed from the Bible: ... *who is not against us is for us*.<sup>25</sup>

The functioning of the Hungarian NEM can be summarised in the following chapters:

1. The five year plans were rethought and did not appear at the level of the companies.
2. Greater autonomy at company level.
3. Limited influence of instructions from above.
4. Instead of free redistribution of the factors of production, the market became the key actor.
5. Equality of company and cooperative properties, the acknowledgement of the private ownership (at a limited level).
6. Autonomy of the companies in decision making related to the profit and investment.
7. Central planning system lost its priority, the Central Planning Office lost a great part of its units.
8. Plans and markets are equal.
9. Liberalisation of prices at 25% of consumer goods.
10. Parallel appearance of USD and Rubels in foreign trade.

When the the efforts of the NEM are analysed, it is generally accepted that if there were some reforms that exceeded the frames of the socialist economy initiated in the Soviet Union, Hungary never thought about the breaking away from the Comecom. The decision about the reforms was announced in 1964 at a session of the State Economic Committee and was finalised at the meeting of the Central Committee of the Hungarian Socialist Workers Party. The introduction of the NEM was planned for the beginning of 1968. However, several unfortunate events preceded and continued the reforms. The six-day war in the Middle East in 1967 and the Prague spring in 1968 forced the Socialist states to approach any changes and reforms carefully. According to the first experience,

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<sup>23</sup> It can be also written as New Economic Policy (NEP), but it is better to use the abbreviation NEM as NEP can also mean the new economic policy in Russia and in the Soviet Union in the interwar period. (Novaya Ekonomicheskaya Politika).

<sup>24</sup> It resulted that in 1967 Hungary nearly became accepted as a member state, however it failed finally.

<sup>25</sup> Mark, 9:40.

the reform seemed to be beneficial. The state budget obtained extra income. However, the proportion of the income jumped to 10 or 12 times in the management and the workers of the companies. This resulted an “anti-management” feeling in the representatives of the Hungarian Socialist Workers Party itself, so the members of the conservative wing began their attack against the reforms, arguing that the initiative of the reform is the restoration of the ancient middle-class Hungary against the principles of the theory of socialism. When we summarise the effects of the NEM, we could say that the roots of the economic troubles couldn't be solved. The reforms were stopped by 1973, the leaders of the programme were secretly removed from their positions. As it turned out from the example of the fate of the reforms initiated by Khrushchev in the late 1950s and early 1960s, it became generally accepted that the reforms had seemed to be viable without general changes in the entire Hungarian economic policy. However, it would have required political reforms as well, which was hardly tolerable in the country and in the Soviet Union. The fears and arguments against the reforms concentrated on the question of criticising the state party in assistance of losing its power by giving greater autonomy of the companies and cooperatives.

## ON THE SLOPE OF INDEBTEDNESS

The failure of the reforms stopped the entrepreneur spirit in the Hungarian economy and the oil crisis opened a new chapter as well. This had a double effect; the increasing prices of the energy resources and the cheap “oil dollars”. The cheap oil dollars postponed the reforms in most Socialist states. The Hungarian level of consumption was at an exceptional level in comparison with the other states from the bloc. However, by the late 1970s it became obvious that a new chain of reforms were needed to avoid insolvency. The ruble-based accounting system became replaced by the dollar-based version that had painful consequences and more information about the difficulties of the world economy. A new restructuring policy was needed in the Hungarian economy. There was an oversupply in the world market as far as those goods the Hungarian industry could export are concerned. In order to handle the fear of insolvency several scenarios were discussed, as it was generally accepted that the increase of the foreign loans could not be acceptable. Finally, a central decision was announced by the Central Committee of the Hungarian Socialist Workers Party in order to handle the economic crisis. However, there were several arguments in favour of the restructuring of the Hungarian economy and to stop the level of loans it took almost five years to work out and to introduce the inevitable reforms. It was not so easy even to convince the old generation of the party elite, but the appearance of the new technocratic experts and their increasing influence caused the conservative socialist wing of the political elite to retreat. In 1984, the introduction of the self-governing system in the management of the (at that time still) state-owned companies was a great step towards the acceptance of the features of the market economies. Approximately two years earlier, as a consequence of the sustainability of the standards of living, the so-called second (invisible) economy became also accept-

able. Apart from solving some increasing social and economic troubles, it had a great influence in the birth of the new entrepreneurs. Private ownership gradually entered in the Hungarian economy and, unexpectedly, people began to work hard without any force coming from outside or above. They simply found their own interest and were fighting successfully against the decline of their standard of living.

## TROUBLES IN THE ECONOMY

Apart from the dissolution of the political sphere, the same problems appeared in the Hungarian economy as well. The Hungarian National Bank had to devalue the forint by 8% in 1986 against most convertible ones which seemed to be an unprecedented step in the past six years. Based on the recently accepted Act on Bankruptcy, the first liquidation initiated by the state also took place in 1986. The first target firm was a construction company from Veszprém. With the increasing process of the liquidation of the loss-making state-owned companies the ideology of the socialist Hungary based on full employment devaluated. Thanks to this painful decision, the Hungarian government had to introduce the unemployment benefit in 1989, because approximately 50,000 to 100,000 unemployed appeared in three years.

The government was not successful enough in economic and social reforms. Partly because of the already existing inner contradiction between the technocrats in the several institutions and ministries and partly because of the insufficiently delineated position of Hungary within the socialist world. It was difficult to calculate to what extent Hungary could make its own decisions and when it became inevitable to get the consent of the already weakened Soviet Union, or when it was at least important to inform the “Big Brother”. Despite the economic troubles, the resourceful population gathered significant amounts of illegal income and changed it – partly at the black market – into hard currency. The introduction of the passport valid all over the world made the position of the population even easier. Thanks to the travelling facilities, masses of Hungarians appeared in Yugoslavia and Austria to buy household appliances and electrical equipment.<sup>26</sup> The most popular items to be bought were the Gorenje freezers, several pictures appeared in the newspapers all over Europe as Hungarian “Trabants” carried freezers on the roof racks. To sum up, the consuming activity of the Hungarian population reached more than 700 million USD spent from the Hungarian foreign exchange reserves.

The rapid growth of the previous decades came to a stop: in 1979 and 1980, Hungary’s growth rate declined to 1.6% and 0.0%, respectively. Poland, in 1981 and

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<sup>26</sup> The aim of the world passport was to ruin the political borders of Hungary and the Western world to let the people to travel to Western Europe and all over the world without any limitation that existed before 1987. Before that time, Hungary was among the few Socialist countries from where it was possible to travel to Western parts of Europe at least every second or third year. However, it was considered a political restriction not to let the people to travel to the West, but it also had practical meaning, too. It was hardly possible to supply the people intending to travel abroad with the appropriate amount of hard currency (L. Lengyel, G. Surányi, *Határátkelés. Beszélgetőkönyv*, Pozsony 2013).

1982, experienced a severe decline, -10% and -4.8% respectively. It became obvious that growth policy of the Soviet bloc had to be changed and the economy slowed significantly – from the annual 3.9% increase of the GDP between 1950 and 1973 to 1.2% between 1973 and 1989.<sup>27</sup> The economic crisis in the socialist world increased the necessity of transformation. It was strongly connected with the oil crisis which began in 1973. However, the real causes lay much deeper.<sup>28</sup> The reserves of the extensive import-substituting industrialisation dried up around the late 1960s. As the economic policy of the Soviet bloc concentrated on the self-sufficiency within the Comecon member states, the foreign trade with the market economies were neglected until the 1960s. The socialist bloc could not get the benefits of the new technological revolution that emerged between the 1970s and 1980s. The appearance of the PC in 1974 signed and symbolised the turning point. Unfortunately for the members of the Comecon, the symbols of the new technology were seldom used, partly because of political and security purposes – were used mainly in the military industry.<sup>29</sup> It also turned out that with the changes in the labour distribution and the developing globalisation, the old leading export branches of the world economy became obsolete. Sales of their products depended on major price reductions. Raw material prices, on the other hand, increased. In case of Hungary, it had a negative effect on the balance of trade between Hungary and the Soviet Union, because for the same amount of raw material, the state had to pay with 3 to 5 times more products. Sometimes raw materials had to be imported from the world market and that also brought the painful recognition of the difference between the competitive world market and the isolated world of Comecon member states. The roots of this issue are based on the insufficiency of modernisation.

There were two methods of industrialisation in the socialist bloc. One of them concentrated on import-substituting that helped in the modernisation of the semi-peripheral region. This method was in practice mostly from the late 1940s. In case of Hungary (and the other Soviet bloc member states), this resulted in the dramatical decline in the standards of living of the population as the greater part of the investments concentrated on heavy industry and among others than the mining sector. This meth-

<sup>27</sup> Here it is essential to make some remarks. As it is visible from the statistical data that both Berend (idem, *The Economic History...*) and Janos (idem, *Haladás, hanyatlás, hegemonia kelet-Közép-Európában*, Budapest 2004, *Universitas*), it turns out that the most dynamic region was the Soviet bloc from 1945 to 1973. Their annual growth of GDP exceeded the annual growth of the Western European region. The reason of this can be explained with the fact that thanks to the rapid industrialisation, an enormously great part of the national income was spent to investments that resulted a significant economic growth. However, this policy concluded with harmful consequences; the development of heavy industry was in the centre of the investments and the light industry, the supplier of the consumption of the population was neglected such as life circumstances. On the other hand, the resources of the rapid growth concentrated in extensive elements that resulted in a slow process of the depletion of resources.

<sup>28</sup> I. Berend, *The Economic History...*

<sup>29</sup> On the other hand, the existence of the so-called COCOM list (Coordinating Committee for Multilateral Export Controls) prevented the Socialist bloc from being acquainted with the tools of the newest technology.



od brought a great increase of energy and mineral extraction, but had a limited concentration on efficiency and cost-savings.

The countries of import-substituting industrialisation could not follow the technological revolution and experienced devastating trade deficits. The lack of adjustment in building new modern export sectors based on the achievements of the technological revolution exacerbated the crisis. According to Berend's vision<sup>30</sup> of the Schumpeterian structural crisis (the decline of the old and the rise of the new leading sectors as a consequence of technological revolution, which generated a 1-2 decade stagnation or slow growth) of the 1970s-1980s hit the socialist countries especially hard; they were unable to introduce competitive new technology and export sectors.

The necessity of restructuring the economies was obvious. In order to get new positions in the Western markets and to obtain hard currency for selling the competitive and exportable goods several reforms were needed. Until the mid 1970s, trade with free market countries was marginal. However, the socialist countries were forced to change their international economic environment and to search for new potential trade partners. The effectiveness of opening the isolated markets was based upon the political openness of the given Socialist state and the necessity of importing several goods that were available on the world market. With reference to this, Hungary was among the more open states as the Hungarian export and import began to orientate to the West already in the late 1960s. That was the reason why the Hungarian trades had to realise that the quality of goods the Hungarian enterprises produced did not meet the quality requirements of the world market.<sup>31</sup> Hungary was not alone in this reaction. An unavoidable slowing down of production increased shortage and pushed countries onto the open, free trade world markets. Hungary, Poland, Romania and Yugoslavia were among the countries which developed important trade relations with free market countries and reduced the trade with the Soviet-led Comecon countries to 50-60%. In order to increase the hard currency income, the Socialist states had to reorganise their economies. From the Hungarian point of view this brought the export-orientated version of production. There were several elements of the transformation that had to be worked out. Adjusting to world market prices and liberalising imports created competition for the heretofore protected and isolated Central and Eastern European economies, and this was also a prerequisite for market adjustments. On the other hand, it caused a decline in output.

The opening of the economies brought the fear of inflation, and the ever-increasing trade deficit. It was functioning as a double-edged sword. The Kádár regime in Hungary and the acceptance, or at least tolerance of socialism was based on a moderate level of the standards of living. It was called socialist market economy, although, in fact, it obtained some elements of the market economy. However, it was still isolated and the requirements towards the Comecon membership obstructed the acceptance of the principles of the market economy. The system of rationing was

<sup>30</sup> I. Berend, *The Economic History...*

<sup>31</sup> J. Honvári, 'Az új gazdasági mechanizmus', *Rubicon*, No. 2-3 (2008), pp. 44-58.



over, most of the goods were available in shops.<sup>32</sup> This was the basis of the calm and boring everyday life of the Hungarian population. Consumption was guaranteed at a moderate level, the possibility of extra work was also acceptable especially from the early 1980s, when the germs of the private sector were already widespread. People had the right to organise small enterprises, so-called communities of works and they could earn extra money.

### THIS WAS THE BEST IN THE KÁDÁR REGIME<sup>33</sup>

Kádár regime-related memories of the Hungarian population (in percentage of the answers)

1.	Safe workplace, no unemployment	35
2.	Material safety, better life, sufficient salary	25
3.	Predictability, safety, planability	11
4.	Facility in gaining a flat, a house	5
5.	"I was young"	5
6.	The possibility of travelling for holidays	4
7.	Social security, equality of dignity	3
8.	Everything was good in the Kádár regime	3
9.	No inflation, strong forint (Hungarian currency)	2
10.	Cohesive society*	2
11.	The communist youth organisations, the Hungarian Socialist Workers Party	2
12.	Good future, safety in future	2
13.	Nothing good	2
14.	Good public safety	1
15.	No answer	23

\* This is a very interesting comment as according to Körösnéni the Hungarian society was among the most individualist ones at that time with a limited participation in any circles, movements, or other elements of the civil society. Körösnéni explains this individualism by the relative high level of consumption. People were less vulnerable to the surrounding environment, social ties were less important. Körösnéni A., *A magyar politikai rendszer Budapest*, Budapest 2004, *Osiris Kiadó*.

Source: I. Romsics, *Magyarország története a XX. században*, Budapest 2001, *Osiris Tankönyvek*, p. 520.

The faith towards the state was the basis of the socialist Hungary. It was assumed that the individual didn't have the possibility (even didn't have the reason) to involve himself or herself in decisions belonging to the political sphere. It was commonly ac-

<sup>32</sup> Of course, this can be examined in two ways. If we compare the level of consumption in Hungary with the Western European standards, we can see how deep the Hungarian level was. But on the other hand, if the level of Hungarian consumption was compared with other Socialist states which still had the system of rationing, like e.g. Poland in case of meat or the Soviet Union where a lot of goods from sugar to washing powder could be bought only in limited amounts, Hungary found itself in a distinguished position. This is the reason why the Hungarian system was called "fridge socialism" together with "goulash communism".

<sup>33</sup> The survey was made in 2007 and the results were published in September, 2007.

cepted that the individual didn't have the possibility to do anything against decisions harmful for the inhabitants, furthermore, the paternalistic political system did everything to convince them that the state would make every effort to let the citizens to meet their needs and the only thing that was expected from them was not to argue against them.<sup>34</sup> This behaviour towards the state survived and transformed at a moderate way. Because of the change of the regime, the convulsive behaviour of the inhabitants previously shown towards the policemen, tollers, or frontier-guards almost disappeared, but on the other hand the fear of economic vulnerability increased. It is recognisable in the conviction that every entrepreneur was swindler and the price of their success was paid by the losing average inhabitant. These two decades of the political and economic transformation still couldn't erase this type of conviction and the consequences of the economic crisis of 2008, the decline in the living conditions of a great part of the population amplified this feeling.

## CORRECTIONS IN THE SOCIALIST MODEL – THE TWILIGHT OF SOCIALISM

Credits and debts were visible everywhere in the socialist world. As there were several attempts to reorganise the economy, it was obvious that because of several reasons the socialist economy could be functioning only with a limited efficiency. It was even a crucial question to what extent the intervention to the economy without political consequences was feasible. As it was one of the pillars of the Kádár regime and the faith towards the socialist regime tolerated no dramatic changes in living condition. As far as the consequences of the failure (or at least half-success) of the New Economic Mechanism are concerned, it was essential to look for alternative solutions in order to avoid the internal political conflicts and to calm the critics coming from either the Hungarian conservative communist politicians or the worrying "friendly" Czechoslovakian, East German and Soviet politicians.

Because Comecom member countries followed the traditional fast-growth policy, they were faced with an ever-increasing trade deficit. The financial market was flooded with cheap "oil dollars", as a great portion of the tremendous extra income of the oil-exporting countries was exported. As it was easy to borrow, the governments of the region did not hesitate to bridge the deficit gap with loans. Between 1970 and 1990, the net amount of debts in the region increased from \$6 billion to \$110 billion. Hungary's \$20 billion debt was two times greater than the value of the country's export, but Poland's \$42 debt was five times higher than its export income. Debt servicing consumed up to 75% of the hard currency income, but in the case of Hungary, by the late 1980s it reached almost 100% that made the balance between foreign and internal trade extremely difficult. New credits were needed to repay the

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<sup>34</sup> This is the opinion belonging to Elemér Hankiss and László Bruszt, the famous Hungarian sociologists quoted in *Figyelő* (2007).

old ones and apart from this, only a limited part of the total income was devoted to investments. In Hungary, from the almost 20 million USD debt only a quarter of its had been invested, but in the case of other states of the socialist region even worse statistical data could be observed.

Besides the economic slowdown, quite a few Central and Eastern European countries which had fixed prices under state Socialism started to lose control over inflation. Between 1989 and 1992, GDP and output across the region declined 25-30% and 30-40%, respectively. The unemployment rate jumped from zero to 15-20% in the CEE region. The economic crisis generated a political crisis and the regimes lost their temporary legitimacy. This led to a peaceful collapse of the state socialism in 1989-91.<sup>35</sup>

The process of debtness in and the correlation of annual growth in Hungary

Year	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
Annual growth of GNP	1.5	0.1	2.9	2.8	0.7	2.7	- 0.3	1.5	3.4	0.1
Share of convertible debt of the total	94.0	92.3	91.5	90.5	91.0	92.4	93.8	95.4	96.5	97.8
Gross debt in million USD	8,300	9,090	8,699	10,216	10,745	10,983	13,955	16,914	19,592	19,328
Share of the total debt in the annual export in%	159	159	139	151	163	182	198	234	242	247

Source: A. Vigvári, 'Reform és rendszerváltás Magyarországon', *Rubicon*, No. 2-3 (2008).

Although according to the socialist methods, the Hungarian politicians tried to hide the actual situation of the balance of the state budget, in the November of 1989 the actual prime minister, Miklós Németh had to confess that the experts of the Hungarian Socialist Workers Party had tried to dissemble the almost 3 billion dollar debt. The reason of this attempt was easy to be understood; they were afraid of the lenders and of the reaction of their inhabitants. After this incident, the IMF revoked the agreement, and a year later, in 1990, some months before the first democratic elections, a new contract had to be accepted with the retiring government. As the criteria of the new contract were much stricter, the margins of the new coalition government were much more limited.

As a result of the inevitable decisions, a two-tier banking system was also introduced in 1987 that was followed by a series of reforms and acts that could lay the economic ground for the transformation.

The state found itself in debt trap by the beginning of the 1980s. As it was already mentioned, the greatest problem was the way how the "oil dollars" were used

<sup>35</sup> I. Berend, *The Economic History...*

in practice. As it was essential to keep the standards of living and to avoid any kind of demonstration or uprising a relatively great part (around 75%) was transferred to consumption. On the other hand, the reasons of the unbalanced economy and the consequences of the collapsed 1956 revolution and war of independence also had to take into account.<sup>36</sup> The Hungarian attitude towards the repayment of loans was also remarkable. In 1989, Hungary decided to pay back all the loans. It was unanimously supported by the newly organised parties, including the reformed Socialist Party itself as well. There was the hope that there was a potential of growth for the Hungarian economy.<sup>37</sup> The reasons of this relatively good outcome can be examined as a consequence of the openness of the Hungarian economy towards the foreign direct investments.

The traumatic news about the level of the Hungarian economic crisis resulted with shock among the members of the parliament and the public opinion. Until the official declaration, the statistical data were state secrets. Even the experts of the National Bank or the Ministry of Finance had limited information about the real amounts. In the early 1980s, a quiet struggle took part causing a cleavage between the deputy prime minister (József Marjai) and the president of the Hungarian National Bank (Fekete János).<sup>38</sup> Seeing the risk of insolvency, the Central Committee of the Hungarian Socialist Workers Party informed the Soviet Union about the hopeless financial situation and asked for a loan already in 1978. The Soviet Union, however, refused to pay 1 billion dollars, as they were interested in the arms race that required a great amount of financial resources. Apart from this, the Soviet Union had to concentrate both on the arms race and the occupation of Afghanistan. Hungary had to look for financial aid in the world financial market. After the fiasco in the late 1960s, the Hungarian negotiation was successful and in 1982 Hungary joined the IMF.<sup>39</sup> After Hungary became the member of the IMF in 1982, 475 million, and another 72 million and in 1984 another 425 million USD were transferred to the state. Despite the help coming from the international sources, the balance of current accounts was still instable. From 1988 the annual basis of the balance on current accounts reached 8-9% of the Hungarian GDP that was difficult to keep in control. A new decision about the introduction of the passport that was valid all over the world increased the difficulties in monetary policy. The share of the private

<sup>36</sup> As Lengyel and Surányi commented in their book dealing with the way to the Hungarian transition, the reasons of the debt trap can be summarised in the following terms: the lost revolution and war of independence with the economic consequences, as most of the events took place in Budapest, the administrative and economic centre of Hungary, plus the loss of the labour force. They were either in prison because of their participation in the events, or the younger and skilled workers simply chose the emigration to the West causing enormous damage to the labour force. The other reason of this economic situation can be explained with the relatively high standards of living compared to the neighbouring socialist countries. In: L. Lengyel, G. Surányi, *Határátkelés...*, pp. 116-117.

<sup>37</sup> According to Lengyel and Surányi, after a slight decline in the mid-1990s, out of the 20 billion dollar debt by the millennium only approximately 2 billion remained.

<sup>38</sup> In: L. Csaba, 'Hadigazdaságtól a piacgazdaságig...', pp. 24-29.

<sup>39</sup> As a matter of fact, the Hungarian timing was partly successful as the application arrived a day before the state of emergency (martial law) was declared in Poland.

import grew to an uncontrolled level and the monthly amount of the outflow reached 150 million dollars. The foreign exchange reserves of the Hungarian National Bank decreased to a critical level. This condition required a quick and strict decision that was made in the summer of 1989. First of all, the amount of the hard currency to one person was limited to 50 dollars and new negotiations were begun in the background about new financial aid coming from several sources. Fortunately, according to Lengyel and Surányi<sup>40</sup> the 95% of the loans belonged to the long-term ones that gave a limited margin to the Hungarian state and, on the other hand, the Hungarian practice based on the controlled exchange policy. However, the difficulties with the foreign exchange reserves persisted. From the spring of 1990 to the summer of 1991 summer, its amount multiplied, but the fear of inflation and the troubles of economy connected with the transformation didn't disappear at once.<sup>41</sup>

Political contexts led to different outcomes across transition countries. Although the principles of Washington Consensus were at least discussed in transition countries, the acceptance of the recommendations of WC were not accepted everywhere. In Hungary, there was a high level of international debt but also a strong community of economists with international standing and good contacts with economic thinkers from outside the old Soviet bloc. They had the confidence to question policy ideas from outside.<sup>42</sup> There were also pragmatic reasons for ignoring the WC strategy, as reform in Hungary had already taken the country long way from traditional central planning.<sup>43</sup> A single package, delivered as a shock, was therefore irrelevant in economic terms. It was a political demonstration of a change of direction. It was also considered a political danger in the government circles to undertake a rapid transition that would leave part of the population "abandoned along the way". When the minister of finance was asked why Hungary would want to proceed more slowly than Poland, he responded: *We cannot risk the social tensions that would put everything in question.*<sup>44</sup>

<sup>40</sup> L. Lengyel, G. Surányi, *Határátkelés...*

<sup>41</sup> In 1990, the lack of hard currency reached a critical level. The total amount of hard currency was equal with the value of one month's import and a year later it reached the 5 month level. The former minister of finance, László Békesi confessed in an interview in 2010 that the foreign exchanges level was at such a critical level that the price of the exported goods that was paid by dollars or any kind of hard currency was simply taken to the briefcase into he Ministry of Commerce and taken to the Hungarian National Bank and this situation lasted for several months. In: *Figyelő*, No. 51-52 (2009).

<sup>42</sup> M. Myant, J. Drahokoupil, *Transition Economies. Political Economy in Russia, Eastern Europe, and Central Asia*, Hoboken 2011, pp. 99-100.

<sup>43</sup> With the introduction of the New Economic Programme valid from 1968 January, Hungary formally left the central planning system leaving more freedom for the (state-owned) enterprises. The reforms were stopped at a moment because of several reasons, so the second wave was not functioning. In practice, the old strategy of socialist economy didn't return. As it is generally accepted, the real importance of the reforms is based on the fact that the spirit of reforms survived and had an enormous importance in the following years.

<sup>44</sup> M. Myant, J. Drahokoupil, *Transition Economies...* The Hungarian government's attitude after the political change simply followed the principles of the attitude of the old regime. The success and popular-

The reforms that were accepted and introduced between 1985 and 1988 led Hungary from the socialist economy to a special type of “socialist market economy”. As Berend and Lengyel László argue,<sup>45</sup> the reforms accepted in socialist Hungary were the next steps towards the economic transformation nevertheless without any attempt to make any modification in the political structure.

One of the most important changes appeared in the life of the state-owned companies as decentralisation appeared at the management level. The responsibility was divided between newly-elected managers and the state having the state party and the organs of the central governments had less opportunity to interfere. This new type of management with the symbolic right of the state as the owner to intervene led gradually to the spontaneous privatisation.

The price and wage system was also modified as the 90% of the goods belonged to the free price system. That had double consequences: the goods didn't disappear from the shops and there was no necessity to introduce any kind of shock therapy to handle the problem caused by the so-called monetary overhang. That made the economic transition less expensive as compared with the Russian or Polish versions.

Hungary's position versus Western Europe according to Hungarian people's opinion in percentage  
(It was better in Hungary then in Western Europe)

		1981	1986	1988
1.	Right to work	98	87	42
2.	Protection of the workers' interest	96	93	80
3.	Level of the medical health care	90	66	47
4.	The well-balanced life of families	86	73	36
5.	The resale value of the currency	66	41	6
6.	Possibility to get/ buy a flat	63	39	16
7.	Material elements of well-being	46	29	10
8.	Large selection of goods	44	34	18
9.	Well-dressed people	42	33	28
10.	Possibilities of travelling abroad	29	27	33
11.	Amount of free time	58	46	27
12.	Equal opportunities	78	69	38

Source: I. Romsics, *Magyarország története a XX. században*, Budapest 2001, p. 521, *Osiris Tankönyvek*.

ity of the Kádár regime was based on the slow, and calm everyday life without greater shocks in order to avoid any kind of mass demonstrations. As it turned out from Kádár's last speech in 1988 in front of the representatives of the Central Committee of the Hungarian Socialist Workers Party (quoted by Góralczyk) he still couldn't break with the question of the collapse of the 1956 revolution and war of independence and his personal responsibility in the execution of the popular prime minister of the revolution, Imre Nagy. Apart from his role, the fear of the repeating of the revolution was present in his political decisions as well. B. Góralczyk, *Magyar törésvonalak*, Budapest 2002, *Universitas*, pp. 49-52.

<sup>45</sup> I. Berend, *Törésvonalak*, 2009 and L. Csaba, 'Hadigazdaságtól a piacgazdaságig..'



## FINAL REMARKS

The transition, however, had another aspect. The major part of the new economy was necessarily built on foreign investment-based or restructured economic organisations. The expansion of multinational firms yielding their profits from their absolute price advantages (cheap products) in the first period of transition served as a basis for this new economy.

The fall of the Berlin Wall in 1989 opened a new historical chapter for Eastern Europe. But it also marked a turning point in neo-liberal globalisation and European construction. The economic crisis in the early 2000's brought to the surface a lot of questions originated in the process of ambiguous transformation. If we combine these elements to the generally accepted components of the successful transformation of backward or semi-peripheral regions in case of the so-called *small open economies*<sup>46</sup> the following elements can guarantee the success:

According to the economists, the level of the openness of the given economy is essential for the future. It can help to substitute the insufficient internal market. It is generally accepted that the speed and level of development of a given economy is based and linked with the size of the internal market. In this regard, Hungary's internal market belonged to the small size ones that could cause an impedimental effect.

The level of the R&D and its support can also determine the effectiveness of the development of the economies. They can substitute the geographical position as well. If a state affords to support the places of scientific research, whether they are universities or research centres, it can also determine the speed of catching up.

Stability of the favourable business environment can also be an important factor of the increase. It has to be in accordance with the supporting legal and institutional background. Apart from those, these are the factors that can also move forward the economic development: reliability, predictability and equality in the competition. If there are no big cultural, language problems and social differences, they can also help.

To conclude our investigation, it is reasonable to think over the following questions: Can we talk about a successful economic transition in Hungary compared with the surrounding states of the post-Soviet bloc? Was it successful from the perspective of the convergence towards the more developed West? How can we evaluate the transition, can we speak about the return to the original path or did Hungary have to make a return from a detour, or impasse? From these factors the Hungarian economy and society were not a good example. Looking at the events of the past decades, it is obvious that social disparities and ethnic conflicts hampered the uninterrupted economic growth. The devastation caused by the world wars, the territorial loss after the First World War and the communist diversion also hurted the Hungarian economy as well as the society. The ethnic and religious purges caused the emigration of the intelligentsia, in par-

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<sup>46</sup> As Romsics writes about it in: idem, 'Félperifériától a félperifériáig, a magyar gazdaság 20. századi teljesítménye', *Rubicon*, No. 2-3 (2008), pp. 4-18.



particular the Jewish scientists, artists left Hungary and settled down abroad. The persecution of the Jews in the interwar Hungary also belonged to the painful moments of the Hungarian history. The consequences, the lost war and the inclusion to the Soviet bloc and the changes forced outside and initiated by the Soviet Union were among the consequences of the economic and social troubles.

The destiny of Hungarian economy and political system was decided in Yalta and Potsdam at the end of the World War II for subsequent decades. The 1956 revolution and war of independence failed and lasted for a fortnight without great influence in economy. The NEM, however, opened a new perspective for catching up with the West. The previously mentioned facts explain the reason why it was only a partly successful attempt. The year 1989, however, brought a new chance. The scenarios were different, however the task to be solved was almost the same. The old-fashioned party members and the reformist technocrats were forced to collaborate in the reconstruction of the Hungarian economy struggling with several new troubles. Sometimes the chosen methods were not the most successful, as Samary points out. She accuses the Hungarian communist leaders that they were the only ones to decide to respond to the crisis of external debt by selling the country's best enterprises to foreign capital. According to her opinion, this made Hungary in the first year of transition the principal host country for foreign direct investment, but the Hungarians were among the first who – following on the new European relations established by Gorbachev, to help bring down the Berlin Wall.<sup>47</sup>

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