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Economic and social changes in Hungary

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Introduction

East European countries are of particular interest due to their dramatic change from a communist type centrally planned and directed economic and political system to a free-market based pluralistic society. Behind contemporary transition in Eastern Europe the transformation of the political and economic system has been the central force. In the *political transformation* we can distinguish several external and internal components. Perhaps the most decisive external political factor in the East European transition was the dissolution of Warsaw Pact and the subsequent re-establishment of political souveregnity. The alteration of external geopolitical status-quo has also made far-reaching internal political changes possible. Among others, the revival of multi-party system, free parliamentary elections and the ousting of communist party from power represented the major steps towards political pluralism. With respect to settlements an important component of political transformation was the return to self-governance and consequently, a shift of control from central (state) to local (community) level.

Economic transformation has also got important external and internal attributes. On the external side first, we have to mention the collapse of the former COMECON market which in itself proved to be a kind of "schock therapy" leading to bankruptcy and mass-liquidation of companies. From the external side the appearance of western firms bringing foreign capital investment and modern technology to the region constituted another driving force in the economic restructuring. On the internal side the disintegration and privatisation of large state companies, especially in the heavy industry played also a decisive role. These economic changes altogether led to a rapid re-integration of the East European economies to the world economy and consequently, to growing competition both at regional and local level.

However, due to the different historical legacies and the different level of economic and social development within Eastern Europe we can observe substantial differences in the transformational policies and the subsequent social processes within the region. In this paper we try to highlight some important features of the economic and social change in Hungary which have taken place since 1989.

Economic modernisation and its capital requirements in Hungary

Modernisation, first and foremost, is a process of adaptation which, in this case means, that Hungary is becoming a modern country with a similar system and socio-eco-

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nomic structure as enjoyed by the Western developed countries. Since the more developed countries are serving as models, it is also a process of joining their ranks. This dual approach to modernisation is important since the need for adaptation, assimilation, and compatibility demands first of all a transformation in the socio-economic structures, while the basic requirement for economic association with the developed world is economic growth.

The transformation of the structures is akin to Schumpeter's "creative destruction": in order to create new structures the old ones need to be torn down. Destruction and creation Hungary and the other post-socialist countries, however, is on a scale much larger than Schumpeter ever envisaged. The question what we are asking more and more often is whether it is only upon the ruins of the old that the new structures can be built, or there is a way of reshaping, and in this way retaining, some of the old structures? Are these processes parallel or necessarily sequential? What resources are available to finance modernisation?

Economic growth and the transformation of structures are tightly interlinking processes. Modernisation strategies are based by and large on dynamic economic growth, the pinpointing of break-out points and the mobilisation of resources. Long-term economic growth can only take place if in the meantime economic balance is maintaned and if these processes enjoy the support of the population or, at any rate, reckon with its level of tolerance. This can only occur, however, if the transforming socio-economic structures measure up to the new economic challenges.

The simultaneous requirements to i.) transform structures, ii.) effect economic growth, and iii.) maintain economic balance can lead to conflicts. One or another objective could suffer, the concurrency just mentioned could turn into a sequential process, as a result of which the transition could be less successful leading to the slowing down of the modernisation process.

Modernisation strategy in Hungary

Each East European post-socialist country has formulated more or less the same objectives – namely, the creation of a democratic society based on a market economy through which they can integrate into the European community of states. All this assures the raising of the living standard of the majority of society.

The differences in the transition strategies of the various countries are observable i.) in their points of origin (societal characteristics, traditions, the level of economic development, the transition stage already reached, resources available to finance the transition, and other features); ii.) in the transformation methods adopted (financial compensation, privatisation, stance on foreign capital, the determination of the role of the state, stimulation of the processes of integration etc.); and iii.) in the determination of the speed of the transition (the fact that modernisation is a long-term process while political power can change on a shorter-term basis can be a source of conflict).

The Hungarian transition's point of origin has been stamped by the fact that ethnically it is more or less homogeneous country, the population has been declining steadily for a long time, and that by European dimensions it is a medium-sized country. Its culture and geopolitical position is characterised by a bridging role between East and West. Even at the time of the system change (1989) it belonged to the more developed group of Eas European countries. During the socialist period Hungary implemented the most comprehensive and effective reform of the state-run economy, as a result of which it has reaped some advantages vis-a-vis its neighbours in its current efforts to forge a market economy. The economic reform programme of 1968 was partly responsible for the accumulation of the country's huge external debt which, in the long-run, acted as a slowing force against the modernisation process and dampen the rate of economic growth. At the same time, however, due to its more flexible economic policy, the relative openness of the country, and its more favourable legal, economic, and infrastructural facilities Hungary proved to be more attractive to foreign capital than its neighbours already by the early 1990s.

The pillars of the Hungarian economy are relatively unstable or, in other words, its capacity to undertake a modernisation programme on such a large scale is rather limited: its human capital endowments are considerably more favourable than any other productive resource; its natural resource endowments favour mostly agriculture, while its geographical or geopolitical position offers good possibilities for some kind of transit role. Clearly, these attributes represent only temporary advantages since other countries are aiming to achive similar role and agriculture cannot play leading role in the modernisation of Hungarian economy either.

The goals of the modernisation strategy are as follows:

– to join Hungary to the most developed West European bourgeois democracies, or at least to decrease the gap between them

– to strengthen its socio-political and cultural adaptability (by strengthening its human resource base with improvements in health services and the situation of the young with emphasis on education etc; through the boosting of private enterprise competitivity, assistance for agricultural modernisation etc.).

– to integrate Hungary further into the global economy (by joining the Euro-Atlantic organisations, by harmonising the legal structures, by improving relations with its neighbours, by developing the infrastructure necessary for further integration into the global economy etc.).

Capital requirements of economic modernisation

Economic and structural transformation requires considerable amount of capital. Precisely how much, however, is difficult to measure since we are talking not only about investible funds, but also about the economy's absorptive capacity. The East European countries, including Hungary, have limited chance to obtain the capital necessary for economic transformation. The establishment of new private firms, the overhauling of the inherited socialist enterprises (especially the larger ones), and the development and maintenance of the competitiveness of the firms that came into existence in the course of privatisation requires considerable amounts of capital. Domestic savings, economic growth and the redeployment of capital in favour of accumulation create the internal sources of capital for the business sector. External sources of capital are made up primarily of foreign direct investment (FDI). Since the level of Hungary's foreign indebtedness is so high and its structure so unfavourable, there is no real possibility to either further increase this indebtedness by raising new loans, or to postpone the repayment of the debt (i.e. payment moratorium).

Unlike in the Czech Republic and Russia, privatisation in Hungary was not a matter of distributing state property free of charge, but was sold on the free market. To be sure, both methods have many advatages as well as disadvantages.

One of the advantages of the Hungarian strategy is the fact that a wide variety of forms came into being, a lot of which also underwent changes on the basis of experience gained as time passed. The advantage of privatisation through the open market lies not only in the considerable revenues it generates, but also in the fact that this method ensures that it is the real owners that will receive the property, those people that are able not only to purchase but also to operate it and also to expand it through further injections of capital.

There is a debate whether the Hungarian population had enough savings to represent a significant role in the privatisation process, or whether it was competitive enough vis-a-vis foreign capital? Opinions vary, KORNAI, J. (1996) feels that the size of the Hungarian population's savings approaches the price of the state property still awaiting privatisation. According to KORNAI, the problem is not with the size of the population's stock of savings, but with the increasingly deteriorating quality of the supply of property to be privatised. In other words, domestic investors are less and less confident about the returns formerly state property is capable of offering; they rather buy government securities, deposit their money into hard currency accounts either at home or abroad, or establish brand new businesses. On the other hand, others feel that the position of potential Hungarian investors is weak, and that it is becoming more and more disadvantaged vis-a-vis that of foreign investors with the passing of time, since the bulk of what is left to be privatised are the more expensive large enterprises.

Despite all criticism, however, privatisation is by far the most important factor in the development of the new ownership relations. Furthermore, privatisation through the open market has proven to be a success story so far. By the end of 1997 – at the very latest, 1998 – privatisation in Hungary will have been completed.

New private companies

Table 1. The number of private companies

Organizational type	1990	1992	1994	1995	1996 (July)
Sole propriator	393 450	606 207	778 036	791 496	749 177
Companies without legal status	27 571	42 405	92 393	144 816	157 637
Companies with legal status	no data	69 368	99 044	116 945	126 312
Total	no data	*717 980*	*969 473*	*1053 257*	*1033 126*

Source: LAKY, T. (1995); Monthly Statistical Bulletins 1996 No. 8.

The data indicate the significant expansion and dynamism of the private sector. The pace of the formation of new economic organisations slowed down after 1993. The new companies need to be divided into two groups, although the private businesses and those without legal status do not need capital for their estabishment. (The larger companies, including the foreign-owned ones, belong to the legal status category). The majority of these enterpreneurs did not have capital, thus, were forced to create independently his/her livelihood, and to take advantage of the possibilities of writing-off expenses. Businesses in the category are small-scale; in 99 per cent of the partnerships without legal status the number of employees do not exceed 10. Therefore, we can say with some optimism that these businesses provide the basis for the preparation for the creation of independent livelihood. Its is more realistic, however, to say that the majority of these enterpreneurs are self-employed, who are incapable of capital accumulation and the expansion of their businesses and production. They are more like survivors who consume their profits and capital.

Foreign direct investments

The participation of foreign capital in the Hungarian economy has to be treated separately. Of all the post-socialist countries, Hungary has the highest proportion of FDI. Up to the middle of 1996, 15 billion dollars arrived into the country – approximately half of all foreign capital invested into Eastern Europe (excluding the CIS and the Baltic republics). The level of per capita FDI arrived to Hungary was more than double of the figure of Czech Republic, four times that of Slovenia, and 16 times that of Poland. Germany became the most important foreign investor, displacing the USA in 1994. Austria and France hold third and fourth position, respectively.

The bulk of the investments were directed into industry. While the share of industry is declining in the national economy, in 1995 this sector still accounted for half of FDI, with 15 per cent going into telecommunications – the second most important branch. In countries with a similar level of economic development, such as Ireland and Portugal, a larger proportion of FDI found its way into the financial and real estate sectors. These possibilities for foreign capital appeared only later in Hungary.

FDI is becoming increasingly important in the Hungarian economy. Currently 98 of the Hungarian "Top 200" – that is, the 200 largest firms – have more than 50 per cent foreign ownership. Foreign companies account for 70 per cent of the country's exports and employ 20–25 per cent of its active workforce. But the negative or, at any rate, not altogether desirable effects of FDI are also present. A significant proportion of the foreign firms were concerned primarily with market expansion while investing in Hungary. Accordingly, they often drive Hungarian competitors out of business and achieve monopol position. The foreign firms assimilate slowly and with difficulty into the Hungarian economy. The competing Hungarian companies find it difficult to get even a subcontractor role; a great deal of government assistance would be required to develop the subcontracting network. The spatial distribution of FDI is very uneven, with two-thirds situated in Budapest and its surroundings, and with a further 20 per cent in North Transdanubia between Budapest and the Austrian border. Consequently, FDI contributes significantly to the regional differentiation of the economy.

Transformation of labour and housing market in Hungary

There are two important aspects of everday life where all the changes implemented in the economic and political spheres converge and these are the labour and housing market.

These two markets are closely linked and interrelated, through the functioning of elements at the micro level, i.e. by the choices and activities of households (VAN WEESEP, J. 1997). During the communist period cheap housing and safe job guaranteed by the state constituted the cornerstones of the welfare system, at least in urban areas. As a contrast, by the mid-1990s unemployment and homelessness became palpable features of life everywhere in Hungary.

Due to the general dissatisfaction with the performance of the centrally planned state-socialist system we could observe a "myth of the market" among politicians and the public on the eve of political changes. At the same time, there was a general belief that market mechanisms are a more efficient way of organising the production and exchange of goods than the previous system of central planning (this was also repeatedly "implied" by organisations such as IMF, World Bank etc.). On the other hand, there was an urgent need both politically and financially to improve the functioning and efficiency of the economy, which has resulted a radical *shift from central distribution to market regulation.* What have been the major characteristics of marketisation on the labour and housing market?

Transformation of labour market

Due to the economic and political transformation the demand for labour and the overall functioning of the labour market has changed substantially in Hungary. As a consequence of the sharp withdrawal of state and the increasing presence of foreign firms a growing competition could be observed on the labour market (DORENBOS, R. 1996). Generally, the demand for young, well-educated labour force increased, whereas older and less-skilled employees got into marginalised position on the labour market. There were two important factors behind the increasing demand for higher quality employees on the labour market one was *sectoral*, the other was *structural.*

With respect to sectoral changes, due to the collapse of COMECON market the outdated heavy industry sank into deep recession after 1989. Most of the former state complexes and giant firms went bankrupt and were either closed or disintegrated into smaller, more flexible units. In the meantime there was a real boom in the tertiary sector, especially in the field of trade, tourism, financial and business services, which generally stand out with their increasing demand for qualified labour. In this respect Hungary and the other East European countries follow the global trend of deindustrialisation with some delay. A good example for the rapid sectoral change is Budapest, where the number of industrial employees dropped nearly to half between 1990 and 1995, and the total share of industry decreased to 18 per cent on the labour market.

From structural point of view, as part of the post-fordist type restructuring of the economy, the number of small and medium-sized enterprises has rapidly increased after 1989. By 1995 97 per cent of the Hungarian enterprises employed less than 11 persons. These smaller firms show much higher flexibility than the former state companies not only in term of production, but also in term of employment. Fluctuation of labour is more intense than used to be and unorganised, well-educated employees with many-sided skills are basically priviledged by such firms.

Growing competition on the labour market has also resulted in growing wage differences. Top managers and senior employees employed by foreign companies and joint ventures enjoy 5–10 times higher salaries than employees of domestic firms and very often a fringe-benefit of the western level (VAN HASTENBERG 1996). Differences between the domestic private and state companies have also increased dramatically. As a consequence, the formerly fairly homogeneous labour market has fallen into smaller segments and the gap between these segments have been continously increasing since the early 1990s.

Transformation of housing market

The transformation of housing market has also set off enormous changes. State socialist housing policy was based on the extreme dominance and control of state, which not only built and operated the formal public dwelling stock, but also organised, built and allocated housing of other non-public sectors (coops, associations, condominiums etc.). Morover, via legal and financial instruments state enjoyed great influence over the single-family housing (i.e. private) sector as well.

The whole system was based on high subsidies, which in fact was accompanied with very low efficiency. In Hungary, just like in many East European countries housing subsidies were often on the order of 3–5 per cent of GNP and comprised, next to food subsidies, the most important consumer subsidy. This type of state intervention meant an enormous burden on the national budget, thus, it was understandable that after the political changes the state started a radical withdrawal from the housing market.

This meant generally a sharp drop in the number of new construction and the marketisation (i.e. privatisation) of the existing public dwelling stock, together with the state-owned maintenance and building companies. In 1995 24 thousand new dwellings were constructed in Hungary, compared to 90–95 thousand in the mid-1970s (*Fig. 1*). The proportion of state radically declined from 35–40 per cent to 3–4 per cent in the same period. By now, the former state housing production and management system has practically disappeared, but not so much the evergreen problems of deterioration, housing shortage, inequity etc. which became even more severe.

In terms of housing allocation system, the basic idea of state-socialism was egalitarianism, in order to reduce and finally to abolish capitalist type inequalities. But as new housing became available, the allocation principle shifted to merit which born new type of inequalities (VAN WEESEP, J. 1997). The well-educated and those higher in the social and political hierarchy (i.e. nomenklatura) had a better chance to obtain better quality housing (SZELÉNYI, I. 1983).

After 1989 privatisation of public dwellings reshaped the ownership structure of Hungarian housing stock. The share of the state on the national housing market decreased from 24 per cent in 1990 to 8 per cent in 1995. Approximately 100 thousand dwellings were sold annually between 1990–1995. In Budapest out of the 400 thousand public dwellings 250 thousand were privatised in the same period, thus, the ratio of state sector decreased to 15 per cent on the housing market of the city. The pace of privatisation was at similar scale in other major cities. Privatisation of state housing under the given circumstances converted state-socialist inequalities and unjustice into capitalist ones. The better-off occupying the most valuable, best quality segment of social dwelling stock were

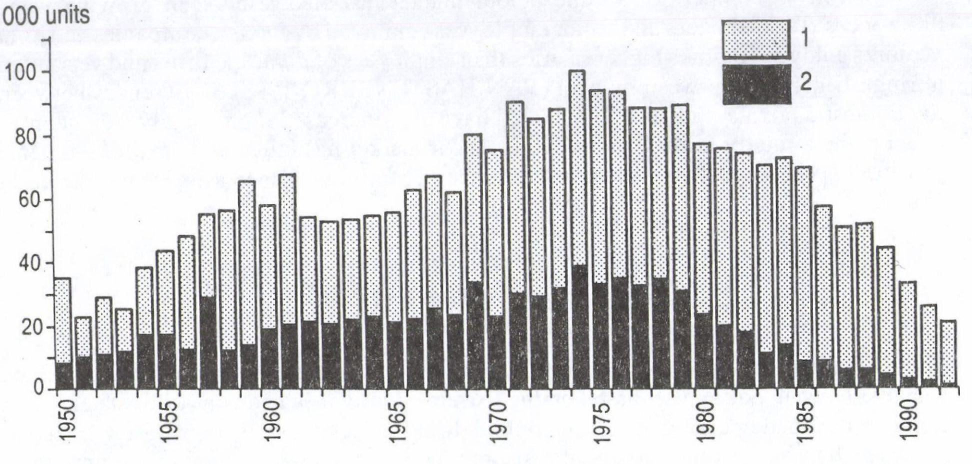

Fig. 1. Housing construction in Hungary between 1950 and 1992. – 1 = private; 2 = state

given the opportunity to gain huge profit upon resale or conversion of the newly acquired dwelling, given the extreemly low (give-away) prices. Low status households who could not, or did not want to buy their generally lower quality flats in the privatisation programmes became marginalised on the housing market, where the remaining public sector serves mostly as a residual sector.

Social polarisation

The link between the labour and housing market is very strong, processes on either side have impacts on the other side, and basically determine the structure of society. Certain groups enjoy priviledged position on these markets others are disadvantaged. The growing polarisation on the labour market is consequently mirrored in the changing demand for residential properties, and vice versa, adequate housing is basically needed for any improvement in labour market position.

As VAN WEESEP (1997) pointed out the political upheaval in Eastern Europe and the subsequent fall of the socialist regimes inspired many social scientists to investigate and to forcast the outcome of the transition of the East European societies. This was a unique opportunity for social scientists to say something about the various dimensions of transformation and about the effects of external change on social systems and in this respect Eastern Europe served as a social-science laboratory. Although the transformation is still far from the end, one can discerne distinct socio-spatial processes which are characteristic in most of the countries and urban areas of the region.

The outcome of changes is fairly apparent in the major cities of Eastern Europe, what we may call a *new urban order.* The urban landscape and functional structure of cities have undergone enormous changes in which three factors played decisive role a.) the privatisation of housing; b.) the revival of land-rent and c.) the infiltration of foreign capital.

The economic restructuring has led to growing demand for non-residential (business, office etc.) space especially at inner-city locations. On the supply side, privatisation of housing generated a vast number of private owners who were keen to sell their newly acquired properties to institutional investors. Thus, the re-establishment of real estate market, based upon land-rent, has led to a rapid functional conversion, from residential to business use in the post-socialist cities (KOVÁCS, Z. 1994).

There is an obvious connection between the functional change and revitalisation of inner city neighbourhoods, which is generated mostly by the corporate and commercial expansion of the global market (*globalisation*). New corporate headquarters, business and commercial centres, hotels and tourist facilities flooded the city-centres all around Eastern Europe (SMITH, N. 1996). The symbols of the capitalist market economy and consumer society have appeared extensively sweeping away the remnants of "shortage-economy" (*capitalisation*). At the same time, economic restructuring has also set off profound changes within the societies. Thanks to the growing differentiation of incomes social inequalities increased very rapidly (*polarisation*). As part of the social differentiation we could observe everywhere the rise of the "new-rich" and the growing number of "underclass". Neighbourhoods have been differentiating also very quickly, the social-mix characteristic so much for the communist period has been disappearing. Social housing is becoming more and more the shelter of urban poor, concentrating in traditionally low-satus areas (segregation). The better-off and the young are leaving the city and invading the green suburbs copying the processes of western cities in the 1960s (*suburbanisation*).

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