the economy—in the enterprises and in the government—acquire more management know-how and can sublimate both short-run personal interest and narrow ethnic-national particularism. Great strides must be achieved in education and social responsibility in order to prevent a repetition of past errors and excesses requiring a reversion to a controlled economy. Success may also depend on factors outside Yugoslavia. While the country has now become a full-fledged member of GATT, Belgrade still fears that tighter economic integration in both Western and Eastern Europe could nullify the drive for greater markets.

The future of agriculture will also be significant. The Yugoslav system of cooperation between private farmers, who own most of the land, and government-oriented cooperatives seems to be working well. But Yugoslav agriculture is handicapped by the fact that two-thirds of the productive land is confined to the Voivodina in the northeast part of the country. In the past, crushing droughts in this area have frequently forced the Yugoslavs to buy vast quantities of grain abroad, aggravating their balance of payments difficulties. In 1950 when the drought hit Yugoslavia and did not seem to enter either Rumania and Hungary, the Soviet ambassador in Belgrade remarked: "God is on the side of the Cominform." Time proved him wrong. On the other hand there is no certainty that Providence is on the side of the Tito regime either.

Hungary: Iron out of Wood

By Joseph Held

The new economic reform program adopted in Hungary is characterized by greater zeal, higher ambitions, wilder expectations—and more double-talk—than any of its counterparts in Eastern Europe. At a plenary session of the Central Committee of the Hungarian Socialist Workers' Party on May 25-27, 1966, the long-awaited system of reforms was finally accepted. According to the official announcement, the most important changes gradually to be introduced between now and 1968 are: 1) a new type of planning that will give greater independence to directors of enterprises; 2) greater freedom of the market through deference to the "spontaneous" workings of the laws of supply and demand; 3) a new system of prices and wages, based on the coordination of national interests with those of individual enterprises; and 4) greater emphasis on the development of agriculture.[1]

A great deal of cautious planning and debate preceded the adoption of the reforms. The significance attached to the program was exemplified in the comment of one participant in the discussions, József Bognár, who stated that "the proposals represent the most important changes in the history of socialist economy since the introduction of socialist relations of ownership." [2] By no means was there universal enthusiasm, however; during the protracted

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[1] *Népszabadság* (Budapest), May 29, 1966.
[2] J. Bognár, "Overall Direction and Operation of the Economy," *The New Hungarian Quarterly* (Budapest), Spring 1966, p. 31.

discussions, the proposals encountered resistance from diverse elements in the party. The old guard saw the reforms as a repudiation of the cherished ideal of a centrally-controlled economy, the basis of the party's monopoly of political power. On the other hand, some of the reform-minded party members were fearful that the admission of total failure of the old methods would produce such a sharp reaction that the new mechanism would represent a step backward to "capitalism."[3]

Yet there was hardly any choice. As early as 1963, it had become painfully clear even to the hard-core Stalinists that the system was bankrupt. In 1964 the *coup de grâce* to Stalinist methods was administered by Iván T. Berend, a historian of economics, in a short book with a long title that created immediate controversy.[4]

The appearance of this book in itself reflected the greater freedom of expression that the Kádár regime had cautiously extended to Hungary's intellectuals. Disregarding ideological myths and fallacies, the study succeeded in indicting the economic policy of the party during the Rákosi era. The author demonstrated—supporting his arguments with documents from the party archives(!)—that the nation's economy had been systematically ruined by dilettantes after the Communist conquest of power in 1948. He maintained that during the entire Rákosi era, waste, deception, incompetence and terror had characterized the process of economic policy-making as well as the direction of the political life of the country. He showed, in fact, that the entire mechanism of the planned economy had broken down by the time the Rákosi-Gerö clique fell from power.[5] Although he did not do so, he might have added the same about the political mechanism, as the events of 1956 strikingly demonstrated.

It is hardly likely that this book could have appeared without the permission of the party authorities, the more so since Berend had been expounding his ideas for some time before the study was published. Probably the intention was to show that the present leadership was thoroughly fed up with continuous obstruction by hard-core Stalinists. The study also served as a starting point for the actual introduction of reform plans. At the same time, in order to show how much times had changed, the regime invited economic experts and "other leading citizens" to participate in preliminary discussion of the reform.

The need for reform was manifest in virtually every sector of the economic system. Hungary's chronic problems were in many respects even more critical than those of the other East European countries. In the wake of the 1956 revolution, the Kádár regime had pursued a relentlessly Stalinist course, relying for its economic survival on credits extended by its "socialist" partners. Collectivization of agriculture had been pressed to completion in 1960-61, but agricultural production continued to lag. Rural living conditions were so miserable that there was a steady exodus of farm labor to the cities, siphoning off the youngest and most vigorous members of the collectives. Even so, there were not enough workers to meet the demand for skilled labor in the factories, reflecting in part a long and steady decline in Hungary's birth rate. The consequence of these and other factors was virtual stagnation in the overall growth rate of the economy. Though there were some improvements in the living conditions of the population during the early 1960's, they were so slow in coming that there was perceptible unrest in both the urban and rural areas. Finally, serious problems arose out of the fact that Hungary's exports had been subsidized throughout most of its "socialist" history; the deficit in foreign trade had steadily increased in the decade up to 1964, leading to the weakening of the *forint*.[6] It was clear that—even without prodding from neighbor regimes—the Hungarian party had to do something to change the situation.

From the start, however, the leaders faced a fundamental dilemma. The problem was not unique; it was—and still is—shared by all Communist-controlled governments of Eastern Europe. If the rigidly-controlled, inflexible economic system was to be replaced by a more efficient one, by a system able to respond to the growing complexities of society, then the parties had to consider delegating greater authority in the economic decision-making process to non-party experts and managers. Yet

[3] See. *e.g.*, József Garam, "A Gazdasági Reformrol" (About the Economic Reform), *Latóhatár* (Budapest), July-August 1966, p. 720.

[4] T. Berend, *Gazdaságpolitika az elsö ötéves terv meginditásakor* (Economic Policy at the Beginning of the First Five-Year Plan), Közgazdasági és Jogi Könyvkiadó, Budapest, 1964.

[5] *Ibid*., pp. 44-45.

[6] In *Statisztikai Évkönyv* (Statistical Yearbook), Budapest, 1964, pp. 223-26, it was admitted that Hungary's trade deficit amounted to 6.3 billion "*deviza forints*" (based on the *forint's* value in Western markets, which is well below the official exchange-rate). The 1964 deficit was higher than in any previous year, totalling 1.7 billion "*deviza forints*."

economic life is hard, if not impossible, to separate from political life; the next logical step would be decentralization of the monopoly of political power. Communists, who take pride in their correct understanding of history, could hardly overlook the many examples from its pages of groups who first gained economic independence and then began to demand a greater voice in the political life of their countries.

This dilemma made itself felt throughout the discussion and formulation of the reform program. Fear of losing its monopoly of power prevented the Kádár regime from accepting the logical conclusions of its own reasoning.

Planning: Old and New

During the Rákosi era the economic plans provided gross output targets for every single enterprise and collective farm, large and small alike. The main task of the managers and chairmen of these units was to follow central directives. Since the managers received bonuses and recognition only if they reached their targets irrespective of any other consideration, they had no interest in improving the quality of production. The orders of the central organs were often unreasonable, failing to take into account special conditions at the enterprise level and forcing managers to indulge in fraud, deception and misrepresentation. Many managers juggled with statistics to show a high level of accomplishment when their factories actually produced substandard goods; in fact, a high volume of production usually meant a large number of unsalable items. Thus the interests of the firms often ran contrary to the interests of the economy as a whole.[7] Relations between managers and the government deteriorated to such an extent that it was not unusual for directors to be threatened with jail if their production fell behind targets.

The error of the regime was one common to all dictatorships. By insisting upon close conformity with central directives, the party eliminated individual initiative of the "right" kind—though there was plenty of initiative for deception—both within and outside its ranks. Such an economic system was suited only to the rigid conditions that prevailed in Hungary, as well as in the rest of Eastern Europe, during the Stalin era. Accordingly, the realization that the methods no longer sufficed prompted the Kádár regime to end centralized, detailed planning.

According to initial explanations of the reform, the central plan would henceforth contain only a few guidelines indicating the long-range objectives of the economy. Instead of being assigned compulsory targets, enterprises would simply be informed of the amount of money they would be expected to contribute to the national budget; any profits remaining to them would be used at their own discretion. Managers would have the task of making short-range plans for their firms, coordinating them with the broad guidelines set forth by the central planners. The most important concern of the managers would be to increase the *profitability* of their production. They would be expected to pay close attention to the market, and they would have to be flexible in their plans.

These stipulations seemed to hold the promise of a significant move toward a more rational system. Yet the degree of independence they appeared to grant to enterprise managers became one of the major issues generating alarm within the party (as it turned out, without justification). A number of party economists argued that if managers were left free to set their own plans, they would be sorely tempted to ignore national interest, just as they had proved soft in resisting erroneous directives during the era of the "personality cult." They would, it was held, promote "anarchy of the market" by following the path of least resistance to the pockets of their customers.[8] In the face of these objections, the architects of the reform found it necessary to clarify just how much—*i.e.,* little—freedom *was* being granted to enterprises, as well as how much reliance was actually being placed on the market.

It fell to Ottó Gadó, a member of the Central Planning Bureau, to explain that

> **. . . the independence of enterprises is not one of our goals. . . Enterprise independence means, instead, that firms have their own fields of responsibility. Central directives—and there will be cases when direct orders must be given to firms—will be stricter than before.[9]**

Another spokesman asserted:

> **The firms will not be independent, but they will have to pay close attention to "spontaneous" economic forces as**

[7] See György Varga, "A gazdasági mechanizmus reformja" (Reform of the Economic Mechanism), *Közgazdasági szemle* (Budapest), July-August 1966, p. 793.

[8] Garam, *op. cit.*, p. 723.

[9] O. Gadó's comment on József Bognár's lecture, *Közgazdasági szemle*, January 1966, p. 119.

well as to central directives; in this way central directives will be more efficient.[10]

Considering the fact that the distribution of industrial supplies is to remain centralized, and that priority projects will undoubtedly be favored by the central planners, it seems patently clear that the authority of managers will not be greatly increased. Apparently the main objective of the reform is not to make enterprise-government relationships more rational but to make central direction of the economy more effective. It is true that managers will have greater leeway in implementing central directives, and that central planners will probably be more restricted in issuing direct orders to firms. Yet while this may be an improvement over the old system, it does not amount to decentralization of the economic process. And since the "remainder" of an enterprise's profits depends ultimately on the planners, the latter will remain in control as before.

The role to be assigned to the "market" was another issue that needed clarification. In a statement reporting on the proceedings of the plenary session of May 25-27, the party economist György Varga noted:

The socialist market is an organized one. This means that all the tools by which the state can exert its influence over both the market and enterprises will be retained by the state.[11]

Varga then reported that new commercial companies would be established by the party to act as middlemen between the firms and the "market."

Added to other restrictions, this plan underscores the fact that enterprises will have very little independence, since the "market" will not represent a regulating mechanism in the true sense of the term. The market will be a new intermediary in the chain of command, its regulation remaining in the hands of the *apparat*. In certain cases it will be used to transmit the orders of the party to the firms. Therefore, it is clearly not a new form in the economic mechanism.

— Mióta lángossütödét nyitottunk, nem ráfizetéses a vállalat!

Sign on gate: "Steel Spring and Bolt Factory." *Sign left:* "Bakery." *Caption:* "Since we opened a pie bakery, there's no deficit."

—From **Ludas Matyi** *(Budapest), Sept. 8, 1966.*

Price Reforms

In a lecture to the 1966 session of the Hungarian Economic Society, József Bognár announced:

We are introducing an economic system that will make comparison between activities in different sectors of the economy possible, one that will promote rational economic activity.[12]

The real basis of such a rational comparison would be a price system corresponding to prices on the world market. But prices have long been arbitrarily determined in Hungary, and the habit of control does not die quickly. Settling on a course of reform must have been a difficult task; but in the end the party came up with the answer. The basic element involved in pricing was not to be changed: prices were to include, as before, the cost of "social investment." [13] The fact that the system

[10] Péter Nagy's comment on József Bognár's lecture, *ibid.*, p. 118.

[11] G. Varga, *op. cit.*, p. 794.

[12] J. Bognár, "Uj gazdaságirányitási rendszerünk körvonalai" (Outlines of Our New System of Economic Direction), *Közgazdasági szemle*, January 1966, p. 114.

[13] See Béla Csikós-Nagy, "A magyarországi árvita két szakasza" (Two Phases of the Hungarian Discussions over Prices), *Közgazdasági szemle*, April 1966, p. 401.

which resulted is no less arbitrary than the old one did not disturb the reformers.

As a first step, radical price increases were ordered in some of the most important categories of foodstuffs. Together with wage increases for certain categories of workers, higher taxes were declared on higher-than-average-income pensioners.[14]

It seems likely that the leaders had several goals in mind when deciding on these rather unpopular steps. It was evident that the party hoped to stimulate production of the most important foodstuffs by increasing wholesale prices paid for them. It is also probable that an important idea behind the increases was to limit consumption of meat and dairy products, since these are increasingly becoming the mainstay of Hungary's exports to the West.[15]

Price increases were only one part of the reform program. In order to establish a balance between the rather conflicting goals of stability and flexibility, three categories of consumer prices were introduced. In the first category prices were to remain fixed; in the second, maximum-minimum limits were to be established; while in the third, prices were to remain free to follow market fluctuations. In its anxiety to maintain the stability of the price system, however, the regime decided to include the great majority of consumer products in the first two categories. Thus the prices of most foodstuffs, clothing, and building material for private use, to mention only the most important items in the average Hungarian's budget, continue under the control of the central government, and there will be relatively little opportunity to determine the real value of goods on the basis of the market mechanism.

Another important segment of the price structure comprises industrial prices. Formerly industrial prices, like consumer prices, were determined arbitrarily. In some of the most important categories of producers' goods, enormous subsidies were given to firms that were unable to operate profitably, especially in the sector of basic industrial raw materials. Increasing these prices therefore became imperative in order to set the producers on their own feet. But the dilemma was that if prices of basic industrial raw materials were raised, this might start an inflationary chain reaction which the regime could not afford. Therefore, the central planners resorted to a partial increase of raw material prices, while at the same time they continued—and intended to keep on—subsidizing the producers of these materials.

A "New" Investment Policy

The most important aspect of the reform of investment policy is that, while managers will decide on short-term investment expenditures or on replacement of depreciated machinery, control over long-term investments and priority projects will be left to the central planners. It is hoped that by gaining control over at least part of their profits, directors will be forced to organize production in their factories along more rational lines.

It is also expected that banks will take on a larger role in financing short-term investments for enterprises by acquiring the right to formulate their own credit policies. Their major consideration in weighing credit requests will be the profitability rate expected from the proposed investments.[16]

In order to propose rational investments, however, the directors will have to know their expected profit rate; in other words, they must know the *actual* value of goods produced in their factories, on the one hand, and market conditions on the other. According to the reform, they will be empowered to spend part of their depreciation fund for market research; they will also be expected to establish close connections with their customers.[17] But the market will not be a freely operating mechanism, and through the fixed-price category the government will again be in a position to assign "real values" to goods. The proposed profitability rates will thus depend on what the party deems acceptable and desirable for its own goals.

Interest rates, which according to the reforms should serve as a stimulant for greater profitability, will reflect instead priority assignments.

In short, the reforms have not yet succeeded in providing sufficiently new motives for rational activity at the enterprise level. Since the reforms will be combined with severe restrictions on the

[14] *Népszabadság*, Dec. 19, 1965.

[15] See Antal Máriás, "Népgazdaságunk struktúrája és gazdaságfejlesztési céljaink" (Structure of Our People's Economy and Our Goals for Economic Development), *Közgazdasági szemle*, April 1966, pp. 497-99. The author describes the losses accruing from Hungary's imbalance of payments, remarking that only by increasing imports of foodstuffs to the West can the situation be corrected.

[16] Kálmán Szabó's comment on József Bognár's lecture, *Közgazdasági szemle*, January 1966, p. 118.

[17] However, the amount reserved for the depreciation funds is so small that they will serve only very minor investments. See Egon Kemenes, "The Firm as a Functional Model in a Planned Economy," *The New Hungarian Quarterly*, Autumn 1965, pp. 61-62.

buying power of the general population in order to avoid sudden scarcities of consumer goods,[18] little incentive will be left for greater profitability. It seems rather strange that the regime should try to disprove the old Hungarian proverb that "one cannot make an iron ring out of wood." Yet granting that its intentions are sincere, the regime has chosen an odd way of going about the rationalization of the economic mechanism. Certainly, it is rather difficult to discover the "free play" of economic forces in this system.

Agriculture

One of the brighter aspects of the reform program may be discovered in the party's new approach to agriculture. Through the aforementioned price increases of last December, the first halting steps were taken to channel needed funds to the collectivized farms. Compulsory production targets were also abolished, and the government began encouraging greater initiative on the part of managers of agricultural units.

But the measures go only halfway; here again commitments to ideology have prevented the party from following up its own lead. Despite all the talk about individual initiative, the party has retained its monopoly over purchasing and distributing agricultural products.[19] There will be little added motivation for collectives and individual peasants to produce more if they have to sell their output at prices that depend on the planners.

On the other hand, further hopeful changes are being contemplated—some of them revolutionary when compared with the party's past approach. For instance, the economist Imre Tar has recommended that a new system of plot-distribution be introduced. He suggested that able and willing peasant families should be given more than the customary single private plot, and that they should be supplied with small agricultural machinery, seeds and chemicals.[20] It is true that these proposals have not yet been accepted, but the fact that they could even be voiced gives hope for a further relaxation of the tight control that the party has exercised over agriculture in the past eighteen years.

There is a further problem, however, that cannot be easily solved. Since last December, there has been seething antagonism between the urban and rural populations. City-dwellers have resented the increase of food prices, regarding it as an effort to placate the peasantry at their expense. The trouble is that the party cannot really divert significant funds from the national budget in the interest of any segment of society without injuring the rest. Thus the situation harbors a potential source of trouble for the future.

In plain fact, the years of neglect of agriculture during the Rákosi era cannot be canceled out in a short time. The lack of agricultural machinery and chemical fertilizers throughout the period only begins to tell the story of that neglect. Rural roads, communications, railways, electrical-power needs and public health were also assigned lowest priority in national planning. Consequently, when the Kádár regime talks of increasing incentives for the collectives, it deals only with the most visible and immediate part of the problem.

The party knows that if it really wanted to improve Hungarian agriculture, it would have to embark on a program that would demand most of the funds available for the entire economy at its present level. It would have to begin building roads, modernizing railroad transportation, supplying refrigerated boxcars for perishable foodstuffs, improving storage facilities, and creating a whole new packing industry. It would also have to end insecurity in the countryside by proving its willingness to leave the private plots alone and to permit the peasantry to sell their produce on the open market.

At the present time, however, the party has neither the funds to embark on such a complete reorganization of agriculture, nor the willingness to discard old ideological clichés. The reforms represent an attempt to bridge the gap of the next few years, in the hope that meantime something might happen to solve an insoluble problem. Price increases of foodstuffs, while they may facilitate higher production in certain categories, cannot be substitutes for "changing the thinking-cap"—the fundamental step that is so badly needed in the Hungarian economy.

* * *

There is little doubt that the Hungarian Communists are moving in a vicious circle, inherited in large part from the unfortunate period of the

[18] See Peter Havas, "A piac megszervezése" (Organization of the Market), *Közgazdasági szemle,* July-August 1966, p. 803.

[19] See Pál Korom, "Az árukapcsolatok uj vonásai a termelöszövetkezetekben" (New Elements of Commodity Relations in the Collectives), *Közgazdasági szemle,* March 1966, p .369.

[20] I. Tar, "A mezögazdaság reformja" (Reform of Agriculture), *Társadalmi szemle* (Budapest), February 1966, p. 201; see also László Csapó, "Hosszutávu novekedéstervezés nyitott gazdaságban" (Long-Range Growth-Planning in an Open Economy), *Közgasdasági szemle,* November 1965, pp. 1368-81.

"personality cult." Common sense and the logic of events compel them to seek a way out of the mess of a bankrupt economic system; on the other hand, they are unwilling to consider the necessary concomitant of genuine economic health—*i.e.*, decentralization of their monopoly of political power. They are not alone in this dilemma, as is evident from the doubts that other Eastern European governments have shown in introducing reform programs.

Manifestly, rationalization of the economic system is closely connected with the problem of democratization of the political life of the region. In Hungary, as in most of Eastern Europe, there is little in the current atmosphere to indicate that the party is willing to cross this historic barrier. Memories of Imre Nagy's innovations and their results are still too strong among most of the party membership to permit a smooth transition towards democracy.

The question whether the Hungarian economy will work better as a result of the reform program cannot be answered with any assurance. The most that can be hoped for, under present circumstances, is that *attitudes,* if not conditions, may change as a result of the reforms. As it is, the economy faces a long uphill fight before there will be any meaningful improvement in the living conditions of the Hungarian people.

Economic Reforms: A Balance Sheet

By Gregory Grossman

The year 1965—like 1953 and 1956—was a memorable landmark in the postwar history of Communist Europe: it was The Year of Economic Reform. Anticipated quietly by East Germany in 1963—and, of course, by Yugoslavia a decade earlier—nearly all the countries of Eastern Europe succumbed within a span of twelve months, one after the other, like so many dominoes, to the winds of economic change: Czechoslovakia in January 1965, Poland in July, the Soviet Union in September, Hungary in November, and Bulgaria in early December.[1] Just a fortnight before the year ran out, East Germany tinkered further with its "New Economic System." And as though to ensure its reformist lead on its neighbors to the east and north, Yugoslavia took another long forward step in July 1965. Only internally rigid Rumania, still too successful with Stalinist economic methods to fully realize their defects, and tiny Albania, defiant in Balkan manner behind its Chinese wall, have so far escaped the epidemic of economic reform.

The East German "New Economic System" is the sole reform system functioning at this time. In all the other cases the reforms have proceeded no

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[1] The cited months refer to the meetings of the Central Committees of the respective parties at which the initial decisions to proceed with the reforms were taken.