EUROPEAN SPATIAL RESEARCH AND POLICY

Volume 4 1997 Number 2

https://doi.org/10.18778/1231-1952.4.2.03

Györgyi BARTA, Miklós KRÁLIK, Éva PERGER*

ACHIEVEMENTS AND CONFLICTS OF MODERNISATION IN HUNGARY

Abstract: Socio-economic modernisation of ex-Soviet-Block countries means both an adaptation to the Western democracies and an effort to decrease economic differences. It requires socio-economic restructuring, growth and the maintenance of a delicate balance – all simultaneously. The 1989–1996 period of transition in Hungary is characterised by potentially conflicting objectives, changing priorities, and necessarily concurrent processes becoming sequential. Democratisation has made power-sharing between the central and local governments an issue. Creating a market economy is expensive. The process touches on questions of national sovereignty, causing conflicts between foreign and domestic interests, end leads to social, economic and regional differentiation and polarisation.

Key words: economic restructuring, economic growth and balance, privatisation, regional differentiation, regional policy.

1. INTRODUCTION

1.1. What is modernisation?

Modernisation, first and foremost, is a process of adaptation which, in our situation, means that Hungary is becoming a modern country with a similar system and socio-economic structure as enjoyed by the Western developed countries. And since it is the more developed countries that 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

* Györgyi BARTA, Miklós KRÁLIK, Éva PERGER, Centre for Regional Studies of the Hungarian Academy of Sciences, 1538 Budapest 114, P.O.Box 527, Hungary.

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 in Hungary and the other post-socialist countries, however, is on a scale much larger than Schumpeter ever envisaged. The questions 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 is there 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 process economic balance is maintained, 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 requirement simultaneously to transform structures, effect economic growth, and maintain economic balance can lead to conflicts. One or another objective could suffer, the concurrence 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. The political leadership and economic policy needs to be able to adjust quickly in order to delimit the processes and priorities between existing conditions and declared objectives, to choose the procedures best suited to achieve these objectives, and to get their timing right.

1.2. Modernisation strategy in Hungary

Each of the East European post-socialist countries 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 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); in the transformation methods adopted (financial compensation, privatisation, stance on foreign capital, the determination of the role of the state, the stimulation of the processes of integration, and so on); and 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, 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 it belonged to the more developed East-Central European countries. Of the former socialist 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 abovementioned reform programme was partly responsible for the accumulation of the country's huge external debt which, in the long-run, will act to slow the modernisation process and dampen the rate of economic growth. At the same time, however, owing to its more flexible economic policy, the relative openness of the country, and its more favourable legal, economic, and infrastructural facilities by the early 1990s Hungary proved more attractive to foreign capital than did its neighbours.

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 agriculture most of all, while its geographical or geopolitical position offers the greatest possibilities in some kind of transit role. Clearly, these attributes cannot offer cause for too long a delay for, in a number of respects, they represent only temporary advantages since other countries are aiming for similar roles, and since agriculture cannot be made to assume a leading role in the Hungarian economy either.

The goals of the modernisation strategy are as follows:

– for Hungary to join the more developed West European bourgeois democracies, or at least to arrest the widening of the gulf between itself and these countries;

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

– to integrate further into the global economy (by joining the Euro-Atlantic organisation, by harmonising the legal structures necessary for this, by improving relations with its neighbours, by developing the infrastructure necessary for further integration into the global economy, and so on).

1.3. Dilemmas associated with the socio-economic transition: balance versus economic growth

The socio-economic transition has reached an advanced stage in Hungary. To a large extent constitutionalism, the new institutional structure (Constitutional Court, Audit Office, a system of local government) and the new economic institutions (to a large extent the process of company transformations have been completed) have been established. The transformations in ownership relations have advanced considerably; by the end of 1995 half of the state property had been privatised and 1998 will see the completion of this process, while the programme of financial compensation has been more or less completed to date. Economic contraction was arrested in 1993/1994, and modest growth in GDP has been recorded in the last few years. The economy is undergoing far reaching structural transformation, which is seeing agriculture losing ground to the services sector. In the course of the six years since the system change a quarter of all jobs have been lost (1.4 million), unemployment has stagnated at a high rate (11–12%), and the job market is continuing to contract. All in all the rate of economic growth has not met expectations (nor the rate of the Visegrad Four), which to a considerable extent contributes to the emergence of conflict between growth and economic balance, and to the forcing of modifications to economic policy.

Signs of an economic resurgence were visible in 1993/1994, but these were accompanied by increasing imbalance. A new consensus of opinion emerged, according to which economic growth without structural change in production, investment, consumption, and foreign trade leads to economic imbalance. The scale of this loss of balance in 1994/1995 indicated that the country had entered a danger zone. Policy-makers were faced with the dilemma of choosing between external balance, the improvement of internal balance, or sustained economic growth. Finally, an austere economic stabilisation programme was implemented on 12 March, 1996. The programme consisted of three elements: devaluation of the Forint, cuts in budgetary spending (including welfare spending), and a break on the growth of wages and incomes. The stabilisation package was successful in that the worsening imbalance was brought under control, but economic growth also decreased. The accompanying decrease in the standard of living lead to the sharpening of social tensions. It is possible that problems with balance will also put an end to the current wave of economic resurgence.

1.4. The subject of our study

We concentrate on four topics which we consider important for the illustration of socio-economic modernisation. The first chapter, dealing with the economy, concentrates on the problems of obtaining the capital necessary for modernisation. In the second chapter we examine the modernisation of public administration, especially the relations between the state and local government, the debate on public administration, the strengthening of the role of the middle level, and the problems associated with the formation of macro regions. The third chapter looks at the social consequences of modernisation: the cuts in welfare spending, decreases in living standards, and the on-going problems surrounding unemployment; while the last chapter explores the regional consequences of modernisation.

2. CAPITAL REQUIREMENTS OF ECONOMIC MODERNISATION

2.1. The need for capital

Economic and structural transformation requires considerable amounts of capital. Precisely how much, however, is difficult to measure since we are talking not only of investible funds, but also about the economy's absorptive capacity. (We can get some idea of the capital requirements of this kind of economic transformation if we compare the Hungarian to the East German investments. By May 1993, privatisation reached 85% in East Germany, while in Hungary by 1995 50% of state property eligible for privatisation had been privatised. The receipts from privatisation of East German property were 29 times higher than those from Hungarian property – that is, 18–20 times higher per capita).

The other East European countries, including Hungary, have considerably lesser chance, therefore, to obtain the capital necessary for economic transformation. The establishment of new private firms, the overhauling of the inherited socialist enterprises (especially the large ones), and the development and the 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 direct foreign investment. Since the level of Hungary's foreign indebtedness is so high, and its structure so unfavourable, there is no real possibility of either further increasing this indebtedness by raising new loans, or of postponing the repayment of the debt or, in fact, of defaulting on it (wiping of debt, payment moratorium).

Compared to other East European countries, the transformation of institutions and ownership relations in the Hungarian economy is taking place gradually. Gradual reform commenced in Hungary in the second half of the 1960s which, necessarily, radically increased following the system-change. The transformation of ownership relations are not yet completed, but we are definitely more than half way. From the point of view of available sources of capital, the period following the system-change can be loosely divided into two periods. The first period was characterised by the appearance and consolidation of the new proprietor, whereas the second period by the development and expansion of the business. The mass privatisation of state enterprises, and the establishment of new domestic- and foreign-owned businesses characterises primarily the first period, while the second period sees the sharpening of competition, capital concentration, and the consolidation of some companies and the bankruptcy of others. But it is primarily the second period in which both the privatised and the new establishments begin to produce, invest, and expand. The Hungarian economy, by and large, is still in the first period.

2.2. Privatisation of state enterprises

One of the consequences of the gradual approach in Hungary was the fact that after 1968 enterprise regulation and management rights were to a significant extent transferred into the hands of the 'state entrepreneurs' (state management); consequently, in the wake of the political system-change, the earlier enterprise managers displayed greater power and capacity in continuing to exercise their ownership interests in the post system-change period as well. Szelenyi's work suggests that approximately one third of the former state socialist nomenclature now constitutes the new economic elite (Szelenyi, 1994).

Of the East European countries, Hungary was the first to adopt the so-called Association Law prior to the system-change (1988), but the privatisation of state property only became a government programme after the system-change. 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 advantages 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. (For example, competition negotiations, the simplification of procedures with respect to middle- and small--sized companies, privatisation through cash, various loan arrangements, preferential repayments schemes, and so on). The advantage of privatisation through the open market lies not only in the considerable revenues it generates (which by the beginning of 1996 totalled over HUF 1000 billion, equivalent to $ 6–7 billion), 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 it, but also to operate it and also to expand it through further injections of capital.

There is debate about whether the Hungarian population had enough savings to represent a large enough role in the privatisation process, or whether it was competitive enough *vis-a-vis* foreign capital? Opinions vary; Kornai (1996) feels that the size of the Hungarian population's savings approaches the price of the state property still awaiting privatisation (in 1995 there was approximately HUF 2300 billion worth of state property to be privatised, while the population's savings deposits approached HUF 900 billion). 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; consequently, 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.

The possibilities offered by the various programmes pursued to date (small investor securities-purchasing programme, employee share-purchasing programme, employee ownership programme with leasing contract, and so on) have either been exhausted, or their scale cannot be regarded as truly significant. Further, they tend also to constitute an expense for the state at a time when receipts from privatisation are urgently needed. It is also clear that the private businesses established with the help of these programmes begin their activities with sizeable debt burdens; consequently, the chances of overhauling and developing these old enterprises with new capital injections are small. (The most viable of these programmes is the employee share-purchasing programme through which around 95 000 employees have received long-term credit to start their own companies).

Privatisation through the open market affords lots of opportunities for corruption. This could take place through the governing political group extending advantages to their clients; in this way the governing parties could draw indirect profit from privatisation. However, it also often happens that, due to corruption, the state does not receive the true worth of the sold property.

Despite all this, 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 so far. By the end of 1997 – at the very latest, 1998 – privatisation in Hungary will have been completed.

2.3. New private companies

The data (in table 1) indicate the significant expansion and dynamism of the private sector. The pace of the formation of new economic organisation slowed after 1993.

Table 1. The number of private companies, and those with and without legal status

Organisational type	1990	1992	1994	1995	1996 (July)
Sole proprietor	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	. . .	69 368	99 044	116 945	126 312
Total	. . .	717 980	969 473	1 053 257	1 033 126

Source: Laky (1995); "Monthly Statistical Bulletins" (1996), 8.

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 establishment. (The larger companies, including the foreign-owned ones, belong in the legal status category.) The majority of these entrepreneurs did not have capital, were forced into independently creating his/her livelihood, and take advantage of the possibilities of writing-off expenses. Businesses in this category are small-scale; in 99% of the partnerships without legal status the number of employees does not exceed 10. We can say with some optimism that these business types provide the basis for the preparation for the creation of independent livelihood.

It is more realistic, however, to say that the majority of these entrepreneurs who are self-employed are incapable of capital accumulation and the expansion of their businesses and production. They are more like survivors who consume their profits and capital. This category is significant mostly in the crisis, job-poor, economically disadvantaged regions; in Hungary 22% of active earners fall into this category. Similar proportions are found in Ireland, Italy, Spain, and Portugal. In Greece this category is as high as 35%.

2.4. Foreign direct investment

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 direct foreign investment. Up to the middle of 1996, $ 15 billion 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 foreign direct investment into Hungary was over twice that for the Czech Republic, four times that for Slovenia, and 16 times that for Poland. Germany became the most important foreign investor, displacing the United States in 1994. Austria and France hold third and fourth position, respectively.

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

Foreign direct investment 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% foreign ownership. Foreign companies account for 70% of the country's exports and employ 20–25% of its active workforce. But the negative or, at any rate, the not altogether desirable effects of foreign direct investment are also present. A significant proportion of the foreign firms were concerned primarily with market expansion when they invested in Hungary. Accordingly, they often drive Hungarian competitors out of business and assume monopoly positions. The foreign firms assimilate slowly and with difficulty into the Hungarian economy. The straggling Hungarian companies find it difficult to fill even a sub-contract role; a great deal of government assistance would be required to develop the sub-contracting network. The distribution of foreign investments is spatially uneven, with two-thirds situated in Budapest and its surroundings, and with a further 20% in North Transdanubia between Budapest and the Austrian border. Consequently, foreign investment contributes significantly to the economy's spatial differentiation. On the other hand, at the moment we can only vaguely guess at the effects of capital withdrawal.

2.5. Economic policy: income distribution favouring the business sector

Maybe Kornai is correct in that the Hungarian population has sufficient savings for the privatisation of state property; but it is certain that the new businesses have not been able to consolidate themselves and to increase their production – indeed, the rate of investment is also steadily declining. At the same time, however, there has been an increase in both the budget deficit and foreign indebtedness, and also a dramatic rise in inflation. It became evident between 1990 and 1994 that domestic savings were insufficient to satisfy the increased capital requirements of the state budget and private enterprise. And while the financing of the state budget enjoyed an advantage, private enterprise's capital needs were squeezed further and further out of the financial markets. In order for private enterprise to become more competitive, its level of profitability and its capacity to raise funds on capital markets have steadily to increase. Therefore, economic policy has to support private enterprise's efforts at capital accumulation, and cut back on public spending. The 1995 stabilisation programme was directed towards achieving this objective.

The stabilisation programme has produced a mixed-bag of results to date. Consumer spending has decreased, increases in exports have exceeded those of imports, while the budget deficit as a proportion of GDP has decreased. At the same time, however, the level of investment stagnated, and there has been a slowing in the growth of both industrial production and exports. Growth in GDP also decreased – while it registered a 2% growth in 1995, a rate of only 0.5–1.5% is anticipated for 1996.

In terms of dynamism, the middle-sized firms lead the field; the large companies are somewhat less dynamic than average, while small business performance has remained the most modest of all. The vast majority of exports are accounted for by the multinational companies. The considerable increases in tax revenues and the increase in the number of profit-making companies indicate that overall company sector profitability has begun slowly to increase. The level of private sector investment has also increased over the last few years, while that of public investment showed a marked decline, leading to stagnation in the overall investment level.

The initial results of the stabilisation policy have been received favourably by both domestic government and international circles. The economy's balance has undoubtedly improved. Improvement in economic balance, however, has not as yet led to increases in growth which, in the final analysis, is the main objective of economic development.

3. THE MODERNISATION OF PUBLIC ADMINISTRATION

3.1. Conflicts of the reformulation of public tasks

The transformation of public administration is the key issue of post-socialist modernisation, and it consists of two processes: denationalisation and democratisation. On the one hand, an ever-increasing proportion of goods and services are taken off the 'public goods' list; on the other hand – consistent with the principle of local autonomy – regional administrative bodies displaying features of genuine autonomy are gaining greater and greater importance. The structure of public administration should primarily be evaluated not in terms of how much it resembles the West European systems, but in terms of how effectively the new structure serves the process of socio-economic transformation.

The pace of denationalisation in Hungary increased radically following the system change. The bulk of the traditional products are now being produced by the private sector, and the privatisation of public services has also commenced. The circle of public tasks has contracted and there has been a reduction in the redistributive role of the state. This reduction in the state's role is accompanied by socio-political conflicts. While the extent of the state's redistributive activities are still higher (almost 60% of GDP) than the West European level, the cut-backs in public spending have brought the structures providing public services – education, health care, social security system – to the brink of collapse.

The main problem is the fact that, owing to the difficult economic situation, the determination of public tasks and their financing get totally confused in the process of transformation. An urgent necessity is the dismantling of the 'welfare state' forged by the former system, since neither the economy's productivity nor the state budget make it possible to offer West European standards of public services. Owing to social and political considerations, the transformation can only be gradual, differentiated, and well considered. Even in the case of services amenable to denationalisation, a long time is required for those market, civilian, and Church institutions to develop that can either partially or wholly assume responsibility for their provision. Precisely which services are amenable to denationalisation, however, can only be determined by social consensus. In the current situation, however, there is no chance for the evolution of such a consensus since society's tolerance is almost at an end.

The conflict can only be resolved with economic growth and a genuine reform of the public finances system. The reform must mean not only either the discontinuation or cut-back in some of the public services, but the transformation of the whole public administration system and a thorough overhaul of the state's revenue and spending structure. Caught in the vice of political and economic tensions, Hungarian governments to date have been largely unsuccessful in tackling these tasks. In place of genuine reform of the most important welfare structures (pension system, health care system) newer and newer austerity measures are introduced. Tax reform to date has been directed primarily by fiscal considerations. Inconsistencies abound in the relationships of the sub-systems of public finances. The public administration system has still not come to grips with the idea that the role of the state should not primarily be to limit or restrict but, rather, to provide services. The regulatory and institutional structure is still incomplete in Hungary through which the state is able to regulate the private sector's activities and create the environment in which individuals, civil institutions, and non-profit organisations are able to pursue those activities that also serve the 'common good'.

3.2. Transformation of the regional system of public administration

The efficiency and democratism of public administration is determined primarily by its regional structure. From this respect, the most important promise and one of the most important achievements of the Hungarian system-change was the establishment of genuine local government autonomy. The past few years suggest that local governments have become one of the most important and best-functioning institutions of popular participation, and have been more or less able to re-establish the identity and self-respect of local communities. The establishment of local government system has proven that, besides its political significance – by adapting to local conditions and circumstances – it is able to unearth such human, material, and financial reserves of which a centralised and hierarchically organised system of public administration is incapable.

Since the advent of genuine local government autonomy, considerable criticism has nevertheless been levelled at the system of regional administration. The problems associated with local governments have not questioned the present system's efficiency, but concern more the inconsistencies present within the system of task and sphere of authority delineation, and with financial regulation. These problems are most sharply visible within conflicts between the state and local government in debates on the middle level of government.

3.3. Conflicts between the state and local government autonomy

A law was passed in 1990 which guaranteed local governments far reaching autonomy, a wide sphere of authority and task structure. Since that time, however – despite their formal autonomy – the freedom of local councils has been gradually decreasing, indeed, according to many, a recentralisation process has been taking place.

Local government autonomy has been attacked from a number of directions. The establishment and strengthening of state deconcentrated organisations – a process that has been continuing practically from the early stages of the system-change – has, in fact, meant the smuggling back of the branch-centred principles of regulation and the unequivocal centralisation of certain tasks. The over-burgeoning of the regionally deconcentrated organisations in many cases infringes upon the ideas of local government autonomy and subsidiarity. It often happened that the regulation of the administrative levels and boundaries, and those of spheres of authority and task structures were not only ambiguous, but positively contradictory.

The sovereignty of local councils is restricted mostly by the system of financing local government. The weight of local governments within public finances in Hungary is relatively high compared to European practice, but their task structure is also much wider. Local governments are legally obligated to attend to a much wider set of tasks than for which they receive central financial support. Furthermore, these subsidies have not kept pace with cost increases; consequently, local councils are forced to dig deeper and deeper into their own pockets to do justice to the obligatory tasks. Some people feel that the transfer of a portion of the public administration's tasks to local councils is a convenient way for the state to rid itself of some of its responsibilities, and to put the onus of responsibility for the consequences of cut-backs in public services squarely on the shoulders of local government.

Normative state support still represents too great a weight in local councils' revenue structure, even though it has decreased from 65% in 1991 to 58–60% to date. Within the current financing system, there is a great danger that the government will further reduce local council autonomy by withholding budgetary support. With the already high rates of general taxation, the majority of councils have little possibility of increasing local taxes. At the same time, however, increases in local revenues have in no way kept pace with the demands made upon the councils. At the current level of regional and settlement differentiation, the only way the weight of local revenues could be increased would be if cut-backs in central support were accompanied by increases in local sources of revenue, and if an efficient system of support were forged for disadvantaged councils and regions.

The other problem with the system of financing local governments is the fact that it is continually changing, is extraordinarily complicated, is multi--channelled, and it affords wide space for individualised treatment and council--specific distribution. Consequently, local councils are defenceless and their situation is uncertain.

3.4. Debate around the levels of public administration

The 1990 local government law specified two basic levels of public administration: local council and central government. While an extraordinarily fragmented and differentiated local government structure came into being (there are more than 3100 local councils operating in Hungary, and the population of 55% of villages is below 1000), the ordinances deprived the historically middle level of government – the county – of its power, and afforded it only a supplementary role. In a situation like this, the question as to how the problems of small-, and larger, middle-level regions (county, or even larger regions) can most efficiently be solved is of significant importance. The legislation did not contain a provision for this problem, but merely outlined the cross-regulation of voluntary associations. The unresolved questions around the middle-level of government necessarily became the most important source of division between experts and politicians. One of the central questions of the emerging debate is what should constitute the new middle-level: the resurgent county with its historical traditions (19 counties and Budapest), the European Union-preferred six larger regions, or perhaps a regional unit smaller than the county – the small region (over 100 small regions). The other debate concerns the method of shaping the middle-level. Should it be modelled on a top-down hierarchical structure, with the strengthening of the deconcentrated state organs, or would a new and strong local middle-level government offer a better solution? What chance is there for the new middle-level (middle-levels) to be built from the 'bottom-up' with local government co-operation?

In essence the debate remains undecided. No effective solution has been found to date to the establishment of a regional public administration organisation that is capable of adapting to the extraordinarily diverse public administration functions and the regional levels associated with them. Regulation after 1994 combined the various solutions in accordance with current political power relations, but totally without a guiding principle. The 1994 local government legislation strengthened the county, but failed to give it any genuine rights or resources. The Regional Development Law passed in 1996 also bases the establishment of the Regional Development Councils upon the county, but maintains, indeed, encourages co-operation-based regional and small-regional organisations. At the same time, however, every actor is anxious to maintain his or her position. In the course of the implementation of the Regional Development Law the government, 'from the top', endeavours to outline its own central conception of the public administrative levels and boundaries, forcing settlements, small regions, and counties into an artificial framework – a centrally directed system of redistribution. The branch ministries are clinging tenaciously to the pool of resources belonging to their sphere of authority, some of which could be designated for regional development. The deconcentrated state organs are continuing to mushroom and consolidate. In the 'middle', using the Regional Development Law as a support, the counties are attempting to gain both more influence and greater financial support. At the 'bottom', there are more and more small-regional local government associations forming and gaining strength. Building from 'below' is increasingly hopeless, however, since the financial position of local councils precludes them being able to mobilise their resources in order to realise their regional development conceptions.

Of special importance would be to find a solution for the co-ordination of spatial tasks in Budapest and its surrounding region, where the real spatial structure reflects the total intertwining of the districts and that of Budapest and the surrounding settlements, while there is no functional or institutional framework within which local councils concerned could work together for mutual advantage.

In our opinion, the most important task to date in Hungary remains the dismantling of the over-, and in some cases re-centralised public administration system. Therefore, we need to find a solution for regional public administration which is built from the bottom up. In our opinion, in the question of the middle--level the most important question is not where we draw the borders – whether at the small-regional, county, or regional level. The most important consideration has to be the flexibility and openness of the public administration boundaries, for in this way the public administration tasks can be solved at the appropriate level. The principle of local government autonomy in a small country need not necessarily mean the existence of a strong, middle-level local government, but perhaps its replacement by a set of local government-type institutions that are more capable of flexible adaptation to the needs of a system of regional linkages.

4. SOCIAL AND WELFARE CONFLICTS OF MODERNISATION

4.1. Why to be pessimistic?

This chapter deals with what seems to be the most serious sources of conflict – namely, unemployment, the streamlining of the old welfare state-type services structure, and people's survival strategies which in no way promote social cohesion.

The economy's productivity is low, the state is becoming progressively poorer, and it appears that there is nothing to stop the continuing impoverishment of those clinging to the old structures. According to the pessimistic social scenarios there is a possibility that what will emerge in Hungary is not the polarised yet stable social structure considered healthy in Western Europe, but one that is both polarised and unstable, in which side by side with the relatively few that are well-off, there will emerge a much wider middle stratum capable of little more than mere survival, while the continued marginalisation of approximately 20% of society will continue unabated despite social service assistance. Today it is the economy that generates social inequalities. Consequently, the success of the programmes designed to reduce unemployment and reform the welfare system aimed at the prevention and handling of social conflict rests basically on their economic performance and on their capabilities to adapt to the expectations of the various sub-systems of the economy: balanced economic development brings forth the demand required by the diversified structures, besides which it is also a source of funds for the social services institutions. This chapter, however, deals more with the 'social price' than the 'social benefit' of modernisation, since we need to call attention to the fact that modernisation efforts are criticised mostly for the social conflicts they generate, while the extensive difficulties associated with the transition stage can stymie the modernisation process itself.

4.2. Unemployment

Today the levels of employment and remuneration are not the reflections of political expectations, but depend solely and completely on the level of demand for labour. With the closing of inefficient production facilities the formerly suppressed unemployment (manifested in in-house underemployment) came to the surface, and the rate of unemployment rose from 0.5% in 1989 to 12% by 1992. At the same time, however, job seekers do not possess the skills and qualifications required to meet these 'new challenges'.[1] Unemployment has not been increasing in the last few years (it is anticipated that it will stabilise at approximately 10%); the stabilisation, however, is not due to increases in the demand for labour. More and more people are forced out of the labour market: more and more people are retired and the numbers on invalid pensions are continuing to swell (25% of the retired are on invalid pensions), and more and more women are leaving the labour force. At the same time, however, first-time--job-seekers are finding it increasingly difficult to find employment. Besides those that have left voluntarily, or were forced out of the labour market, the proportion of the long-term unemployed – those incapable of re-entering the labour market – is also rising: by 1994 the proportion of those out of work for more than two years had risen to over 15%.

Unemployment is one of the most important factors in regional social inequalities. There are wide differences in the regional rates of unemployment in Hungary. In the north-eastern part of the country it is around 20%, while in Budapest and the north-western regions it remains below 8%. The modernisation of the densely-packed, uncompetitive industrial establishments is made difficult by the undeveloped physical and human infrastructure. State intervention aimed at reducing unemployment – parallel with the efficient system of support – should be directed at developing the economic infrastructure of these regions. On an individual basis, internal out-migration is the only solution in these regions; resettlement, however, offers only limited possibilities, since the

[1] On account of their low interest-enforcement capacities, a higher and higher proportion of Hungarian employees are forced to work for minimum wages. The low level of Hungarian wages still remains one of the most important considerations for foreign investors investing in Hungary.

receiving capacity of the more developed regions is low. The dwellings market is immobile, and one's place of residence acts as a status conserving force.[2]

4.3. Income differences and the reform of the welfare system

Average real wages and salaries in the last few years have not only declined, but have also been unequally distributed. Despite their equalising effects, the 'natural' inequalities between labour incomes have not been compensated for by social welfare payments. The still rather universalistic welfare system acts to strengthen the differences: the top quintile receives a larger proportion of the social incomes than enjoyed by the bottom quintile.[3] Between 1987 and 1992 the total incomes of the first seven deciles of the population considerably decreased, the share of the upper two deciles, however, increased. The incomes ratio of the lowest and the highest decile increased from 4.6 to 6.2 during the same period. It is clear that the differentiation processes have begun – the middle strata are falling back, while the upper strata are rising further.

In the current situation the productivity of the economy is low, but the social welfare-type entitlements assured by the former system have to be satisfied. This is particularly true in the case of the Hungarian pension system. The stratum entitled to a pension has widened (from the 1970s onwards all active earners have become eligible), and the Hungarian population can be considered aged from a demographic point of view. (Currently, there are just over two active earners per pensioner.) A paradoxical situation has developed in which, despite the extraordinary efforts (we spend more than 10% of GDP on pensions), the real situation of pensioners is deteriorating, and the current pension system is on the verge of collapse.[4] The key to the reform of the pension system is one that would resolve the conflict between the active and inactive age-groups. In this system, pensions would not be financed exclusively from the contributions of the active age-groups, but, besides the basic guaranteed pension, every employee would be encouraged to take out supplementary insurance and superannuation fund membership. This requires, on the one hand, a conscious decision and

[2] Naturally, the process of migration to the more developed regions has commenced. The other most important process is the migration back to the less developed regions of those that were previously commuting from here to more developed centres. These act to swell the ranks of the unemployed and those on social security services in these regions.

[3] Even though data which makes possible the precise determination of the proportions of the different types of incomes is available only for 1989, despite the changes which have occurred since that time – the cut-back in the price, dwelling purchasing, and other types of subsidies distinctly favouring the top strata – the differences generated by labour incomes are only being amplified by the current welfare system.

[4] Compared to other groups, pensioners are not modernisation's biggest losers. The young, and families with more than two children have a far greater chance of falling into the lowest income bracket. The young, however, have a chance to improve their situation; an older person does not.

willingness to save and, on the other hand, the appropriate financial background. The rise in the importance of private insurance, and the exit of the better-off from the Social Security system, could lead to sharp differentiation within the pension age-group and to a breakdown of the social solidarity formerly symbolised by the Social Security system.

The health of the population is the basic indicator of the quality of human resources, while the adequate standard of health services depends on the quantity of community resources. While approximately 6% of GDP is spent on the National Health Service, this is insufficient for it to meet its obligations. In its structure, health care is poorly equipped and has lots of excess capacity.[5] The most important task is greater reliance on private funds and effective implementation of preventative programmes which are more cost effective in the long-term. The crux of the reform here, too, is the separation of the universal--type medical treatment covered by the Social Security system, and the privately paid for supplementary treatment. Today, patients have to pay the full price for some medical services (cut-backs in medication subsidies, dental services, higher quality services), even though some people cannot even pay for the subsidised ones.

The human qualities required by modernisation and the quality of human capital is determined mostly by the levels of qualification and the standard of instruction. The highly qualified characteristically enjoy not only higher incomes and standards of living, but are also more able to adapt to changing circumstances. The Hungarian education system is relatively developed, its share of GDP has remained more or less constant. The general quality of instruction is still determined by the past structures designed to offer a standard level of mass education. The reforms introduced in educational service provision and its financing has, on the one hand, seen the appearance of new actors (the Church, private school, foundations[6]) and on the other hand, a greater stress placed on private individual funding, which means that families have often to sacrifice a great deal for their children's education (partial tuition fees at universities, textbooks, and other related expenses). The other challenge facing the reform of the education system is increasing the numbers with greater and greater knowledge that is also convertible. Happily, there is an increase in the numbers

---

[5] For example, in proportion to the population, hospitals are relatively well-endowed with beds. The maintenance of such bed capacity is not only wasteful, it is often dysfunctional as well. Many bed – ridden hospital patients are not there because they require the specific treatment only hospitals can provide, but quite simply because they cannot take care of themselves in a social sense.

[6] According to statistics on non-profit organisations the bulk of the foundations operating in Hungary are so-called supplementary foundations whose role is to compensate reduced state funding. The proportion of non-profit foundations is by far the highest in the area of education and culture. Despite all this, however, even free education remains a large burden for people – books, school equipment, and so on.

partaking in tertiary education (1994 recorded an increase of 50% over 1990). Despite this, however, only approximately 10% of the relevant age group receive tertiary instruction.[7] Paradoxically, some population strata still do not ascribe particular importance to education. Owing to their poverty and lack of motivation, approximately 20% of students in the marginalised groups do not even complete the eight years of elementary schooling by age 14. Unfortunately, the losers of modernisation have already commenced forging a culture of poverty which will hold them captive for generations.

The reform of the welfare system, therefore, seems justified. In the process of the transformation of the large redistributive structures, however, the seeming social cohesion disintegrates: The winners of modernisation are forging their own private social service systems; the middle stratum still utilising the existing social services is receiving an increasingly lower level of service; while the strata squeezed out of the labour market and the social welfare-type services systems are continuing to swell the ranks of the long-term marginalised living off social welfare benefits of various sorts (income subsidisation support, social security payments, and so on).[8]

4.4. Survival strategies

Owing to the growth in social tensions and the disintegration of social cohesion, people pursue all sorts of individualised 'strategies of survival'. To begin with, in order to try and improve their standard of living, people are susceptible to self-exploitation. Self-exploitation is responsible for the population's poor level of health, and for the disorder that plagues many family relationships. Secondly, since the state centralises more than half of GDP, people try to contribute as little as possible to the central budget.[9] At the same time, an increasingly large part of the economy and society manage to avoid state supervision. An indication of how widespread and important alternative structures are is the fact that GDP calculations have to be corrected 20 to 35% – depending on who is doing the calculation – to take account of the grey and black markets. Corruption

---

[7] The Hungarian economy is not yet sufficiently prepared to receive a large mass of highly qualified workers. Not surprisingly, those with exceptional abilities and convertible knowledge – the potential brain-trust of modernisation – work outside of the country: Hungary is a net exporter in the brain-drain.

[8] According to estimates this represents at least a million people in the future. This problem is exacerbated in Hungary by the incapacity of the high and increasing proportion of the gypsy population to join the modernisation process owing to their low levels of schooling, high rates of unemployment in their ranks, and their general marginalisation born of social intolerance.

[9] Even though Hungarian society demands a wide range of social services, it is 'traditionally' distrustful of the state. A popular Hungarian joke has it that in the past Hungary was the Mecca of the guardians of state property; today, these people have been replaced by the accountants capable of constructing the lowest level of tax eligibility.

and uncontracted co-operation (handshake deals) are widespread in the grey and black markets. Dispensing with clean and official contractual procedures, the various informal networks are playing an increasingly important role in business transactions.[10]

5. HUNGARIAN REGIONAL POLICY IN THE LEAD UP TO EUROPEAN UNION MEMBERSHIP

5.1. Regional disparities

Regional disparities have increased since the system-change. This is attributable to the different problems associated with the economy's regional structure; to the one-sided spatial concentration of foreign investment; and to the regional specificities of business tradition and mentality. A polarisation process between Budapest and the provinces is clearly visible, and there is a 'slope' from West to East in the economy's level of profitability, investments, as well as in the population's living conditions. The per capita GDP of the most developed region – Budapest – is currently three times that of the least developed North-East corner of the country. This disparity is wider than common within the European Union.

The low level of spatial mobility of both labour and capital is attributable to the shortage of accommodation, the minimum risk-taking of foreign investors, the scarcity of jobs, and to the regional differences in habits and the level of infrastructural development.

The policy of regional development aimed at reducing these regional disparities is weak and ill-equipped in comparison to the magnitude of the task. The territory designated for state support in 1993 was relatively small and contained only 10% of the country's population (1 million people). This region contained exclusively villages, and dwarf villages at that.

But the limits of regional development are also indicated by the fact that, to date, the Hungarian government has not been able to co-ordinate the tools of regional development. Thus, the frittered away instruments of regional development have remained significantly less efficient. The regional institutional structure for the formulation, financing, and implementation of regional development programmes is only now taking shape (a system of national –

[10] Personal connections are required as much to begin a business (owing to the undeveloped state of business infrastructure and the difficulties associated with obtaining and paying back loans) as to run and supervise it, and for the enforcement of compliance with agreements (the impotence of state authorities needs to be compensated for).

regional – and county development councils). The new regional development law did not take steps to establish the abovementioned institutional structure, and also left open the question of the relationship between the regional development institutions and (1) local government and (2) the county general assembly.

Six years were spent in a debate with very modest results.

5.2. The EU and the regional policy

Whatever contact that has taken place between the Hungarian government and the European Union Council has been restricted to the PHARE programme. In the last three years two of the most disadvantaged and crisis-ridden regions have received special PHARE assistance. The aim of this was to assist in the solution of the problems associated with the iron and steel industry of one of the counties mentioned, and to assist in the restructuring of the economies of depressed regions. This programme did not continue beyond 1996 because the Hungarian ministries were unable to demonstrate their unified and co-ordinated individual contribution. This sad reality offers plenty of food for thought.

The fact that the PHARE programme currently assists the Hungarian regions bordering the Austrian disadvantaged region – the Burgenland – is also a source of heated debate, for these regions are among the most developed and dynamic in Hungary. Consequently, it appears that the European Union's regional development programme, whose primary aim is to reduce regional disparities is, in fact, promoting regional differentiation.

A serious dilemma associated with joining the European Union is the fact that regional differentiation is on the increase in all East European countries, including Hungary, and it is possible that by the time these countries gain membership, the most advantaged regions of a country will be as much as four to five times more developed than the most disadvantaged ones. Owing to the internal limitations [restrictions] on regional mobility, an increase in [intra-regional] international migration is anticipated. This being the case, the European Union should provide effective assistance to the potential East European member countries to reduce regional differentiation in lead up to their admittance to the Union.

The other problem, however, is awaiting more of a 'Hungarian' solution. A basic condition of EU support is the contribution of the supported country to its own development projects. Currently there are nine ministries concerned directly or indirectly with regional development. To date, we have not been able effectively to co-ordinate them. We need, therefore, to develop a unified system for the handling, regional distribution, and utilisation of ministerial funds earmarked for regional development (as well as for other areas).

Owing primarily to political considerations, the Regional Development Law does not fully facilitate the formation of a regional structure that is in conformity with the EU system. Therefore, the Hungarian participants must be made to understand that the establishment of the NUTS 2 system (in Hungary this would mean the formation of six regions) is not inconsistent with the system of local and county council autonomy, since the role of these regional councils will exclusively be planning, the supplying of information, and programme management.

REFERENCES

CZAKÓ, Á. and SIK, E. (1995), *A hálózati tőke szerepe Magyarországon a rendszerváltás előtt és után (The role of the network capital before and after the system change)*, "2000": 2.

DICKEN, P. and QUÉVIT, M. (eds), (1994), *Foreign investment in the Hungarian economy: the role of transnational companies*, [in:] *Transnational corporations and European regional restructuring*, Netherland Geographical Studies, Utrecht.

EHRLICH, É., RÉVÉSZ, G. and TAMÁSI, P. (eds), (1994), *Kelet-Közép Európa: Honnan-hová? (Eastern-Central Europe: from where to where?)*, Budapest: Akadémiai Kiadó.

ENYEDI, G. (1994), *Regional and urban development in Hungary until 2000*, [in:] HAJDÚ, Z. and HORVÁTH, G. (eds), *European challenges and Hungarian responses in regional policy*, Pécs: HAS Centre for Regional Studies.

ILLES, I. (1996), *A magyar regionális politika az Európai Uiós tagságra való felkészülés időszakában (The Hungarian regional policy in preparation to enter the European Union)*, manuscript, Budapest: Centre for Regional Studies.

INOTAI, A. (ed.), (1995), *Tudósok a modernizációról és az európai integrációról (Scientists about the modernisation and the European integration)*, Working Paper, MTA.

KIRÁLY, J. (1989), *Kollektív vagy egyéni racionalitás? (Individual or collective rationality?)*, "Közgazdasági Szemle", 2.

KORNAI, J. (1996), *Négy jellegzetesség: A magyar fejlődés politikai gazdaságtani megközelítésben. Második rész. (Four characteristics: the Hungarian development from the political-economical approach. Second part*, "Közgazdasági Szemle", 1.

LAKY, T. (1995), *A magángazdaság kialakulása és a foglalkoztatottság (The formation of the private economy and the employement)*, "Közgazdasági Szemle", 7/8.

SZELÉNYI, I. (1994), *Circulation of elites in post-communist transition*, Working Paper, 3, University of Michigan, Advenced Study Center, International Institute.

TÓTH, I. G. (1994), *A jóléti rendszer az átmenet időszakában (The welfare system in the period of transition)*, "Közgazdasági szemle", 3.