

THE ROLE OF PRIVATIZATION PROCESS IN THE TRANSITIONAL PERIOD TO MARKET ECONOMY IN HUNGARY

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Abstract

This study summarizes the experiences of Hungarian privatization up till now. It is pointed out that a lot of important questions haven't been answered because of the lack of overall privatization strategy of the government.

The new private enterprises are burdened by high taxes and other payments into the budget and they make a certain part of them work in spheres of grey and black economies. So the progress of privatization was restrained by the lack of enterprise-friendly economic environment.

The expectations for foreign capital taking part in privatization to bring modern technology and new markets hardly ever come true. On the other hand, monopolistic structures were transmitted to the foreign capital which offend interests of Hungarian producers and consumers.

Privatization techniques supporting Hungarian investors haven't had the necessary results.

Keywords: privatization strategies, privatization technics, the role of foreign capital, the role of the state, decentralization, deregulation, liberalization.

Introduction

The fall of socialist systems in Middle East Europe and the former Soviet Union is mainly due to the fact that the productive forces of society were made work at a very low rate of effectiveness. On the one hand, they were unable to procure resources to realise and maintain attractive social aims. In this connection the most important role was played by state ownership with extremely low effectiveness. It isn't accidental at all that in the economical reshuffle the most important task is changing radically prop-

erty relations, laying off state ownership, that is privatization. From this point of view Hungary to a certain extent was different from all the others. On the one hand, one of the main aims of the economical mechanism reform introduced on 1 January 1968 was to make state-wide enterprises work more effectively and have bigger output by changing commodity and money relations, increasing the role of market and changing the system of interests. The other fact we should take into consideration and can be called as a Hungarian peculiarity is that the role of small private property became more and more important. It is pointed out at the very beginning in a study on Hungarian privatization of Credit Suisse First Boston, which is one out of the ten largest investment financial institutions in the world, that the early economical reforms in Hungary in the 80-es were followed by significant privatization in agriculture and in small business. The contribution of private sector to GNP was 31% in 1988.

Taking all these facts into consideration the privatization in Hungary is historically unique and differs very much from privatization processes in economically developed countries. On the one hand, in my country market economy should be established from a centralised, plan-directed economical system. On the other hand, in economically developed countries privatization was established in real and existing conditions of market economy. There were developed commodity and capital markets there and state-wide enterprise mainly worked in market-oriented and market-conform ways. In Hungary property reshuffle should be carried out parallel to many other things, such as deregulation, liberalisation, ceasing monopolistic positions. All of them should be done to build up market economy but make the whole privatization process even more complex.

The aim of this essay is to analyse experiences of Hungarian privatization up till now.

1. Facts on Privatization

The *Table 1* shows data of privatization carried out between 31 March 1990 and 31 December 1992.

State property was divided into two parts according to the privatization laws passed by the Parliament in the summer of 1992. The companies may be privatized in a short period of time gathered into the first group.

They stayed under the control of State Property Agency, which was established in 1990. The rest of the companies were put into the second

Table 1
Privatization

	31 Dec. 1991	31 Dec. 1992
Change of state-wide enterprises into economic corporations		
Number of accepted changes	218.00	602.00
On book value (milliard Fts)	345.07	645.54
On accepted value (milliard Fts)	465.20	1364.44
From this		
Self privatization (number)	20.00	257.00
On book value (milliard Fts)	1.15	28.50
On accepted value (milliard Fts)	1.56	26.30
Number of changes refused	11.00	11.00
On book value (milliard Fts)	5.04	6.99
Number of changes in process	636.00	443.00
On book value (milliard Fts)	304.47	10.00
Property Protection Transactions		
Setting up companies with foreign partners (number)	56.00	73.00
On book value (milliard Fts)	17.61	17.89
On accepted value (milliard Fts)	28.20	31.42
With Hungarian partner (number)	70.00	99.00
On book value (milliard Fts)	3.73	5.33
Sale together with setting up companies (number)	7.00	7.00
Accepted property protection cases (e. g. real estate selling; number)	207.00	451.00
On book value (milliard Fts)	8.59	14.39
Pre-privatization		
Number of initiated privatization	8491	10289
Number of privatized shops	2120	7637

Source: Book of Facts 93, pp. 522-523

group. It was either impossible to privatize them or from one reason or another the state wanted to possess them. Companies belonging to the second group were under the control of State Property Holding Plc.

At a rough estimate [1] at the end of 1992 the two institutions were in command of about 1000-1200 milliard Fts of state property (ca 11-13 Mrd \$). According to the announcement of State Property Holding Plc issued in the middle of 1993, the value of state property that may be privatized is about 5 milliard dollars [2].

The figures given above don't reflect the whole state property because other institutions and organisations possess a great amount of state property, e. g. the Hungarian National Bank is in charge of the gold reserves and foreign exchange reserves of Hungarian state. Also a great amount of state property is possessed by the State Development Institution, the Financial Centre, the Treasury Holding Organisation and a very important part of the state property belongs to the Hungarian Army in form of real estates and fixed assets.

If you have a look at only the figures an external spectator can form a positive picture about the results of Hungarian privatization process up to the present. But if you look behind the figures the picture is not so positive at all.

2. The Lack of Overall Privatization Strategy of the Government and its Consequences

Unfortunately during four years the government was able neither to work out an overall privatization strategy passed by the Parliament nor an economic policy conception. There was a so-called 'Kupa programme' (Mihály Kupa was one of the Ministers of Finance of Antall government) but the government has never had it as its own, it has never been tabled to the Parliament and the father of this programme was dismissed under spectacular circumstances. This fact caused serious damage to Hungarian economy and it's very difficult to forecast its consequences. As for privatization, because of the lack of overall privatization strategy a lot of important questions haven't been answered.

2.1 What Will be the Role of the Government Like?

In socialist economic systems the state is all-high, all-knowing and wants to direct economic processes in details. This conception was queried by the beginning of economic reform processes mentioned above and in the second part of the 80-ies an effort towards decentralisation and deregulation became stronger in economic policy.

The neo-liberal economics admits the justification of state's role and intervention only in the regulation of money circulation and in passing laws guaranteeing the legal frameworks of economic activity. Neo-liberalism,

which became a dominant theory in highly industrialised countries at the beginning of the 80-ies, did attack Keynes's macroeconomic views, saying that market and competition are the most suitable mechanisms for optimum using up of resources and creating economic equilibrium. The state intervention only disturbs these market forces and the disorders of economic life go back to the intervention of the state into economy.

How does neo-liberalism influence economic policy of highly industrialised countries? One of the sharpest forms of it is the attack against state sector. The most important slogan and impulse of privatization ambitions is that the state sector is unable to work effectively. The other main effect of neo-liberalism was realised in the attacks against welfare state. That is in the period after the second world war the role of the state grew remarkably in social infrastructure. The state took great part in financing social security system, public health service, education, etc. At the beginning of the 80-ies the situation completely changed in this field, too. The consequence of slower economic growth was the absolute decrease of social expenditures, the partial privatization of social supplies and services and the reduction of budget financial sources. The ideology was taken again from neo-liberalism, saying that the social expenditures of the state make people passive and the private sector is able to do social services more effectively than the state. The intervention of the state into social sector only disturbs labour market and prevents unemployment to be on a normal rate.

It can be shown that neo-liberalism influenced the Hungarian economic thinking of mind of the 80-ies very much. As it has already been mentioned earlier the main features of Hungarian economic policy of the 80-ies were strong decentralisation and deregulation. It had certain negative effects as well. In about a year 5 milliard dollars of individual foreign exchange inhabitants saving were taken out of the country to the pockets of German and Austrian merchants. It happened under such circumstances when the country had major problems of balance of payments and would have needed it very much.

After the 1990 elections the relationship of government coalition in connection with economic tendencies of neo-liberalism was odd and contradictory. They have always spoken about the necessity of building up civil society and privatization but acts and words were in contradiction. On the one hand, it has never been determined clearly what rate of national property and what economic key positions they want to have under the government control for a long period of time. On the other hand, having 160 important companies and the economic key positions you often feel

that this government besides the political power would like to have considerable economic power, too. At the same time it would like to withdraw from such 'weak links' of market economy as education, culture, scientific research and social policy or at least would like to reduce its role strongly. The tragic consequence of this can be felt now. Culture is overflowed with 'dirty tide', e. g. topics of books and films are mainly violence, brutality and murders. On the one hand, it is very difficult to find publishers for books of real literary values or outstanding professional and textbooks. Educational and scientific research institutions are on the margin of their existence. But they are essential sectors for future development and it is impossible to imagine long term and permanent economic growth without them.

The government budget reforms should have been carried out by 1991 and it hasn't been carried out yet. Indirectly the lack of it has made the economical environment of privatization process worse to a great extent. Figures showing great budget deficits and the force to finance them push out the entrepreneurs of capital and loan market by the government. They are unable to obtain satisfactory development resources. The fact that the Hungarian state budget still concentrates more than 70 per cent of incomes makes worse the economic environment of enterprises considerably. Major part of enterprises are unable to manage with profit because of high taxes and other budget payments. This fact make them work in spheres of grey and black economy. According to the rough estimations 30 per cent of GDP is produced in black economy in Hungary.

2.2 What Shall We Apply Incomes of Privatization for?

Another controversial question of privatization is how to spend incomes of privatization. Data of *Table 2* are based on privatization incomes and expenditures.

Analysing the data we can set down the following important facts: In 1990 79% of privatization incomes is foreign exchange revenue. In 1991 it is 78%, in 1992 55% and in the first five month of 1993 foreign exchange revenue is 42%. Concerning the data mainly in 1991 and 1992 we can say that foreign capital played a definite role in privatization. If we examine expenditure items the most obvious is the fact that in 1991 83% and in 1992 53% of expenditures were spent on financing state budget deficit and repayment of state debt. At the same time in 1992 13% and in the

Table 2
Privatization incomes and expenditures
(milliard HUF)

	1990	1991	1992	1993 J-M
Incomes				
Property proceeds (dividend, lease fee)	-	0.94	4.74	0.42
Sale				
Foreign currency	0.53	24.64	40.98	10.00
HUF (cash)	0.14	4.82	17.51	6.26
Cash income on the whole	0.67	30.37	63.23	16.68
Loan	-	1.01	9.07	6.69
Compensation certificate	-	-	2.26	0.33
Total income	0.67	31.38	74.56	23.70
Privatization property management cost	-	1.14	5.78	0.70
State debt, budget	-	22.37	39.22	-
Reorganisation	-	-	9.75	3.82
Job creation	-	-	1.00	0.40
Expenditures				
Set up companies, investment	-	0.18	6.86	0.27
Expo fund	-	-	1.50	-
To municipalities	-	1.37	1.99	0.79
Repayment to companies	-	0.92	2.32	0.44
Contingency reserve	-	0.80	-	-
Guarantee paying off	-	-	5.78	2.81
Time deposit for aims under guarantee	-	-	-	4.00
Regional development fund	-	-	-	0.50
Agricultural development fund	-	-	-	0.30
Vehicle liability insurance fund	-	-	-	0.70
Total expenditures	-	26.78	74.20	23.83

Source: Tamás Szabó: 'Three years of Privatization and its Preliminaries' State Property Agency, July 1993, pp. 55 - 56

first five months of 1993 16% expenditures were spent on reorganisation. The most important interest would have been to roll back privatization incomes into economy, grade up companies to be privatized in order to sell them in higher price. In estimations about 80-85 milliard forints should be invested into companies before privatization. On the other hand, new owners, Hungarian investors should get right development resources. That is not enough to buy and obtain state property. Investors should have perfect credit conditions to make their companies work effectively and interest rates shouldn't be too high. Examining expenditures items we establish the fact that only a small amount of money was spent on creating new working

places although employment was reduced by 5% due to privatization. 700 000 officially registered unemployed is a big social burden on such a society where unemployment was unknown some years ago.

2.3 Who Shall We Privatize for?

Who Shall We Give from the Property to be Privatized to?

Analysing the data of *Table 2* it has been pointed out the foreign capital was dominant in privatization process. Data of *Tables 3* and *4* demonstrate it, too.

Table 3
Foreign capital taking part in privatization in Hungary
(milliard HUF, cumulated data)

31.12.1990	31.12.1991	31.12.1992	30.06.1993
25.35	58.68	96.23	114.875

Source: Tamás Szabó: 'Three years of privatization and its Preliminaries.' State Property Agency, July 1993, p. 51

Table 4
Data of newly founded enterprises with foreign direct investment in Hungary

Period	Number of organisations	Capital paid in	Foreign capital paid in
		million Fts	
1991 J-D	5642	138751.6	55480.1
1992 J-D	4101	70407.3	42936.1
1993 J-S	3040	36318.1	26767.9

Source: Monthly Bulletin of Statistics 1993/11. p. 99
Central Statistical Office, Budapest

Our statement is strongly supported by the data of both tables that foreign capital played a dominant role in privatization at least till September 1993. The main reason for that was that privatization philosophy of the government was strongly income centric. The process of primary accumulation of capital in Hungary didn't take place actually so Hungarian investors' capital intensity was very weak comparing the foreign ones. There were great expectations regarding foreign investors hoping capital,

modern technology and new markets. Unfortunately these expectations didn't come true. Motivation factors of foreign capital were completely different. They were as follows:

- to obtain market share of Hungarian enterprises;
- to crowd Hungarian companies as competitors;
- to obtain cheap intellectual capacity;
- cheap labour force;
- not so strict ecological requirements.

Foreign up-to-date technology was brought to Hungary not mainly by privatization but by the so-called green field sites, e. g. Suzuki, GM Opel, Audi, etc.

Certainly populist slogans about selling out the country are not correct. Hungary needs foreign capital and its property share far under 10 per cent. In economists' circles the general opinion is that the property share may reach 30 per cent. (In 1938, in the last year of the peace before the second world war the share of foreign capital from the Hungarian national property was 38 per cent.) Because foreign investments are diversified according to countries of origin there is no danger of unilateral dependence from any countries. Data of *Table 5* demonstrate it.

Table 5
Distribution of foreign capital according to countries
(May, 1993)

Countries	Number of enterprises	Foreign capital paid in	
		milliard HUF	%
Austria	58	39.50	35.87
UK	25	12.80	11.62
Germany	30	12.49	11.35
France	18	10.43	9.47
Switzerland	12	9.61	8.73
Netherlands	18	9.48	8.60
Italy	4	4.43	4.02
USA	10	2.22	2.02
Others	13	9.17	8.32
Total	188	110.13	100.00

Source: State Property Agency: Three years of privatization ... p. 55.

Naturally all the countries in the world protect certain positions, territories or sectors against foreign capital. The government should decide

on areas where to keep national state property, or only national proprietary majority and to avoid to obtain foreign property majority on the secondary market of shares. (It was very spectacular e. g. when GE swept out Hungarian state property from Tunggram by devaluation and then by increasing capital.)

It seems to be a great problem if monopolistic structures are transmitted during privatization and it is especially true when they are owned by foreigners. (e. g. National Vegetable Oil Industrial and Detergent Producing Company.)

By this means the Hungarian productive and consumer interests may suffer serious damages. So foreign investors aims are multi-coloured. Knowing them and harmonising them with Hungarian national interests is indispensable and it hasn't been a significant feature of the government's privatization policy so far. As we have already seen Hungarian investors have played a moderate role in privatization although the development of a middle class well provided with capital is a fundamental national interest. It has been pointed out by some researchers too and certain changes in privatization philosophy of the government showing in this direction we could see since 1992 when privatization techniques helping Hungarian investors came into prominence. Data of *Table 6* refer to this fact.

Table 6
Sellings based on techniques supporting Hungarian investors

Types of selling techniques supporting Hungarian investors	1991	1992	1993	Total
MRP*				
Number	-	6.00	6.00	12.00
Value (milliards HUF)	-	1.47	1.12	2.59
Leasing				
Number	-	-	4.00	4.00
Value (milliard HUF)	-	-	0.90	0.90
E-credit**				
Value (milliard HUF)	1.01	9.07	6.70	16.78
Compensation certificate				
Value (milliard HUF)	-	2.2	2.4	4.6
Total	1.01	18.74	21.12	40.87

Source: Three years of privatization ... p. 52.

* MRP: Employee Participation Programme

** E-credit: Existence Credit

Seeing the data of this table we can conclude that the techniques mentioned above didn't really help to rise capital-intensive middle class. On the one hand, we haven't had new data yet, on the other hand, some of the techniques mentioned above may be efficient with certain corrections and changing of views to reach set aim.

As for Employee Participation Programme on 7 March, 1994 Mr. Tamás Szabó minister of privatization said on a TV interview that within the sphere of MRP 100 companies have been privatized so far in the value 20 milliard HUF and this form touches about 20.000 employees. It was a very important announcement. The antipathy of Hungarian society against privatization derived among other things from that fact that employees felt themselves excluded from this important process. There are reservations with employee participation hence forward. On the one hand, some people say that if too big rate of shares is concentrated in employees hands it frightens foreign capital from privatization. On the other hand, the so-called ESOP (Employee Stock Ownership Plan) in the United States is often mentioned as a counterexample and has proven to be a successful construction. ESOP was introduced in 1971 and since then the number of companies taking part in it is over 10.000 and more than 10 million employees belong to it. Three out of the ten largest steel manufacturing companies, 2 out of the ten best provided with capital shipping companies and 2 out of the 10 biggest building societies can be found among ESOP companies [3]. The popularity of ESOP in business life is principally based on not only tax allowances but also it is reinforced by productivity advantages. As experiences show, connecting employers' and employees' interest is an expressive motive power.

The Small Investors Share Buying Program hasn't been mentioned yet among privatization techniques in the *Table 6*. It was advertised in the middle of 1993. The government had double aim by introducing mass privatization techniques. One of them was to stop devaluation of state property and the other was to create the possibility of wide range participation for inhabitants. This privatization construction guarantees for each Hungarian citizen 100.000 HUF interest free share buying credit if a minimum amount of entry fee (2000 HUF) is paid. That's why this construction is called preferential share-buying programme, too. This credit should be paid off in equal instalments during five years. For loan recovery compensation certificates can be used as well with interest-raised value. The sum of loan recovery is used to reduce public debt. If the dividend of the company isn't enough to pay the instalments, shareholders should

pay them. If repayment is cut off, shares will be reverted to State Property Holding Plc and small investors will get back the instalments paid so far. So this construction has a minimal risk for them. In this construction company shares offered by State Property Agency and State Property Holding Plc can be bought in the value 20–30 milliard HUF. The privatization of National Savings Bank has been going in this construction recently. There have been mentioned certain reservations in connection with Small Investors' Share-Buying Programme. Some people state that it is rather a social compensation programme than a privatization technique. Because in reality privatization means that instead of state owner comes a conscious owner who can vindicate his rights. Actually, small investors are worse owners of companies than the state was because they can vindicate their rights even worse than the state did.

The leasing construction has been formed to promote of manager by out among others. International experiences show that they should let the management get property. Namely, too big economic power is concentrated in their hands and they shouldn't be let out of property risk. This property should be significant but the property and manager functions shouldn't be allowed to merge.

The essence of leasing construction is that government takes irrevocable responsibility that the leased company will belong to the leaser if the leasing conditions are fulfilled at the end of duration term. The minimum duration term of leasing is 5 years and the maximum is 10 years. The discount factor corresponds to the base rate of interest of Existence credit. Leasing instalments can be settled as costs. Hungarian individuals and groups of them can take the advantage of this construction. If somebody doesn't fulfil the leasing conditions, he or she will be excluded from leasing, the leasing contract will be abrogated and the paid in leasing fee will be automatically lost. Bank guarantee should be secured to 5% of leased property. At the beginning of duration term the leased property can be sold only in justified case with the permission of State Property Agency in order not to rob property by the selling real estates and assets.

Company management was treated with intense distrust by government from the very beginning although in the last 15 years of Kádár era a well-trained company management was formed. In some cases it was a great surprise even for western firms of management consultants. That government was unimpressed by it and the vice-president of the leading government party announced that expertness is a Bolshevik trick and it is only good to preserve the power of management. And then at compa-

nies, banks and other economic institutions there were frequent reshuffles with political motivation. I myself called the attention to its danger in one of my studies earlier [4]. The choice of new leaders based on only loyalty to the party and the government coalition. The consequence of it was that damnably unprepared people made earlier prosperous companies go bankrupt in a very short period of time. The reasons mentioned above manager by out didn't play an important role in privatization.

In fields of credit constructions there were 2 privatization credits earlier. One of them was the Existence credit and only individuals have were able to obtain it. The other was the privatization credit and it could be obtained by companies only. Later on the basis of gained experiences they were contracted and now it is called Existence credit and both of individuals and groups of individuals have access to it. 20-22% interest paid seemed to be too high besides the low profitability and that's why the interest conditions of Existence credit had to be revised. According to this change the interest of Existence credit is 60% of basic interest plus 4% interest margin. In opposition to expectations the positive change of credit conditions of Existence credit haven't had mass prosperity in private enterprises. The main reason for that — as it had already been pointed out — goes back to the lack of enterprise-friendly economic environment.

Compensation certificates were given to those people whose property were nationalized, who were in captivity or were harassed politically, who were deported, etc. I have already referred to the fact that compensation certificates can be used in privatization process. On the one hand, for loan recovery in Small Investors' Share Buying Programme, on the other hand, state property in the value of 60 milliard HUF was assigned by the State Property Agency and one of the terms of payment is compensation certificate.

One more privatization technique is worth mentioning and it is the so-called option leasing. The essence of it that the shareholder has an option right to buy the leasehold state property when the lease contract is matured. It differs from leasing construction in a way that in this case buying is not a necessity it is only a possibility.

3. Summary

Navigare necesse est! It was said by ancient Romans. Summarising experiences we can say that there is a compulsion to privatize. But its not all the same how to do it. Nowadays in Hungarian society there is great distrust and aversion to privatization. The main reason for that are as follows:

- non-transparency;
- secret-mongering hiding behind the magic slogan of business secret;
- very frequent corruption cases and sometimes only the minor figures of them put on the pillory but only in very few cases;
- the unemployment increasing effect of privatization.

Although one of the criteria of competition conditions is to keep the level of employment, nobody takes it seriously, and the government hasn't any means to call people to account.

- the feeling elimination;
Company management and employees are excluded from privatization. Bodies representing interest are often left out, too.
- Great debates within government coalition about privatization and they often look senseless.

That's why the very first task of the new government should be working out an overall privatization strategy to be approved by the Parliament. Insuring transparency is very important to cease social distrust of privatization and the whole process should be carried out under the control of the Parliament.

The new government will have narrower possibilities to continue privatization than the present one because only a minor part of the state property left behind can be privatized directly. It is quite obvious that nobody wants to buy losing enterprises, enterprises with high debt burdens. Among others the decreasing interest of foreign capital to privatization is connected with this fact. So the new government also should work out a conception of how to work permanently state-owned enterprises effectively, performance-oriented and in market conform way. The centralized, standardized forced transformation, the centralization of owners licence and the frequent public administration supervision created an atmosphere of complete uncertainty at these companies and the management had a short term, running through attitude to the property. There are a large number of companies — the estimated number is about 300 — where state prop-

erty methodically was stolen out and was carried over to limited company. Only the debt and some immovable property remained in the centre of companies.

Interpretation of economy in political terms and political reshuffles should be ceased. From this point of view the situation is much worse than it was in the last years of change of regime. In economic policy Hungary should go back to the ground of decentralization, deregulation and liberalization.

By modernizing bank and credit systems, carrying out the reform of budget, decreasing tax and other liabilities of enterprises better conditions should be guaranteed for new enterprises. That's not enough to buy state property but it should be worked effectively. The success of privatization doesn't depend on the number of companies having been sold or the amount of money having been paid for them. It depends on effectiveness. The privatized companies should work more effectively than the ex state-owned ones.

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