Hungary: capitalism triumphs

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In 1989 the Hungarian Socialist Workers Party voted to dissolve itself and relinquish its monopoly of power. Eight years and two governments later many of the old Stalinist bureaucrats at that conference are at the helm of state as the country reintroduces capitalism. Keith Harvey maps out the country’s tortured journey back into the hands of imperialism

In 1994 Gyula Horn, leader of the Hungarian Socialist Party, became the country’s Prime Minster. Over the last four years he has been a key figure in Hungary’s transition to capitalism.

Horn’s career brilliantly illustrates the truth of Leon Trotsky’s view of the Stalinist bureaucracy as an agent of imperialism in the workers’ state. Forty years ago Horn was a member of Janos Kádár’s security services which engaged in a search and destroy mission against the remnants of the workers’ councils and militias that were crushed by Soviet intervention into Hungary in 1956. He helped to smash the political revolution against Stalinism.

By 1989, Horn was Foreign Minister in the Stalinist government of the Hungarian Socialist Workers Party (HSWP). In June that year he sanctioned the uncontrolled border crossings to Austria that led to a breach in the Iron Curtain. Before the end of 1989 the Berlin Wall was hauled down and the west’s victory in the Cold War was complete. Thus, in his own way, Gyula Horn played a key part in precipitating the end of Stalinism in Eastern Europe.

Having once preserved Stalinist dictatorship against workers’ democracy, Horn has just completed the sale of the country’s prime industrial and financial assets to western multinational companies and turned Hungary into a dependent, semi-colonial capitalist state.

The west is pleased with Horn’s work. A year ago the Financial Times recognised the fundamental structural changes that have put Hungary at the forefront of the fast-track reforming countries of east Europe.1

Indeed, it claimed then that Hungary’s transformation to a market economy is all but complete. Twelve further months of privatisation, the liquidation of ailing firms, an unrivalled stock market boom and a wave of enterprise restructuring have completed the decisive phase of Hungary’s transition to capitalism: it stands with both feet on capitalist terrain, if a little unsteadily.

In order to guide the working class of Eastern Europe in the changed conditions of class struggle, we must confront the implications of the successful restoration of capitalism for Marxist theory?not just in Hungary but also in Poland and the Czech Republic. This article is the LRCI’s latest contribution to that task, and uses Hungary as its reference point because it has advanced furthest and fastest down the path of capitalist restoration in central Europe.

The dissolution of the Stalinist bureaucracy
To understand the process of capitalist restoration in Eastern Europe it is essential to take into account the history of the states involved in that transition. Capitalism was uprooted in east and central Europe by Stalinist administrations in the years 1945-49. Bureaucratic command economies were built on the basis of:

- nationalised industries;
- a state monopoly of foreign trade;
- the abolition of profit-driven production.

The concrete tasks of the restoration process today are affected by this historical point of departure. First, those who wished to restore the profit system had to re-create a class of private capitalist owners/managers and a proletarian class with no access to ownership of the means of production.

Second, they had to transform money from the passive instrument of accounting that it was in the bureaucratic command economy into a measure and store of value and hence into profit-oriented investment capital.

Third, they had to purge and restructure the bureaucratic Stalinist state machine into one that could ensure the reproduction of all these features against resistance both from the working class and, where necessary, deficient elements of a nascent capitalist class.

After 1989 the new Hungarian regime approached these tasks with a number of advantages. As the European Bank for Reconstruction and Development (EBRD) remarked, Hungary entered the transition with particularly favourable initial conditions.

After securing political stability in 1957 through outright repression, Janos Kádár embarked on a series of economic reforms which encouraged, or turned a blind eye to, small scale entrepreneurial activity. This met basic consumer needs better than the old system; by means of what became known as goulash communism the HSWP hoped to buy the acquiescence of the population.

After the introduction of a further round of market socialist reforms in 1968 (the New Economic Mechanism NEM), the major state enterprises in Hungary ceased to be simply the property of the state, and ownership was jointly vested in the central ministries and the enterprises themselves. This gave an important share of independent control to the enterprise managers. Many decisions regarding product range and use of labour fell to them instead of to the central planners. The central state and party bureaucrats retained control over decisions on longer term investment. But by the 1980s the resources available to them were substantially diminished and, with this, so too was the central bureaucracy?s leverage over the enterprises.

Reforms in 1984 further shifted control away from the centre. After 1984 more than two-thirds of the enterprises had ownership rights concentrated in enterprise councils where the managers had a preponderant influence. In 1988, on the eve of the fall of the Berlin Wall, the power of enterprise managers was further increased by the Companies Act; this gave local managers the right to sell their ownership rights in the factories and led in turn to a process of spontaneous privatisation.

Before the collapse of the HSWP?s monopoly rule and the elections of 1990, several large enterprises had already converted themselves into joint stock companies.

Hence, before the final removal from power of the ruling Stalinist caste within a degenerated workers? state indeed with its active encouragement the legal framework for the transformation of state property into industrial capital had made great strides forward, even if it still lacked a genuine social and economic
content.7 Through these measures the enterprise and industry strata of the economic bureaucracy were preparing themselves to inherit the fruits of capitalist restoration.

But in 1988 the leadership of the HSWP was captured by the ?new technocrats?. Rising as a result of the post-1968 market reforms these ?communist? bureaucrats had, by the early 1980s, consciously abandoned any commitment to a centrally planned economy. In 1988 they forced the resignation of Kádár and opened up multi-party discussions with opposition forces inside Hungary with a view to abandoning the HSWP?s monopoly of political and military power and arriving at a ?negotiated transition?.

While being openly pro-capitalist they objected to the process of enrichment by the ?red managers?. They preferred a more controlled process of transition, which would include foreign participation and help for the substantial layer of Hungarian small businesses to take a large slice of privatised state assets. But in 1988 the technocrats were still too weak to stop spontaneous privatisation.

In 1989 the adoption of the Transformation Act by the dying Stalinist regime further entrenched enterprise managers? rights in return for a commitment to keep the economy going during a phase of accelerated decline,8 a measure which effectively gave up on central planning as any kind of direct economic mechanism. This was complemented by the decline, in the late 1980s, in the amount of direct budget subsidies given to the enterprises by the central ministries. By 1988 they were down to 8% of GDP ? the lowest in Eastern Europe.9 As the central state?s direction and influence shrank further, spontaneous privatisation mushroomed and the number of joint stock companies increased five-fold in the last year of the Stalinist regime.10

**Hungary as a moribund workers? state**

As a result of the elections of 1990 Hungary became a Stalinist state with an openly pro-bourgeois government: an unprecedented and by definition transitory phenomenon which we have defined as a moribund workers? state (see box). Henceforth, its ruling regime was actively dismantling all the remaining centralised economic mechanisms that prevented the capitalist law of value11 from dominating the economic life of the country.

The Hungarian Democratic Forum (HDF) government abolished the already much weakened central ministry-based planning institutions and removed all restrictions in the way of individual firms trading internationally. This was accompanied by the ?liberalisation? ? i.e. removal of state control ? of prices. Both measures helped to convert money from a passive instrument into an active agent in establishing the relative exchange ratio of commodities in the market. This led in turn to the prices of most enterprise assets (factories, stocks etc.) being marked down as they were far less valuable than in the west.

The break-up of the existing exchange relations in the Comecon bloc precipitated a catastrophic economic slump throughout Eastern Europe. In Hungary, output collapsed by 20% in 1990-93.12 The main task of the new government was to ensure that the costs of this crash were borne by the working class in the form of mass unemployment. By the end of 1993 the labour force fell by an incredible 40%. The largest 150 manufacturing firms reduced their workforce by 47% between 1989 and 1993.13

This massively speeded up the process of transformation of labour power into a commodity. Under the social relations of a degenerated workers? state, despite the existence of the ?wage form? of payment, labour power did not function as a commodity as it does under capitalism. Workers were ?tied? to the enterprise. It was very difficult to sack them. So there was no system of ?free labour? typical of capitalism, which guarantees a permanent reserve army of labour that can act as a pressure on the employed labour force to depress wage levels. On the contrary, wage levels were predetermined by the plan, irrespective of the demand or supply for any specific type of labour.
But the mass unemployment of the early 1990s "freed" the workers from the means of production to become a truly exploited proletariat, i.e. a class with nothing to sell but their labour power.

For workers, their enterprise was the main point of access (via the trade unions) to welfare payments, housing allocation and even holiday entitlement. A key task of the regime in a moribund workers' state was to oversee the wholesale destruction of this welfare function of the enterprises, stripping the trade unions too of their role in distributing benefits.

Instead, in a much reduced and weakened condition, benefit distribution was transferred to the state. This process also involved turning non-wage benefits, such as housing and even some food supplies, into commodities to be bought and sold in the market in return for a part of wages received.

This too was pioneered by the HDF government, although as with the other countries in the region, "reform" of the pension and social security system has been one of the last elements of the welfare system to be restructured, requiring as a precondition the prior solution of another problem - the overhaul of the taxation system.

This change in taxation is crucial, since it determines the volume and rate of the new state's revenues. In a degenerate workers' state these were derived primarily from a charge on the enterprise (a turnover tax). As part of the transition process the bourgeois government of the moribund workers' state has to remodel taxation so that it is primarily a charge on the working class. It does this by introducing a regressive taxation system such as a sales tax (for example, VAT or GST) as well as introducing an income tax on wages.

Naturally, all of this takes a great deal of time since the social structures, culture of acceptance and professional skills necessary to implement it have been obliterated or driven underground for 40 years. The necessary legislation on property and contract law, a bourgeois justice system, an internationally recognised system of accounting - all these have to be rebuilt and then enforced.

But all these problems pale into insignificance compared to the task of creating a class of capitalist property owners. While the new government inherited some of the legal framework for this from the 1980s, it had to fill it with a social content via the privatisation of state assets. This, in turn, begged a series of questions: what kind of capitalist class should be created and how? What should be done about the pre-war claims of old bourgeois owners? What role should foreign capitalists play? What share, if any, should the workers have in the ownership of the new firms?

There is no "rational" solution to these questions, to be drawn out of some general model of the capitalist economy. The answers depend upon a struggle, a struggle of existing classes and castes and of nascent ones. The outcome reflects the residue of past struggles and their results. Because of this, each country in the region has arrived at different specific solutions.

In the case of Hungary, by the time of the negotiated agreement with the opposition forces in 1989 and the parliamentary elections of 1990, the majority of the "new technocrats" in the re-named Hungarian Socialist Party (HSP) and most of the opposition parties had agreed on the need to establish a State Property Agency (SPA). The purpose of this was to halt and, if possible, reverse the process of "spontaneous" privatisation and the resulting enrichment of the enterprise managers. In this way the state machine hoped to regain control over the restoration process.

The first two years of the HDF government (1990-92) witnessed a sharp struggle within the state machine over the direction of capitalist restoration, focusing on the nature and powers of the new SPA. Privatisation
from below did not cease. But the SPA bureaucracy, made up of figures drawn from formally different parties, united in opposition to the enrichment of enterprise managers, fought for control over the right to sell firms.

The various parties and coalitions, in and out of government, were weak. Their economic policies did not express clearly different programmes for restoration. This reflected the fact that the multiplicity of newly created parties ? made up of intellectuals, former Stalinists, small entrepreneurs and enterprise managers ? did not represent stable bourgeois forces, but overlapping and sometimes contradictory programmes. In this situation the possession of control within the state machine, rather than parliament, was more decisive in influencing the form of restoration policy.

The imperialists recognised the importance of continuity and stability in the state machine both before and after the formal change of ruling political parties. The 1997 Transition Report contrasts the situation in Eastern Europe to the fragmentation of the federal state in the USSR after 1991:

?The political transition?did not entail the same challenge to the capacity of the central state, enabling the key state institutions to continue to function through this transition albeit under different political leadership.?14

The privatisation law came into force in August 1992. The battle for control resulted, in the words of one observer, in the ?centralisation of the entire ownership right [which is] nothing other than renationalisation.? 15

The SPA was able to appoint the top managers in the enterprises that had been formed into companies, together with the members of the management board.

The HDF government, until its demise in 1994, spent much of its time resolving these essentially political disputes about the character of privatisation, implementing the privatisation of small-scale state property (shops, small enterprises) and legitimating the many previously illegal small businesses that mushroomed during the Kádár decades.

**Contradictions of the transition process**

As in all moribund workers? states, Hungary?s new rulers had to work their way through a number of real social contradictions on the road to capitalism. Alongside unambiguously pro-capitalist measures they also had to carry through a series of measures that worked in the opposite direction and, for a whole period, acted to protect much economic activity from the operation of the law of value.

The bulk of material production in a moribund workers? state can become surplus value-generating only on condition that its initially unprofitable character is sustained and reproduced for some time during the process of transition. A generalised and immediate imposition of the law of value on the entire production process in these states would have destroyed the possibility of future surplus value creation.

The limits of the law of value at this stage can be observed in the gradual increase in the number of loss-making enterprises in Hungary in the period 1990-92, as the real worth of assets is revealed. The opening up of the internal market to international competition soon revealed the extent of loss-making firms in Hungary. One estimate suggests that, in 1992, half of all enterprises were ?drifters? (i.e. barely solvent), one-quarter healthy and capable of withstanding short-term competition, and another quarter hopelessly failing.16

In 1992, much to the chagrin of its western advisers, the government picked out 14 big state-owned companies for debt-relief. These employed 83,000 workers and were responsible for a quarter of all
Hungary’s industrial exports at the time. The government poured in $1.7 bn of aid to keep them going while it decided which ones could be saved in the medium term.

Inter-enterprise debt (IED) mushroomed to $5.2 bn by the first quarter of 1992, as traditional supply lines between similarly afflicted enterprises were maintained. This amounts to the extended reproduction of loss-making production in the old state sector. IED was accompanied by systemic use of non-commercial bank-lending to replace missing government subsidies and the government itself tolerated non-payment of enterprise taxes (and energy bills) to ease the financial crisis of the lame-duck firms.

The 1990-94 government also, rather uniquely among the Visegrad countries, attempted a reflationary economic policy by borrowing abroad to keep up domestic demand. As a result, although unemployment skyrocketed, wage levels of those in work rose: by the end of 1993 they stood at 130% of the 1989 level.17 Pensions remained pegged to real wage levels and were eroded at a slower rate than elsewhere in the region.

This reflationary programme was aimed, quite unashamedly, at keeping vast swathes of the ailing smaller domestic industries (the ?drifters?) afloat: not surprisingly, since these firms formed the main social base of the leading party in the government, the HDF.

A further notable feature of Hungary’s policy at this time was the way in which the government used bankruptcy laws which they introduced in 1992. Their function under capitalism is to remove unprofitable sectors from the circuit of capital and release whatever assets can be saved from the liquidated enterprise so that they can be used productively by another firm or bank.

The spontaneous, purely economic, movement of capital is insufficient to ensure the destruction of capital: bankruptcy is a conflict between creditor and debtor. Hence, the state must adjudicate and resolve this conflict in favour of one side or the other, usually the creditor.

When implemented, early in 1992, the bankruptcy laws were the most far-reaching in the region. They required all firms more than 90 days in arrears to file for reorganisation or liquidation. Over 22,000 firms did so by the end of 1993. But by mid-1994 over 95% of the firms that went through the procedures were still in business and yet only one quarter were profitable. The major study of this experience concluded, in 1995, that ?what the system lacked and still lacks, is an efficient and dependable exit process on which creditors can rely as the final stage in debt collection.?18

Hungary’s experience shows that a government of a moribund workers’ state uses the bankruptcy legislation not to enforce the untrammelled logic of the profit system but to protect illiquid enterprises from being destroyed.

As Marx said, no matter what laws are on the statute book ?right can never be higher than the material foundation upon which it rests.? Hungary possessed neither the political balance of forces, nor the technical infrastructure, to carry through capitalist restoration in the originally intended form.

To put it bluntly, the new laws were used by debtors to gain protection from creditors. No bankruptcy laws in a moribund workers’ state allow for creditors to initiate bankruptcy. By acting in this way the state machine acts to prevent the law of value being imposed, objectively impeding the transition to capitalism, despite its subjective and strategic desires.

But we are dealing here with a contradictory process and the bankruptcy legislation did have effects which prepared state-owned industry for privatisation. Almost two-thirds of all the enterprises that entered into the process of bankruptcy proceedings slashed their workforce by between one-quarter and one-third as a
condition for survival. This undoubtedly prepared some of them for being sold off later. But this kind of passive restructuring? was typical of the early years of the transition whereby any reorganisation of production takes place on the old technical foundation by means of wage cuts and/or mass sackings, by finding new markets, rather than by transforming the production process by new investment in plant and machinery.

Thus we see that, in the form of extended IED, a government reflation package and bankruptcy laws ?of a special type?, the moribund workers? state in Hungary carried through a contradictory historical task: it protected decisive sectors of the economy from the re-introduction of the law of value in order to ensure its introduction at a more favourable moment in the process.

**The role of bank reform**

Major problems plagued Hungary?s banking sector during the first half of the 1990s. Banking reform began in the 1980s with the creation of five state-owned commercial banks separated off from the central bank. Their function was to provide long-term investment finance for industry.

These banks entered the transition process saddled with non-performing loans to bankrupt industries. In 1991 the government guaranteed Ft 10 bn worth of ?doubtful loans?. Then, in 1992, it began the process of recapitalising these banks by siphoning off these debts and pouring in new capital to bring their reserves up to internationally acceptable levels. Without this the banks could not act against the ailing and failing firms which they owned, or were creditors of, for fear of forcing themselves out of business if they forced the firms into liquidation. By 1997 this amounted to a Ft 334 bn injection of capital?equivalent to 8% of the 1994 GDP.

This process of recapitalisation was carried through in the form of a tax on the future profits of the capitalist class. It represented the nationalisation of banking debts and, as such, indicated the deepening of the capitalist character of the state machine. The state was now proving capable of raising itself above the individual interests of any one capitalist and undertaking measures beneficial to the capitalist system as a whole. This was an important measure since it enabled the process of new production to be separated off from the burden of past production.

However, all commentators agree that in the first two years of operation the terms of the recapitalisation programme were so lax that it did not require the banks to fundamentally change the nature of their lending operations to ailing firms. This created what is known as ?moral hazard?, whereby banks continued to extend bad loans in the belief that, in the last instance, the government would step in and bail them out. It therefore failed, initially, to force the banks to be an instrument in the battle to restructure the social relations of production inside the enterprises. And it failed to force the banks themselves to become commercial, profit-oriented businesses.

By mid-1994, therefore, Hungary?s economy was still structurally dislocated. There was a growing profit-oriented private sector which consisted of: newly founded private enterprises in the hands of domestic owners, newly acquired outlets of foreign multinationals and a few commercially restructured former state enterprises. In addition, there was a sizeable ?grey? sector of the economy which delivered informal goods or activities but did not appear in official statistics.

The non-state sector was strongly represented in retail and wholesale trade, personal and business services and light industry oriented to consumer goods. Due to slow progress with privatisation the non-capitalist state sector continued to dominate large-scale industry (e.g. steel) together with the energy and transport sectors.
Many of these enterprises not only operated at a loss but were not even geared to the goal of profit-making. More than half of the biggest loss-makers in state ownership as of 1992 had still not entered into bankruptcy procedures by mid-1994. Some of them retained their monopoly position, backed by state subsidies, and were therefore not forced to change under the impact of competition.

Still more enjoyed protection because it was thought that ways had been found to make them commercially viable under state ownership in the future. This category includes four of the original 14 state-owned giants that the government picked out in 1992. As long as the old state sector dominated the whole economy as long as the non-capitalist laws of this sector regulated the accumulation process of the bigger part of the economy and held the other sector in dependence and subordination Hungary remained a moribund workers' state.

Crossing the Danube

The Danube, which flows through the centre of Hungary's capital, Budapest, divides the old historic city of Buda from the commercial and industrial district of Pest. The river could easily stand as a metaphor for the transition process from degenerate workers' state to capitalism. The Hungarian economy, after several years of lingering on the Buda bank of the mighty river has now passed over into Pest. All the key institutions of modern Hungarian capitalism, its stock market, major banks and MNC headquarters are to be found there.

In this process the election of the new HSP-led coalition government in May 1994 was a watershed. The restoration of capitalism, after all, is not a blind, spontaneous economic process. The state is the forcing house of transition, and during the last three years Horn's administration has speeded up the privatisation process especially in the big state-owned industries and above all the banks.

By a strict tightening of the bankruptcy procedures it has ensured the liquidation of more than half of the firms that entered into the process. Those that have survived have been sold off to foreign multinationals, where they have been restructured through the use of new technologies rather than simply through mass sackings. And, in a marked departure to the previous administration, Horn implemented a draconian austerity programme in which he has applied his shears to social welfare and wages.20

The new government showed itself to be deaf to the protests of the trade unions or small domestic producers. Horn and co. have shown themselves to be genuine comprador agents of multinational capital. They have proven willing and able to enforce the general logic of capitalist accumulation against both small-scale private capitalists and state-owned enterprises.

The government virtually completed the privatisation process with the 1995 Privatisation Law. In 1990 the SPA held 1,698 enterprises for privatisation. By May 1997 state ownership had been reduced to less than 50% in 1,489 of these. Nearly 1,000 of these were completely sold off and only in 209 companies does the state now have a share of more than 50%. In 1996-97 key companies such as MOL (oil) and Richter (pharmaceuticals) have gone to foreign owners. In 1998 the government aims to have shares in only 109 firms and intends to keep 100% ownership only in the postal service and the rail industry.

But it is not the mere change in ownership rights that is crucial in the restoration of capitalism. The experience of privatisation in Eastern Europe and the CIS has been quite diverse. In itself, the return of state-owned industries and banks to formally private ownership does not signify the return to capitalism, any more than state ownership in itself signifies the transition to socialism.21

If ownership rights are distributed too widely, they can impede the centralisation and concentration of capital ownership needed to effect changes of behaviour among the managers of the enterprises? most of
whom are products of a different social system. This problem has slowed down the restoration process in the Czech Republic, for example, until recently.

Or if for political reasons ownership is vested in ?insiders? (i.e. managers and workers) this can slow down the restructuring process by which managers are turned into agents of capital and workers are turned into wage-slaves exploited by capital. This has been the experience in Russia.22

Finally, ownership may come to reside in banks which are also creditors of the mass of ailing and failing enterprises. They are reluctant to impose ruthless, profit-oriented financial restructuring on these firms for fear of provoking their own collapse.23

Hungary adopted a different strategy early on. As part of its long-term openness to imperialist multinational firms and banks, Hungary had borrowed heavily in the 1970s and 1980s. Consequently, it entered the transition process after 1989 saddled with a far higher level of foreign-owned debt than anywhere else in the region?a debt totalling $17.8 bn.

The idea of raising cash to pay off this debt appealed to the leading figures in government. But only the western multinationals had the necessary money, given the weakness of a domestic Hungarian bourgeoisie.24

Privatising state firms into foreign ownership gained favour for a further reason; it was a way of preventing the embourgeoisement of the enterprise managers through spontaneous privatisation.

The long-term ties that multinationals had formed with the Hungarian bureaucracy before 1989 to some degree predetermined the route taken by privatisation. As the European Bank for Reconstruction and Development (EBRD) notes:

?More than in any other centrally planned economy, Hungarian enterprises were extensively engaged with western companies by the 1980s and many of these original links formed the basis of subsequent sales.?25

The Economist noted in 1995 that:

?Western business instinctively went to invest [in Hungary] when communism fell because it had long been the easiest place in the old eastern bloc to operate in. Its system was by far the most liberal. . .?26

Hungary?s well developed ties with imperialism before 1989 made the new regime very suggestible to entreaties and threats from the battery of new inter-governmental agencies thrown up to oversee the restoration of capitalism. And just to make sure, in 1992 the World Bank forced the HDF government to abandon any attempt at an industrial policy that sought to restructure SPA property with a view to keeping it in state ownership.

The figures for foreign direct investment (FDI) into the country illustrate the scale of multinational capital penetration. At $1,113 per capita Hungary has attracted twice as much FDI as the Czech Republic. Between 1989-95 it attracted a total of $11.3 bn, which amounted to one third of the total FDI that went to Eastern Europe and the CIS. And this for a country of 10 million people.

After 1992 the multinationals bought the best and potentially most profitable parts of Hungarian industry for knock-down prices in recessionary conditions. Alongside this many western companies have set up in greenfield sites in Hungary to establish a regional productive base for sales to other former Stalinist countries. These include Audi, GM, Suzuki, Unilever and Pepsi.
As a result, 49% of Hungarian manufacturing is now foreign-owned and 70% of Hungary’s manufacturing exports (aimed at the bigger markets in central Europe and the CIS) come from companies partly or wholly owned by multinationals. Most of these have largely set up low-value added sub-assembly operations according to the Economist Intelligence Unit. The head of economic strategy in Hungary’s industry ministry, László Csernszky, admits that these firms import, assemble and export with hardly a link to the local economy. There is, as a result, little technology transfer or demand for domestically produced inputs. In many ways Hungary is a carbon copy of the Irish Republic, but without the huge inward funds from the EU which have helped sustain its growth.

By undertaking a bonfire sale of industrial and financial assets in the last five years the Hungarian government has also met two other key objectives of the restoration process:

1. Finding the necessary investment capital to go beyond passive restructuring (e.g. sackings, change of product line and market direction) and into active restructuring of production technologies;
2. Imposing profit-oriented behaviour on the managers of the privatised firms.

As one commentator has said:

“Virtually all cases of foreign ownership have been associated with a major investment programme. Considerable change in management structure has also taken place, with senior local managers typically being supplanted by foreign managers.”

In a moribund workers’ state the enterprise managers typically resist pressure to impose the logic of capital on the production process. They resort to maximising output rather than profit; they engage in deals with other stricken enterprises to roll over debts; they make special pleas to government for funds or plead for concessions on their tax obligations. All this reflects a corporate identity that stresses the needs of the enterprise (including its workforce) and abstracts from the class divide that separates worker from boss under fully restored capitalism.

While Polish and Czech owners and governments have addressed this problem too—by insisting on government or Investment Fund representatives on management boards and by training up a new generation of bourgeois-minded managers and accountants—the Hungarians have often imposed foreign managers upon a newly purchased firm, or set up their own operations on greenfield sites.

But the experience of foreign management has filtered through to domestically-owned enterprises as well. The hard-to-please EBRD conceded in its latest report that:

“Available evidence reveals that strategic owners of Hungarian firms are more directly involved in management than is the case in the normal operation of a firm in an industrialised market economy. New owners have tended to exert direct influence over the running of the firm rather than relying on the formal structures of corporate governance, such as the General Assembly or the Supervisory Board.”

In other words, the private owners of Hungarian industry have broken through any insider resistance to the single-minded, profit-oriented operation of the firm and imposed the social relations of capitalist exploitation on the working class.

With the country’s industries enjoying a sustained recovery since 1994, and exports growing at 13% a year since then, it is clear that the majority of the country's enterprises are making an operating profit. The bankruptcy process has liquidated those that can never be profitable and restructured and/or sold those that could, dealing with their debts along the way by negotiated settlements with creditors and absorption
Once again, the banks

The final part of Hungary’s transition to newly restored capitalism (see box) was assured by further important changes in the relationship between the banks and the state on the one hand, and the banks and industrial capital on the other.

The banks play a critical, even decisive, role in the economics of transition to capitalism. In the market socialist? forms of the degenerated workers? state, the banks have no independence from the state. But by controlling the supply of investment credit to industry, they are the key agencies of central planning. The goal of the restoration process for banks is clear: extend commercial-based investment credit to industry and where they are owners of industrial capital, enforce profit-maximisation behaviour. But realising this goal is fraught with difficulty.

First, they have to gain their independence from the state so that lending is not politically directed. Secondly, they have to gain freedom from their ties to any one firm or sector of industry with which they have a privileged or unique relationship, so that they can carry out their function of aggregating and recycling total social capital to wherever it is most profitable. Thirdly, they must take a lead in the process of destruction of unprofitable output in conditions where many of the firms responsible for this output are assets on the banks? balance sheets.

To complete these tasks the government has to legislate and enforce the autonomy of the banks from the state. In Russia this took the form of a massive growth in new banks; in Poland it involved the commercialisation of state-owned banks. But in Hungary it has primarily occurred through the foreign take-over of domestic banks.

All five of Hungary’s previously state-owned commercial banks have now been sold to foreign banks. Now, more than 50% of banking assets in Hungary are held by foreign banks. The state?s share in all remaining banks must be less than 15% by the end of 1997. These banks have taken advantage of their new asset structure and autonomy to enforce profit-maximising behaviour inside firms they own or lend to. They have done this through direct participation in the management of the enterprise, selling off shares, varying the terms of loans and petitioning for bankruptcy.

With the widespread banking reform of 1995-97 the government has done much to ensure that surplus capital is systematically directed into spheres of investment that promise the most profitable employment of capital irrespective of its origin in any particular line of production or in any one firm. The profits from individual firms are now concentrated and centralised (together with savings of the working class) into a formally autonomous financial sector. This sector is the institutional embodiment of the power of money capital, which extinguishes all traces of its specific origin in the profits squeezed from workers at the point of production.

By redeploying capital to more profitable areas of investment, by speeding the velocity of capital’s circulation (i.e. by reducing the turn-over time between production of surplus value, its realisation in profits and its reinvestment) the autonomous and privatised banks ensure the formation of an average rate of profit. They do this by ensuring that capital is allowed to move unhindered between different sectors of industry, wherever the best returns can be made. Over time this tends to lead to the equalisation of profit rates between different economic sectors. Finally, an independent banking sector assists in the destruction of irredeemably unprofitable enterprises.

When the state excluded itself from the political direction of the financial sector, through the 1995-97 bank
privatisation process, an important stage was reached in stabilising Hungary?s existence as a newly restored capitalist country. A now autonomous finance sector (including capital markets) finally entered into an independent (but at the same time fully integrated) relationship with industrial capital, providing for the bulk of its investment needs on a commercial basis.

Where the state retains ownership of industry it does so merely as one among equals capable of applying its own laws equally to itself and the rival capitalists in the regulation of competition.

**Future evolution**

The Economist reported in June 1997 that ?Hungarian companies have been through the bankruptcy wringer. Privatisation is virtually over. And huge foreign investment flows have sucked the survivors onto a new plane of efficiency.?

As a reward for its ?progress? Hungary was given a seat at the top table of industrial capitalist economies?the OECD?in 1996. In March 1994 it had already applied for EU membership. The Commission opened negotiations with Hungary on the terms for membership and is due to issue a report on progress by the end of 1998. Already it has made it known that ?Hungary can be regarded as a functioning market economy?.

The restoration of capitalism in Hungary has been achieved at a great price for Hungary?s workers. Since Horn?s government came to office in 1994 real wages have fallen by a third. Unemployment in the eastern part of the country is above 15%. Many more are without work but cannot officially appear so in a country with the harshest rules on welfare entitlement in the region. Many of those who do have a job have more than one in order to survive. Some 20% of the population lives below the official poverty level.

?Goulash communism? has given way to soup-kitchen capitalism. The meat in the dish ? the prime cuts of Hungarian industry and the banks ? has been devoured by foreign multinationals. But they were served up to the IMF, the EBRD and World Bank by one-time Stalinists who now watch, like the bloodsuckers they are, as profits drain out of the country and the national debt to the foreign bankers mounts.

They will demand even more sacrifices from the Hungarian workers.

In an epoch of globalised capitalism, a country like Hungary, so weak and exposed to foreign capital movements and capricious demand for exports, is a crisis waiting to happen.

The working class of Hungary must disabuse itself of the lying promises made in 1989 of lasting prosperity and a consumer paradise. A capitalist Hungary is and will remain an impoverished semi-colony of the big imperialist powers.

But there is an alternative and Hungarian workers can discover it in their own past ? though not in the Stalinist dictatorship and bureaucratic planning. The parents and grandparents of today?s Hungarian workers created a heroic legacy of struggle. Twice ? in 1919 and in 1956 ? they created a republic of workers? councils. To recreate such bodies as fighting organisations for the expropriation of the foreign and Hungarian exploiters is the first step.

The second is to create a state of workers? councils running a democratically planned economy. That is the way to make the country?s first post-war capitalist crisis also its last one.

**Capitalist restoration and the Marxist method**

This article presents a concrete application of a method the LRCI has used to analyse the process of the restoration of capitalism which has been under way in central and Eastern Europe since 1989.
We started from Trotsky’s analysis of the USSR as a degenerated workers’ state and considered all the Eastern European states where Stalinist bureaucracies presided over centrally planned economies? including those with an important degree of ?market socialist? decentralisation like Hungary ? to be qualitatively the same as the USSR.

After the overthrow or fragmentation of the ruling Stalinist bureaucracies and the dissolution of the central planning apparatus we characterised these countries as moribund workers? states (MWS).

We defined a MWS as one in which a bourgeois restorationist government had come to power, and actively undertaken the restoration of capitalism but where this restoration process had not yet succeeded in ?crossing the Rubicon? into an economy dominated by the operation of the law of value. The institutions of command planning were dismantled in this phase together with the removal of Stalinist control over the apparatus of state repression. In the sphere of trade and commerce the law of value triumphed and a capitalist sector of production began to grow.

The countries of central Europe and the Baltic states passed into this stage in 1989-90. In the Commonwealth of Independent States this occurred later, in 1991-92. In some Balkan countries the MWS-process started even later? due to the wars in Croatia and Bosnia-Herzegovina? and was halted several times. In Serbia and Montenegro bourgeois-restorationist governments have not yet been established: the rump Yugoslav republic remains a degenerate workers? state in which (like China and Cuba) the Stalinist bureaucracy is taking steps towards capitalist restoration while retaining a monopoly of political power.

By the beginning of 1997 capitalism had been restored in certain parts of Eastern Europe: in the Czech Republic, Hungary, Poland, Slovenia and the Baltic states the social system is now one which we describe as newly restored capitalism (NRC).

We have identified two phases within this transitional stage. Poland and Hungary have already entered the second phase of restoration in which they have shown themselves to possess not only a mainly profit-making industrial sector, but an independent and dominant financial sector.

The Czech Republic displays certain defects or structural weaknesses which remain in the application of the law of value to the whole circuit of capital. The finance sector remains partially under state control with the result that profit-maximising behaviour is circumscribed by political considerations.

While there is a high level of product markets, at this stage there are few market institutions to mediate between enterprises and between industry and finance capital. There are relatively few bankruptcies due to the lack of creditor incentives with the result that capital is frozen in non-performing assets. Finally, residual state ownership of banks and/or investment funds prevents effective commercially based lending from taking place.

We can expect a situation in which actual production is already governed by the law of value whereas the investment process is still distorted, as indeed it is in other capitalist states in extreme situations. The lack of an autonomous finance sector is an important defect that will not allow such a system to develop beyond a certain stage. It is a deformation of capitalism, but one that is not absolutely unique in the history of capitalism.

In Eastern Europe after the war the first waves of nationalisation took place before the establishment of degenerated workers? states in 1948-51. The most important banks were statified before 1948. In many cases the state industries were often privileged in relation to private firms because the labour movement (and to be sure, the Soviet Armed Forces) was in a position to put enormous pressure on the
governments. This means that the point of departure for the emerging degenerate workers’ states was the existence of already ‘deformed bourgeois states’?. Rewinding the film backwards is likely to produce similarly deformed bourgeois states.

Naturally, the starting point, the institutional framework and the tempo of the transition has varied enormously in all these countries: it is impossible to describe any one of them as ‘typical’.

Nevertheless, Hungary has gone further faster than the others. It started the process earlier, met less institutional resistance from the working class along the way and adopted forms of ownership of capital that have allowed the new bourgeoisie to impose the law of value more completely and sooner over decisive sectors of industry and finance. As the furthest country along the road it shows the others important features of their future.

Although qualitatively capitalist, the system of NRC is quite different in appearance from modern capitalism in its western form. The share of state ownership in industry (often over 30%) remains higher in most restorationist states than in the most ‘state capitalist’ countries in Europe (e.g. Austria, Sweden where there is a still a large state sector). State responsibility for big loss-making enterprises far exceeds what is usual in the OECD countries. Labour markets remain distorted and ‘rigid’ in important ways unpalatable to the capitalists.

In these respects NRC combines features of capitalism in its infancy and in its senility. Similar degrees of state ownership can be found in the poorest third world countries and in war-oriented or crisis-wracked imperialist countries. NRC represents a particular combination of ‘modified’ capitalism ? not as it emerges from pre-capitalism but from a failed post-capitalist social transformation.

Footnotes
2. Here we use the term transition process to mean the series of measures enacted since 1990 under the post-Stalinist governments, during and beyond the stage of a moribund workers’ state. This is to distinguish it from the broader ‘restoration process’ which predates 1989 and of which the Stalinist bureaucracy was the chief agent.
7. The Economist noted that even before the Stalinists ceded power Hungary’s ‘laws [were] half-way conducive to a market economy.’ Survey of Hungary?, 18 November 1995
8. Average growth between 1978-87 was 1.8% but in 1989 it was -0.7%. State investment had fallen by 10% in the previous decade and inflation was 15% and rising fast.
9. Compare this with a figure of 20% for Czechoslovakia in 1988.
10 E Szalai op cit p59
11 The law of value is the Marxist term for the process by which capitalism spontaneously reflects the amount of human labour power embodied in a commodity. See K Marx, Capital Vol. 1, Harmondsworth, 1973
12. Labour productivity too fell for the first three years of the new government.
15. Quoted in E Szalai op cit p67
17. The reverse is true for the Czech Republic. Here the regime traded off relatively low levels of unemployment against a massive drop in real wages.
18. C W Gray et al, op cit p443/44
19. Of the 10,423 state owned shops and small firms in 1990, 9,990 were privatised by June 1994.
22. In the case of enterprise managers they too continue to operate according to other criteria than profitability at the outset, such as revenue or output maximisation; they may also be forced to concede to the interests of their co-owners (i.e. the workers).
23. Again, this has been the experience in the Czech Republic.
27. Foreign-owned companies accounted for 14% of GDP in 1997
29. ibid
31. Transition Report, op cit p91
32. Hungary is still the only country in Eastern Europe or the CIS to get full marks from the EBRD for its progress on banking reform, which entails ?Significant adoption of banking laws and regulations towards BIS standards; well-functioning banking competition and effective prudential supervision; significant term lending to private enterprises; substantial financial deepening.? ibid, p16
33. Hungary had the region?s most rapidly developing stock market in 1996-97. Turnover quadrupled in 1996 and market capitalisation more than doubled in the first half of 1997 before the East Asian crash affected Hungary along with all markets. Most investment for industry still comes from issuing shares and foreign owners rather than domestic banks.
34. This system of regulation has necessitated easily available, consistent and readily understood state enforced rules for effective competition. The government has introduced a regulated market in securities and equities as well as effective registers for property claims.
35. Business Central Europe, op cit
36. As a geopolitical counterpart to Hungary?s economic trajectory, in November 1997 a referendum delivered 80% backing for Hungary?s application to join NATO ? i.e. to place the defence of Hungary in the hands of US and EU imperialism.

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