PLANNED CONTROL AND MANAGEMENT OF THE SOCIALIST ECONOMY IN HUNGARY

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More than three years have gone since Hungary[1] launched a comprehensive reform of its "economic mechanism". This term is used with us to denote the concrete system of functioning, planning, control and management of the socialist economy.

The necessity of elaboration and introduction of the reform was rooted in the fact that the concrete form of the socialist production relations, that is the given economic mechanism, was ever less suitable to secure the fast development of productive forces. The basic resources and reserves of economic growth were getting exhausted and fast economic growth could be ensured in the future only by the more intensive revealing of economic reserves, by increasing efficiency and by acceleration of technological development.

The reform aimed at a type of socialist economic system in which the planned control and management of the national economy is organically combined with the operation of the market mechanism, the active role of the market. In this system the socialist enterprises operate under market conditions and the self-regulating market mechanism is working but the central plan embraces the whole national economy, it exerts an active influence on the main lines and main proportions of development, on the market itself. The implementation of the central plan is secured mainly by "indirect" methods, the so-called economic methods. These are not concrete, unique obligatory commands but regulators determining the circumstances where the enterprises are working in. Such regulating methods are: prescription of certain rules for the enterprises, fiscal policy, credit policy, price policy etc. Besides, there are existing "direct" methods of control too, especially in the sphere of investment and foreign trade. So, in this system the plan regulates the functioning of the market mechanism and the allocating role of the market is substantially limited in order to realize the targets of economic policy.

The reform was preceded by three years of fundamental preparation, and was introduced to the whole of the national economy on January 1. 1968, without prior experimentation on parts of the economy. The preparatory work was guided and organized by the Party. More than 200 economists, including theoreticians and practical experts, working in 14 teams, first prepared a critical analysis of the old economic mechanism, and then worked out the essentially consistent reform-principles. This was followed by working out concrete methods and regulations within the state apparatus.

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1) Hungary has 10 million inhabitants and reached a medium level of economic development (the per capita national income is about $700–800).

The reform was characterized by combining consistency towards reaching the goals set up, with care and foresight to ensure smooth transition. The consistency manifested itself in the full abolition of the obligatory plan indicators for the enterprises, in the liquidation of the so-called "breakdown" of the national economic plan, in the immediate introduction of the market for the production goods instead of their central allocation. Care and foresight aimed at preventing inflation and unemployment, maintaining the foreign trade balance, ensuring operability to weaker companies, avoiding disruptions stemming from greater organizational changes. Care manifests itself in the price system, the income-regulation system, the capital allocation system, the foreign trade system, the system of state assistance, and in the organizational issues.

Here below, I intend to enlighten the basic elements and some problems of the new economic mechanism.

The price system

At the beginning of 1968 within the frame of the economic reform there was a price reform as well in Hungary. New industrial *producer's* prices came into force. The new relative prices got closer to the costs of the domestic production and also their general level became higher. Agricultural producer's prices were raised substantially, too. However the *consumer's* prices have not changed essentially.

The all-embracing system of centrally fixed prices was abolished. At present there are prices fixed or maximized by the state, prices allowed to move between certain limits, and free prices. About 65% of total industrial output has free producer's prices and about 24% of retail trade turnover belongs to the sphere of the free consumer's prices. But fixing, maximizing or limiting the consumer's price limits also the increase of the producer's price of the same commodity even if its producer's price itself is free. (Since in such case the producer's price can only be raised at the charge of the tiny commercial profit margin.) This means that the sphere of free price determination for industrial enterprises in practice drops to about 40 % of total industrial output.

At the beginning of the reform the sphere of free prices was set very carefully but it was hoped that this sphere could be extended shortly afterwards. However in this we were disappointed. Ending certain inherited imbalances in the economy, weakening the positions of monopoly enterprises, strengthening the pressure of competition, and developing the buyers' market progressed at a slower rate than it had been expected. In these circumstances we cannot give up broad-scale direct governmental price regulation. Direct price regulation, together with other factors contributed to avoid inflation. During the last three years the annual increase of industrial producer's prices amounted only to about 2% and that of consumer's prices to about 1–1.5%.

The prices of the new price system are undoubtedly better than those of the old one. The relative prices are expressing different capital intensity of the different products. The prices better reflect the supply and demand relations and also they did get closer to the equilibrium-prices being necessary for the proper functioning of the market. But the new industrial producer's prices follow the cost of domestic production (and the average branch cost or the cost of the individual enterprise[2]). Thus, the price system has an autarky character however the Hungarian economy is an open one. This is an essential shortcoming of the new price system. The difference between domestic and foreign trade prices is surmounted by custom duties and export subsidies. It is obvious that the approach between domestic and foreign trade prices can and must take place gradually by a process in which on the one hand the liberalization of foreign trade and its prices put on pressure for the restructuring of domestic production, and on the other hand restructuring of home production, speeded up by centrally planned and controlled development, makes the gradual liberalization of foreign trade possible.

There is also another problem of our price system: the ratios of the consumer's prices are strongly deviated from the ratios of the producer's prices (i. e. from the costs of production) by means of differentiated turnover taxes and consumer's price supplements. A certain part of these deviations expresses the actual preferences of the socialist state, but many of them are economically unjustified. This has an unfavourable effect on the structure of consumption, burdens the state budget and makes living labour too cheap for the enterprises compared to the cost of investment. But it is clear that this situation can be changed only gradually. To change consumer's prices is an extremely hard job in a socialist country where it has to be avoided that such changes should act against the regular increase of real incomes, and should decrease the living standard of any single social stratum.

The place of the firm, the system of incentives and income regulations

The stately owned firms, the so-called state enterprises play a decisive role in the Hungarian economy. In 1969 state enterprises produced 93% of total industrial output, while 5.6% was supplied by the co-operative industry and 1.2% by the privately owned small industry.

State ownership of enterprises appears in the fact that the state can found, unite, separate or liquidate enterprises; the foundation document determines the sphere of activities of the enterprise; the branch ministries have supervisory rights over the enterprises and in this framework they appoint and discharge the directors and deputy directors of the enterprises, determine their salaries, evaluate their work, and the enterprise activity ; by means of economic regulators the state guides and influences the economic activity of the enterprises and if necessary may intervene in enterprise activity by issuing direct instructions.

Since the new type of central economic control requires a smaller staff, ministry staff has been reduced by 30%. But no combinations of ministries have taken place and none are planned.

The reform substantially reduced the number of industrial trusts. At present only a few trusts exist, for instance in the electric energy industry, in the oil and aluminium industry. Enter-

2) Enterprises include a 25% charge on wages and a 5% charge on capital among their production costs. The average rate of profit in industry is about 10% (calculated on capital).

prises may form so-called unions in order to conduct certain activities in common. These unions are small in numbers and differ substantially from organizations running under a similar name in other socialist countries, for they are formed voluntarily and each enterprise remains independent.

Nevertheless we have to take into consideration that the Hungarian industry is strongly centralized: during the old economic mechanism many enterprises were united by means of administrative measures and large scale enterprises were formed, generally with a horizontal character. Owing to this, Hungary has got the most centralized industry amongst the socialist countries. The concentration of production——the proportion of plants employing a large number of workers——is exorbitant, too. Also the Hungarian trade is characterized by strong centralization.

This exaggerated centralization and concentration, the monopolistic position of many enterprises is disadvantageous from the point of view of competition. It seems to be necessary to dissolve some large-scale enterprises which proved to be economically unjustified. But the development of competition is hindered not only and not primarily by the existing organizational forms. In many fields the excessive demand provides the decisive obstacle. Consequently, it has a special importance that the economic policy of the Government and the central planning should strive to abolish market imbalances and to realize a balanced growth to a still greater extent. Nevertheless there are already promising symptoms. Many examples provide evidence that large enterprises after abolishing the rigid restrictions——are getting into competition with each other by extending their field of activity. Also industrial co-operatives recently having been developed rapidly are entering competition to a much greater extent. Finally——and this is of special importance in the case of a small country——imports are playing an increasing role in the development of competition.

The enterprises enjoy a wide economic autonomy. They do not receive obligatory plan indicators at all, neither such ones which prescribe production, rentability or other tasks for them, nor such ones which limit material inputs, number of employees, wages or investment. The enterprises are obliged to work out medium term plans for themselves and to present their plan to the branch ministry concerned. This procedure is a means of information and coordination. In case the enterprise, following the advice of the ministry concerned, changes the original plan, the responsibility is taken by the enterprise itself.

The enterprise operates in market conditions and in essence decides itself whom it wants to purchase from, whom to sell to and how much. The system of central allocation of the goods of production was abolished immediatelly as the reform began to work. A market for production goods has been established and the limitations temporarily necessary in free product circulation were gradually removed. Only meat remained centrally allocated. Purchasing quotas for some big producers (limiting their inputs) have shrunken to 4 products, those for domestic trade (securing domestic supply) to 10 commodities. Impport quotas dropped to 4 and export quotas to 10 products.

These limitations are no longer of importance for the operation of the market.

The incentive system of the enterprises is based on the idea that the volume of possible investments and growth rate of the personal incomes of the managers and the workers should depend on the achievements of enterprise economic activity, i. e. on the formation of "profits". This dependence is manifested in the so-called income regulation system.

The *concrete* form of this system, introduced in 1968, imposed rational restrictions in the increase of the average wage level (and of supplementary incomes) and prevented exaggerated income differences between workers of different enterprises. But it did not provide sufficient incentive to increase productivity of labour and worked against the efficient use of the labour force, against its necessary re-grouping among enterprises. It was much easier for an enterprise to increase its production and profits by employing more workers than by increasing the average wages of existing workers and demanding and receiving more work from them in exchange. This promoted the extensive development of enterprises and contributed to overemployment, to the tension on the labour market.

Therefore the system was modified at the beginning of 1971. Now it can be characterized as follows:

The profit of the enterprise is divided into two parts in a compulsory proportion. One profit-part (let us call it "S" part) goes (after tax) into the enterprise sharing fund while the other (let us call it "D" part) into the enterprise development fund.[3] The compulsory proportion depends on the organic composition of capital i. e. how the annual wage fund of the enterprise compares to its total capital. The "S" profit part is taxed progressively (the bigger the "S" part compared to the wages fund the higher the tax) while the "D" part is subjected to a linear 60% tax. The enterprise may use its development fund[4] for investments i. e. for replacing and enlarging its fixed capital and for increasing its working capital. The sharing fund goes to supplement the personal incomes of the enterprise workers and employees in the form of year-end profit shares, bonuses etc. and to finance some enterprise expenses of social and cultural character.

The enterprise can——on the basis of increasing profits——raise its average wage level. But doing so it has to pay a special single-time tax on the raise from the sharing fund. The size of the tax will depend on how the percentile increase of average wage compares to the growth of an enterprise index, the fraction of

$$\frac{\text{sum of annual wages} + \text{profit}}{\text{number of workers and employees}}.$$

This fraction can be considered as a certain type of an efficiency index. After each percentile growth of this fraction the enterprise can increase the average wage by 0.3%, paying a preferential single-time tax of 50% of the wage increase. Average wage increases running beyond this

3) About 10% of both profit parts (after tax) must be placed into the enterprise reserve fund.

4) This fund is not only fed by the "D" part of profits but by an average of 60% of amortization sums as well; the state budgets diverts 40% of amortization from the enterprise.

limit are taxed very progressively: the tax rate for a further increase up to 0.5% is 150%, for a further increase between 0.5–1% it is 200% and so on. The enterprise may of course use the remaining sharing fund to pay bonuses and year-end profit shares.

The managers' profit shares are in the same ratio with their basic salaries as those of the workers are. Apart from this, high and medium level managers are granted so-called profit bonuses to be paid also from the sharing fund. Their size depends on how the "S" profit part (after tax) compares to the annual wage sum paid out. The bonus is calculated according to a general formula but can be modified by supervisory organs evaluating the work of the managers.

In this regulation system there is a fundamental identity of interest of workers and managers and the profit bonus causes interest to deviate only slightly. Here, I should add that in case of a deficit year (if the loss cannot be covered by the reserve fund) the managers receive only 75% of their basic salaries, whilst the state ensures the workers' payment of their full wages.

As one can see the modified income regulation system is complicated enough. It makes easier for the enterprises to raise average wage in an appropriate ratio to the increase of labour efficiency and along with this more of the profit increment can be placed in the sharing fund. But even the new regulations do not completely eliminate unfavourable effects mentioned earlier. For the time being we cannot say definitely that we possess such an income regulation system which could satisfactorily adjust the various and often contradictory requirements.

Also in Hungary we can find some economists who oppose the basic principles of this income regulation system. They disapprove of workers' wages being dependent on enterprise economic achievements (growth in profits or in productivity of living labour), because in their opinion it has an inflationary effect and distorts economic calculations hindering the optimal allocation and combination of resources. They want all enterprises to pay identical wages for identical individual work, to provide a uniform price for identical labour force on the labour market. At the same time they consider it necessary for enterprise managers to be interested in increasing profits.

This concept has been rejected by the official standpoint. I too consider it incorrect. Attempts were made in the past to achieve uniform wages in Hungary through obligatory state instructions and proved unsuccessfull. Today votaries for uniform wages are not thinking of a method like this, but of some form of mechanism of a type operating in modern capitalism: collision of interest of trade unions endeavouring to raise wages and of managers striving to increase or maintain profits. But the different enterprises do not pay completely identical wages for identical labour even in modern capitalism. Secondly, and this is much more important, because of the nature of socialist society wage regulation cannot be built on the collision of interest between workers and managers. A mechanism of this sort would be a caricature of socialism and would in practice be inoperable: the managers would be unable to resist pressure for wage increase. In socialism it is possible and imperative to realize the fundamental identity of interest between workers and managers and this can operate as a new and important driving force of economic development. This demands that workers' wages (personal incomes) shall be dependent to a certain extent on the economic achievements of the given enterprise. By this enterprise behaviour can be deviated indeed from the optimum of abstract economic theory. However I am convinced, although for the moment it cannot be proved exactly, that in the case of a suitably chosen income regulation system these deviations are practically negligible disadvantages compared with the tremendous economic and social advantages brought about by the "ownership" consciousness of the enterprise collective and the identity of interest in increasing enterprise achievements.

The investment system and the forms of capital allocation

An important element of enterprise autonomy in the new economic mechanism is that enterprises have substantial independence regarding investment decisions, too. At the same time the socialist state naturally directs and influences the total process of investment, based on the national economic plan.

At present total investment in Hungary ammounts to about 25% of the GNP. The proportion of investments decided by the state (so-called state investments) and of investments decided by the enterprise (so-called enterprise investments) is approximately half and half. In industry the proportion is about the same. *Enterprise* investments are essentially financed by the existing development funds and by bank credits which are repaid from the development funds. In many cases enterprises get also financial assistance from the state budget. *State* investments are financed from the budget. These include, first of all, non-productive investments outside the enterprise field: cultural, educational, social, and health investments, road construction, building state owned flats etc. But state investments play an important role also in the enterprise sphere itself, that is in the sphere of the national economy where economic activity is organized in enterprise form. The large-scale individual projects for exploiting raw materials and developing basic material and energy production are realized primarily in the form of state investments. But so-called "investments grouped according to objectives", that is state investments which are implemented by a series of more or less homogeneous objects, each of which serves the same purpose (e. g. creating a network of powerlines, oil and gas lines etc.) also extend to the enterprise sphere. Realizing concrete state investment decisions is obligatory to the involved enterprises but at the same time it is generally also advantageous for them, because of the money received from the budget, even if they must contribute to the investment concerned from their own development funds and if they must repay a portion of the sum received from the budget as a state loan.

It would be desirable to restrict the share of investments concretely decided by the state in the enterprise sphere and to develop a differentiated system of budgetary financial assistance (tax allowances and grants) to influence enterprise investment decisions. But the proportion of state investments will remain high during the period of the fourth five year plan (1971–75), in so far as it will account for about 50% of total investment (because the proportion of non-productive investments is increasing) and about 30% of total industrial investments (because the proportion of unfinished state investments is big in industry). The proportion of *new* state investments in industry will be substantially lower during the plan period, particularly in the years following 1973, assuming that the government will not approve further state investments.

At the moment *bank credits* play only a small role in financing investments in Hungary. In 1969 total investment was financed approximately to 48% from the state budget, to 41% from own resources of enterprises and co-operatives and to only 11% from bank credits. In industry the corresponding figures were 50%, 37% and 13%. The total volume of investment credits which the bank system is capable of giving is small and a big part of this is given in the form of 24–30 months credits.

For the time being enterprises can——with a few exceptions——receive long term (5–10 year) credits only for preferred investment objects which are prescribed for the bank by the government. Such preferred objects are: increasing the export capacity of the country, developing industries in certain branches, developing services for the population, reconstruction of the clothing industry, developing of building industry and industry for building materials, developing of animal husbandry etc.

Thus, for the time being——in contrast to the reform principles——investment bank credits do not play a big role in capital allocation although this allocation form has unnegligible advantages over others. It provides good incentives and independence for enterprise investment decisions and at the same time gives the possibility for a central survey and control of the investment process. Naturally realizing this latter possibility depends on the character and structure of the *bank system*, too. The centralized character of our bank system and its strong control by the state was not and will not be changed by the reform. Only changes of organizational character are under way. The two kinds of credits for enterprises (credits for working and for fixed capital) will be granted by the National Bank, and the Investment Bank will be transformed into the Development Institute, financing mainly the big development programs decided by the state.

The basic precondition for bank credits to be able to fulfill their suitable role in the reallocation of capital is increasing their total volume and by that enlarging their repay period. For the time being this has got a very limited possibility. At present, as it happened so often in the past, there is a big tension, an excessive demand on the capital goods market or more precisely on the building market. There are a number of reasons for it. Non-productive, mainly infrastructural investments (including housing) were postponed for a long period, so there is an urgent necessity for them now. Prior to the reform, in the last minute, enterprises began construction investments financed by the state and these must be completed. Branch ministries all try to get as many state investment as possible for their development programs. In the coming years it will be absolutely necessary to cease this investment tension both by increasing supply (through the more rapid development of the building industry and building material industry, through better organization and stronger incentives) and by limiting demand (demand of the budget and of the enterprises).

In a socialist planned economy which combines planning and market, suitable flexibility of capital allocation and the extension of the scope of enterprise initiative makes necessary that the real-location of capital should not take place only through the state budget and bank credits but also on a *direct* way among enterprises. This field remained up to now unattached by the reform, old prohibitions still prevailed. But recently the supreme state decisions were made in this respect and the new legal and financial measures came into force. This measures facilitate the simple associations of enterprises for certain common activities and the creation of new common enterprises, too. They permit capital transfers from development funds among eneterprises for investment purposes either in a final form (in this case the supplier of capital can have a share from the profit of the recipient enterprise) or in the form of credit. Also commercial credit, prohibited untill now, is permited in a restricted form: enterprises may grant each other commodity credit or payment in advance from their development funds. Thus, commercial credit will not be re-financed by the bank system.

As an experiment with rather limited scope it is thought also to permit the issuing of bonds for meeting mainly local (communal) needs. Concerning stocks the situation is quite different. Genuine stocks presume the existence of a stock-exchange where everybody (including private persons) may enter either as a seller or as a buyer, further that stock-holders have a partial ownership of the given enterprise. Thus, it is clear, that a genuine stock——disregarding our economic relationships with Western countries——cannot be fit into the actual model of our economic mechanism. As it appears to me, opposition to the true stock is justified even in more distant perspective for it would institutionalize and increase speculation and——this is even more important——it would lead to separation of labour and ownership which is undesirable from the socialist point of view.

The system of foreign trade[5]

The reform fundamentally changed the system of foreign trade, too. In the old mechanism also exports and imports were regulated by obligatory plan instructions. Producers bought from and sold to our foreign trade enterprises at domestic prices, completely independently of world-market prices and the price differences were settled by the state. Thus, the producing enterprises and the country's domestic market were in fact completely isolated from the economic impulses of the foreign markets. The reform ended this isolation. In the new economic mechanism the enterprises do not receive obligatory plan indicators neither regarding exports nor imports.

A decisive step was taken by the introduction of the so-called "uniform foreign trade price multipliers": 40 Forints =Rouble and 60 Forints= Dollar.[6] The different foreign currencies and

5) It must be taken into consideration that the socialist countries trade with each other on the basis of long term foreign trade agreements which fix export and import quotas, and these agreements represent state responsibility. About 2/3 of Hungary's foreign trade turnover is realized with the socialist countries.

claims expressed in them are converted to Forints in the sphere of foreign trade with the aid of these multipliers.

Based on these uniform multipliers, exports for certain producing enterprises are rentable and in some cases highly rentable. However there is a large number of enterprises which earn foreign exchange at a cost exceeding the multiplier but whose exports are needed by the country in order to ensure the satisfactory total volume of exports. This is why the system of temporary state refunds was introduced. Till now the export refund was differentiated for individual *enterprises,* in such a way that the weaker firms mentioned got differentiated supplements to the uniform multiplier. In 1971, the system is going on to be replaced by differentiated refunds for *branches*. Those enterprises which earn the Dollar cheaper than the uniform multiplier or cheaper than the higher branch average, will receive the state refund determined for the branch. Those enterprises which export less favourable than the branch average will continue to receive state refunds only on the basis of individual consideration, which will be more strict than previously and this refund will be reduced as time is going on. This further development of the export regulation system will promote the development of those enterprises which have a comparative advantage in exports and will restrict those whose foreign exchange production is too expensive.

Limiting *imports* through administrative measures has shrunken to a narrow field. Licences of the Ministry of Foreign Trade are needed for imports (and for exports as well), but issuing the licences is primarily a means of influencing the direction of foreign trade. Import quotas, as mentioned above, extend to only 4 products. This means that the import of materials is essentially free also from the Dollar relation. For importing consumer goods from Dollar relation the Ministry of Domestic Trade receives a lump sum of foreign exchange and it imports what it chooses whithin the limits of this sum. The compulsory Forint deposit for machinery imported from the West——which was a special import-limitation——was reduced to Zero in 1971. The basic instrument to regulate imports is the new system of custom duties.

Summary

Hungary succeeded in developing a system of the socialist economy in which planned central control and management is combined with the active role of the market and economic methods play a decisive role in the implementation of the central plan.

During more than 3 years in our country the new economic mechanism proved its superiority over the old one. The transition was carried out smoothly, without economic or social shocks.

Output of industry and agriculture increased satisfactorily and adjusted itself better to the structure of demand. Accumulation of inventories slowed down. Increase of labour produ-

6) Determination of the multipliers was based on calculations completed at that time. The result of these was, that——in the average of the national economy——we have to export 40 Forints worth of domestic products in order to earn 1 Rouble and 60 Forints to earn 1 Dollar. Tnus the multipliers are intended to express the average (and not the marginal) production cost of the Dollar and that of the Rouble and they deviate not only from the official rate of exchange (which itself was not changed) but also from the purchasing power parity.

ctivity accelerated. Exports and imports increased rapidly both in Western and in socialist relations and the balance of foreign trade improved considerably. Real income of the population increased favourably, commodity supply improved and assortment became richer. Unemployment and inflation could be avoided.

But some inherited problems of our socialist economy could not be solved yet and also the new mechanism includes some insufficiencies. The improvement of economic efficiency and the rate of technological development are unsatisfactory. Competition of enterprises and the pressure of the market are weak. There is a tension on the construction market and on the labour market. Solving our economic problems requires an adequate economic policy and further development of the economic mechanism. Stopping the progress of this development would mean a regress.

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