

**Hidden Enterprise, Property Rights Reform
and Political Transformation in Hungary¹**

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Abstract

The particular historical trajectories of economic reform in East European socialist systems were important causal factors in their transformation, and often account for the different paths now open to each. Taking the case of Hungary, this paper argues that socialist reforms, even when justifiably assessed as ineffective attempts at improved efficiency, interacted with an expanding second economy to alter in a gradual but profound manner the state-imposed relationship between the political and economic realms. This process of incremental social and ideological change "politicized" the economy and partially "privatized" the public sector, albeit often in informal ways. The turning-point was a 1982 reform of property-rights which legalized much of the second economy and opened up newly-legitimate channels for its cooperation with the state sector. Though sometimes seen as a logical consequence of Hungarian reform-cycles, these statutes were highly controversial and far from inevitable. By formalizing the previously informal relationship of mutual dependence between the state and the second economy, they engendered new economic and political contradictions and possibilities in the system, as the enfranchisement of previously-excluded groups led to further concessions on the part of the state. The legalization of the second economy, the creation of new private partnership forms, and the public campaign to legitimize the resulting hybrid, constitute a significant difference between the legacy of Hungarian socialism and other East European varieties. Seleny is a Ph.D. candidate in the M.I.T. Department of Political Science and a coordinator of the Center for European Studies' Program on Central and Eastern Europe.

Hidden Enterprise, Property Rights Reform and Political Transformation in Hungary

East European socialist systems, once judged not only unreformable but virtually immutable because they were totalitarian,¹ varied markedly in their individual departures from the classical-bureaucratic socialist model;² and in retrospect appear quite distinct from one another. The debate about whether economic reforms forestalled or precipitated these departures remains unresolved. Yet a new consensus has emerged on the "unreformability"³ of socialism. A majority of analysts and participants agrees that efforts aimed at the improved efficiency of the classical model or the attainment of some ideal mix of plan and market failed to render socialist economies competitive; and that socialism proved unreformable, except, perhaps, at the margin. Thus the myriad uses of the concept of reform have been replaced by unreformability, an opaque notion that begs the question of why -- if a wide variety of reforms failed to sustain a particular economic and political system -- this turned out to be the case.

This consensus, moreover, ignores not only the considerable differences now evident among the legacies of the various "socialisms", but an ongoing debate which centers on the fundamental reasons for the "collapse" of socialism in Eastern Europe: on which elements were common to all countries, which obtained in some and not in others, and which may have been unique to each. On such questions agreement is virtually absent, which comes as no surprise, since the events themselves surprised most. As one sociologist pointed out, it was not long ago that factors now often seen as having precipitated the disintegration of socialist systems -- including reforms -- were evoked to explain the relative stability of the various regimes.⁴

Such disagreement has engendered a multiplicity of explanations for socialist "collapse" -- or more accurately, transformation -- which go beyond systemic economic failure, each emphasizing diverse, though not necessarily mutually exclusive factors. An illustrative, but by no means exhaustive list of the latter could be divided into three broad categories. I) Exogenous causes, such as Gorbachev's personal leadership,⁵ international economic pressures, or the indirect effects of "culture-shifts"⁶ like the '68 West European "youth revolts".⁷ II) A mixture of

exogenous and endogenous variables such as creeping consumerist influences understood both as independent of⁸ and as one aspect of the evolution of a "second society".⁹ III) Largely endogenous factors divided between state-centered and society-centered approaches,¹⁰ like the direct influence of the efforts of socialist reformers working within the system¹¹ or, alternatively, of dissidents fighting it "from without" as part of a parallel polis.¹²

This essay shifts attention from the issue of the relative efficacy of economic reforms, as defined by Party-state reformers and analysts, to their political implications. The discussion focuses on two aspects of politics: power-relations and identity-formation of groups in socialist systems. I take the case of Hungary because it is the country where economic experimentation and reform under socialism are often judged to have gone farthest;¹³ and advance two general claims. The first is that socialist reforms -- even when accurately assessed as partially or wholly ineffective as economic reforms -- had important political effects, in the sense that they led to a redistribution of control over economic activities. Generally intended as compromises between ideology and what their advocates saw as "pragmatic" economic policies, reforms invariably resulted -- to greater or lesser degrees -- in redefined rights of particular groups to command obedience or resources as an expression of their position in the socialist economy. Ultimately, reforms opened up the possibility for the renegotiation of the basic assumptions of socialist ownership. This essay demonstrates, for example, how power-relations within firms and ultimately, between the larger population and the Party-state, were fundamentally altered by informal relations of production. Then it shows that this was not a zero-sum game in which one group always lost and another gained economic or political power, partly because the very identities of actors were altered in the process. And to the extent that they were altered, classical categories of analysis -- state vs. civil society, manager vs. worker, socialist worker vs. capitalist entrepreneur¹⁴ --- sometimes obscured as much as they revealed.

The second claim is that specific historical trajectories of economic reform help explain the way particular socialisms transformed themselves, as well as differences in the remaining socio-economic landscape of formerly socialist countries. Stated differently: individual economic reforms represented more than either ideologically-bounded or pragmatic responses to

systemic or external economic crisis: the choice of any particular reform can be fully explained only by the history of reform in that country.

It is, of course, not my contention that the history of economic reforms in formerly socialist countries by itself accounts for recent transformations even in those countries with substantial experience of reform. A reasonably comprehensive account of such transformation in any one country--a task far beyond the scope of the present effort--would also include careful analysis of social changes "from below" (not only the evolution of the second economy, but the role of dissident intellectuals and religious groups); and of systemic economic rigidities in interaction with both a changing society and intensified international constraints. But this essay shows, for example, that because of its particular history of reform, Hungary entered the post-socialist era with a "hybrid" economy: although still predominantly organized along classical socialist lines, the reformist character of the system left it with a better- developed and institutionalized private and quasi-private sector (second economy) than found in most other East European countries. The immediate background to this fact was a 1982 reform of property rights and the 1989 Association Law (see section II). In addition, due to the 1968 New Economic Mechanism and to the 1985 Enterprise Law, both relations of production and the distribution of residual rights to state property were substantially more flexible and diffuse than those of non-reform socialist countries. Although this hybrid is unlikely to be self-reproducing in its present form, Hungary's reform-history should help the country make a successful transition to its own variant of "capitalism".

Both the first claim -- concerning the political character of economic reforms; and the second, concerning the centrality of history to the chances of any particular reform -- are grounded in close analysis of what I have elsewhere called the "institutional residue"¹⁵ of economic reforms. Consisting of people, practices and ideas, including innovative adaptations of received political discourse, the institutional residue was the cumulative product of individual reforms and reform attempts -- even those which were partially reversed and whose proponents were marginalized for years at a time. More precisely, it was the result of cyclical economic crises and reforms of Hungarian socialism, and its elements were observable in both the formal and

informal institutions of the system. These elements, which came into play at critical junctures, included 1) groups of reformers and their allies who frequently remained in official positions even if the reforms they sponsored were partially rescinded; 2) reform-terminology which became part of official vocabulary; and 3) practices altered due to reforms, both within state firms and outside them (e.g., in second economy activities not directly associated with state firms but which became informally-institutionalized features of the system). As we shall see, the formation of the institutional residue was also a manifestation of the state's inability to keep strict control of the economy in the face of systemic rigidities, as well as evidence of a subtle and complex subversion from within and below. Increasingly constrained to improve the performance of state-firms, the leadership implemented reforms in a cyclical pattern, while oscillating between repression and toleration of an expanding second economy -- defined here as the sum total of all non-state private economic activity: licenced and informal; legal, illegal and on the borderline of illegality, both prior to and after its partial legalization.¹⁶

Second economy expansion was the result of a complex combination of factors, a number of which are discussed in sections a. and b. below. These included socio-economic pressures, which led the Party-state apparatus to tolerate the growth of this sector to varying degrees in different historical periods. At the same time, the second economy had deep roots in structural features of the socialist system, which manifested themselves in a variety of problems such as recurring shortages of consumer goods and inputs to the production processes of state firms -- including labor. This essay shows that the scope of activities pursued in the second economy was also indirectly influenced by reforms intended to improve the performance of state firms; and the behavior of state firms toward workers was in turn deeply affected by second-economy expansion.

I argue that the institutional residue, produced in part by the interaction between second-economy expansion and cycles of state-sector reforms, revealed the inextricable entwinement of politics and economics in socialism: the one became the other almost at the moment of definition, and invariably in the instant of enactment. In the philosophical sense, and probably at the deepest level of practice as well, politics and economics (and hence political and economic

reform) are always and everywhere connected. Nevertheless, I contend that this connection was, paradoxically, both more palpable and more profound under socialism than is normally the case in most capitalist systems. The latter, especially if they operate in the framework of reasonably democratic politics, allow space for public struggles over economic issues to proceed within existing legal and political-institutional structures. Governments fall but political systems remain in place. Socialist systems, on the other hand, officially permit only high-level struggles over economic questions; most other debate and bargaining, and a good deal of action, therefore occur in the informal realm. In Hungary, when informal economic activities, for example, were formalized through reform, they took on even greater political significance than similar changes in capitalist systems (e.g. recent Spanish or earlier Italian efforts to legalize large informal sectors). In a socialist system, such formalization and legalization meant, at a minimum, a de facto loosening of the state's extremely broad claims to rights to control the economic realm. At a maximum and over time, it meant a de jure repudiation of such claims.

Thus, although not generally appreciable in the short run, even relatively small losses of control over the economic realm eventually had direct or indirect political repercussions. Evidence for this view can be found in the frequent reversals of economic reform: in the common pattern (e.g., in contemporary Soviet politics) of reforms from above running up against the self-preserving instincts of those who initiate them or collaborate in their initiation. But as the Hungarian case shows, such reversals ultimately led to a resurfacing of the same systemic troubles which originally impelled radical and reluctant reformers alike to undertake reform programs--and whose consequence was their loss of confidence in scientific socialism and socialism's loss of legitimacy in the view of the population. This process, in conjunction with social pressure from a society transformed over time partly by the experience of these same reforms, precluded the indefinite perpetuation of a zero-sum system of reform cycles. In Hungary, the turning point in the reform process, which had already resulted in an increasingly "politicized" economy and a partially "privatized" public sector,¹⁷ was a 1982 partial restructuring of property rights that legalized much of the second economy and opened up important new channels for private enterprise.

This reform constituted one of the most important differences between the legacy of Hungarian reform socialism and other East European varieties. For the first time on a wide scale, the leadership felt obliged not only to acknowledge the right of individuals to own and operate private businesses and business partnerships, but also to legitimize them through a public-relations campaign which emphasized their importance to the improvement of the socialist "market economy". To be sure, the legalization was in some respects incomplete and performed based on a confusing and often self-blocking regulatory system; the public-relations campaign was itself an exercise in the socialist dialectics of contradictory signals. Numerous further refinements and amendments of the original would follow before it was possible to speak of a reasonably unfettered private sector in Hungary. Only with the implementation of the 1989 Law on Association was the mix of *de facto* and *de jure* rights granted the private sector in 1982 codified in a uniform law passed by Parliament, not contingent on state administrative directives.¹⁸ But this was merely one more case of socialist law lagging behind the reality of socio-economic practice and attempting to rationalize its earlier piecemeal legitimation. The 1982 statutes created new forms of private enterprise, but also legalized pre-existing second economy activities and called them "new"; the 1989 Association Law unified regulations introduced in 1982 and thereafter, and stated clearly that this was its purpose. This law was a direct continuation of the 1982 initiative (as well as of some earlier ones) and of other 1980's regulations affecting both private and state firms. Its authors in the Ministry of Finance noted that "results hitherto obtained in the field of company law enable[d] the maintenance of continuity", although it had become necessary to "place the regulations originating from different dates into a uniform context."¹⁹ In essence, and despite what it did not do,²⁰ the 1982 reform expanded the scope and changed the basis of entrepreneurship and private business ownership from privilege -- licences granted at the discretion of local authorities -- to that of a right based in government decree and a broad regulatory mechanism.²¹

Section I of this essay illustrates how this reform's conception and implementation were tightly linked to the historical development of economic reform and of the second economy; and explains why reformers who maintained that it would not alter power relations in any significant way -- to the extent that they actually believed their own rhetoric -- were seriously

mistaken. Section II. examines the new property forms legalized by the decrees of 1982, and their economic and political implications for the socialist system. The central conclusion is the following: the history of Hungarian economic reform in particular and, more broadly, of the relationship between the second economy and the Hungarian socialist state (rendered transparent in the 1982 reform) not only closed in practice the analytic duality so often posed between economics and politics, but also blended two opposing notions of politics which have held sway both in capitalism and socialism.

At one extreme of this implicit polarity, the object of politics is the defense of collective identity: political decisions are concerned with making the distinction between friend and foe, and political struggle inevitably pits the one against the other. At the other extreme, politics is a pluralistic contest over the allocation of goods and values enforceable by the state and to be enjoyed by private individuals and groups.²² In the 20th century, it has often been according to some variant of these views that practitioners have tried to shape the world and theorists to make it intelligible. Thus in the 1960's, as the rule of terror eased in the East, scholarly consensus in the West moved away from totalitarian accounts of immutability and, via modernization/convergence theories, toward pluralist accounts of change. Interest groups and bargaining relations within the socialist state became the central object of analysis, and socialist politics were described with increasing frequency as corporatist, or alternatively, as an "institutional" variant of pluralism.²³ But such views of socialist political practice and struggle failed to specify the relative strengths of competing groups or the limitations and possibilities of the structure in which they operated. Class-based theories, on the other hand, became entrapped in circularity: they understood socialist power structures as natural outgrowths of a prevailing logic of production; but the state itself had imposed the new economic order and set the parameters of class relations through its own administrative policies.²⁴ Such theories simply could not explain the failure of class-based support for the classical bureaucratic socialist model, or the variation in departures from the model over the course of socialist practice in Eastern Europe. As a result, like the older totalitarian alternative and the present consensus on unreformability, neither interest group nor class theories had much to say about the process of reform and transformation.

I. Politics and economics: the one the genesis of the other

a. Ideology, cycles of reform and recentralization, and implicit property rights in the hidden organization of work.

The effort to conceptualize the profound coaction of the political and economic realms at the core of the process of reform and transformation must begin with an examination of politics in socialist Hungary.²⁵ During the Stalinist period, the Party-state was impelled by notions of revolutionary duty to create and defend a socialist collective identity; and within this context, it came to perceive statecraft as synonymous with politics and the task of politics as entwined with the eradication of intra-Party and societal pluralism, private property, free association and autonomous relation to work. Decisively, the Party-state took punitive measures against dissidents, intellectuals, professionals, and individuals engaged in all manner and scale of private economic activity. At the same time, it drafted a centrally-planned economic blueprint which left minimal space for independent decision-making by actors in the state sector. While the end of the Stalin era and the Hungarian revolution of 1956 did not lead to a fundamental revision of this narrow view of politics, they did transform this draconian conception of political objectives into a more benevolent version of itself. More importantly, the combination of the internal rigidities of the centrally-planned economy, together with the external constraints imposed by the competitive capitalist system, resulted in the gradual erosion of the Party's control over the production and allocation of goods and services. This essential aspect of politics, which took pride of place in official rhetoric but had in fact been subsumed by elites under the politics of maximal cohesion, became a systemic problem which left them determined to regain control over production and allocation without surrendering their view of politics. Accordingly, official treatment of all private economic activity alternated between repression and relative unofficial toleration, and economic reforms moved in a fairly clear cyclical pattern of one step back, two steps forward.

The leadership was resolute in its initial attack on the private sector. The nationalization of non-farm enterprises employing more than ten workers was completed by the

early 50's, and most of the smaller units forced to join state cooperatives. By 1963, only a miniscule portion of the economically active population was still self-employed.²⁶ And the collectivization campaign of peasant farms, which began in the late 40's after the expropriation of large landholdings, occurred simultaneously with the institution of a forced delivery system which aimed to substitute centralized redistribution for market mechanisms and ensure agricultural exports to the Soviet Union. After the 1956 revolution, however, many of these cooperatives broke up, and by 1959 the number of small private farms approached the pre-collectivization figure.²⁷ The second collectivization campaign was completed by 1962, but in a tacit concession to peasants in the aftermath of the violence of 1956, each individual who was a full member of an agricultural cooperative was granted a small household plot for private production and consumption, and thus the opportunity to keep up with the living standard of the industrial wage-earner.²⁸ Indeed, a vital agricultural second economy eventually grew out of the relationship between the household plots and state-cooperative farms.

Still, national economic management in this period aimed primarily at forced industrialization, which shortchanged both agricultural development and private consumption;²⁹ and hinged on five-year plans that established obligatory targets in terms of macroaggregates, and on annual plans for enterprises. This period of centralized planning was characterized by vertical organization of the economy and political institutions, central allocation of production inputs, and "commands" flowing from the authorities to enterprises concerning investment, employment, wages and prices. The bias toward heavy industry and large firm-size was also clear.³⁰ As long as reallocation and intensive application of previously underutilized resources made extensive growth possible, output and industrial capacity grew rapidly, but this process slowed as labor reserves were depleted and heavy industry was built up and diversified.

But even before the revolution of '56, and long before the most dramatic expansion of the second economy, the reaction of the larger society to the elite politics of maximal cohesion took economic forms. This was evident in the behavior of individuals in the workplace, and in the behavior of firms as economic agents, which together engendered structural problems like the hoarding of materials and workers. Almost from the beginning, the Party's responses to such

problems helped to alter both the original economic blueprint and the political ideology underlying it. For example, the attempt to ease institutional problems led the authorities to make limited concessions to the private sector as early as 1953. Industrial cooperatives of former small firms had been so completely vertically integrated with the state sector that they were producing almost exclusively for the large state enterprises, and thus were not able to meet consumer demand.³¹ In one of numerous swings between orthodoxy and reform, the earlier attempt to abolish small-scale industry was partially reversed between 1953-55 as part of Imre Nagy's "New Course"; members of cooperatives were given the opportunity to resign and private artisans allowed to apply for licences; in a year and a half, more than 60,000 such licences were issued.³² But the number of employees in small-scale industry never even reached 1951 levels, a brief resurgence of the trend in '56 and '57 notwithstanding. By 1955, amid accusations that "speculators and former capitalists...[who] never pursued any productive activity" were taking advantage of liberalized licencing, increased taxation and cancellation of some licences had slowed the rapid growth of small-scale businesses.³³ In spite of proposals by economists that the small-scale private sector be more actively encouraged in an effort to promote flexibility in the economy, this sector was further restricted after 1958, and its size diminished as a consequence.³⁴

Indeed, between 1957 and 1964, conservatism in socialist economic management predominated. But compulsory deliveries in agriculture were abolished in 1956-57, and by the mid-60's, reform was high on the national agenda. In 1968, substantial changes were introduced by the New Economic Mechanism, which decentralized economic management to the extent that the system of compulsory plan targets was eliminated and state firms were given increased latitude in a number of areas.³⁵ During the NEM period, some restrictions on the licenced non-agricultural private sector and on the operation of agricultural household and auxiliary plots were also eased. With the 1968 reforms, the household plots which were supposed to have been "organically" (vertically) integrated into the agricultural cooperatives (MGTSZ), were encouraged to market their produce either directly or through the MGTSZ, which frequently supplied the necessary inputs and technical advice, lent equipment, and often shared profits from the sales of privately or partially-

privately produced goods. In fact, the finances of MGTSZ and the private peasant producers were intricately intertwined, amounting to substantial symbiosis.³⁶

Outside agriculture, the second economy arose, in the first instance, spontaneously and from below as a result of factors involving the worker as both producer and consumer. The worker as producer -- the ultima ratio in the socialist economy as in any other -- responded to needs for greater autonomy, demonstrable recognition of work through appropriate incentives, and for enhanced consumption possibilities. Thus, the worker's weak identification with his work in the state sector and his wish to increase earnings beyond his limited means to do so, together with the state's political decision to maintain full employment in a system characterized by firms' "soft-budget constraints" and "investment-hunger",³⁷ gradually embroiled the state in a struggle of defensive and counter-defensive competition: firms hoarded workers and workers hoarded labor power.

This hoarding of labor power by workers has prompted endless debates in the Eastern European literature concerning how best to instill "interest in property"-- how to interest workers in expanding enterprise capital.³⁸ But workers acted in light of the macroeconomic fact of labor shortage in an economy where firms, ultimately invulnerable to failure, ran at full employment even when the marginal cost of labor was higher than its output. Independent labor unions, of course, would have recognized in this fact a source of political leverage, and the authorities would have been forced, in turn, to acknowledge them as a potential political force. But under socialism, such organization would have meant repression and loss of power, so that the will of workers was generally expressed informally.³⁹ Most commonly, this took the form of conserving labor power for second economy work. Workers also used materials, vehicles, tools and personnel from state-sector jobs for after-hours second-economy projects or businesses. Even hiring practices in the "official" economic sector were affected: the manager of a state plumbing firm took care to hire workers skilled in bricklaying, wiring, or painting so that the new addition to the factory could help co-workers build their own houses on weekends; later the group might hire itself out as informal private contractors.

State-sector employees and pensioners could legally work part-time in private small-scale industry from 1968 on. Some of the more prohibitive tax-rules were also eased. But it was the varied informal, illegal or semi-legal private activities which had managed to survive that increased the most in response to the '68 reforms.⁴⁰ These activities were more severely punished at some times than at others, but in general the relatively liberal attitude of the authorities until 1972 contributed to their expansion. Private entrepreneurs in the 1960's and 70's often operated without licences and secured work orders through first economy firms. Even in the more orthodox '70's, harsh verdicts against transgressors were insufficient to put a stop to the wide variety of private contracting, partly because it was either expedient or profitable for all concerned; partly because defensive networks of high-trust alliances often served to protect the individuals involved. In order to escape notice by anonymous informers, as well as the jealousy and disapproval of neighbors and acquaintances, second-economy entrepreneurs and their clients developed a coded language of polite ambiguities, and a kind of informal referral service which, drawing on the accumulated information and experience of past transactions, identified trustworthy participants for the simplest exchange to the most intricate cooperative arrangement. In a shortage economy -- preponderantly a seller's market -- the window-washer and plumber, like the electrician, auto-mechanic, dentist or language-instructor working after official hours, were far from paralyzed by the need for caution. A provider, to be sure, was always selective, but if satisfied with a client, might establish a durable professional relationship based on loyalty not only to the individual but often also his close friends and relatives.⁴¹ Most evaded punishment for unlicensed private activity, which could be harsh: property was confiscated, heavy fines levied, and people were sent to jail for terms of several years duration.⁴²

During this recentralizing period --1972-79 -- the trend toward industrial concentration in the state sector was pronounced: the number of firms decreased while the percentage of workers employed in firms of more than 1,000 grew considerably as smaller firms were reorganized into larger enterprises and mammoth trusts. This was done on the theory that the bureaucratic chain of command would be simplified and macroeconomic planning rationalized, since consolidated firms would not compete against one another or duplicate productive efforts.

Between 1972 and '74, hard-liners also attempted to reverse the expansion of the agricultural second economy of household plots, citing the "threatening development of rural capitalism". Due to a powerful agricultural lobby, the conservatives were only partially successful, and by the late 70's, the process of commercialization of private small-scale agricultural production was well underway.⁴³ But the truncated process of economic reform and partial reversals of earlier liberalization left industry poorly suited to adapt to the new, more stringent international economic environment following the first oil crisis, which was *in se* a contributing factor in the recentralization.⁴⁴ Hungary responded to the oil crises and ensuing trade account imbalances with an effort to extend its long-standing model of extensive growth: since domestic inputs of labor, capital and raw materials had already been mobilized, the country turned to external credit. By 1978, however, in the context of deteriorating terms of trade (due partly to Hungary's increasing import-intensivity and loss of market-shares to the NICs) and to rising interest rates, the debt-service could only be met by holding down consumption and expenditures on social services, and real wages fell between 1978-80.⁴⁵

A new wave of reform measures began in 1979 with the attempt to bring domestic non-agricultural producer prices in line with world market prices in a dynamic fashion. The new policy, which also meant the reduction of some subsidies on food, was implemented as part of a larger effort to reduce foreign indebtedness through the restriction of domestic demand; which in turn led to the fall in real wages and to a trade surplus that helped reduce slightly the country's by now considerable external indebtedness.⁴⁶ And in an attempt to increase economic efficiency, a number of large companies were now reorganized into smaller ones, while other large plants were decentralized, so that some 300 new state-sector firms were established between 1980 and 1983.

These cyclical reforms, to be sure, served temporarily to maintain socialist political structure⁴⁷ as they simultaneously altered socialist politics. This gradual transformation was not always apparent to those living the economic experiments -- even when practices changed substantially -- because formal political structures remained intact. But structures often hide as much as they reveal. Even as the Planning Office struggled to construct balances with the aid of input-output models or mathematical programming in the pursuit of ever-greater plan

consistency,⁴⁸ the informal institutionalization of high-trust alliances in the second economy entailed a retreat to seemingly antiquated forms of economic transaction which turned on rituals of formal behavior and on the personal reputations of participants.

Moreover, the elements of future change began to accumulate in the institutional residue of reforms, whether the latter were intended to perfect "scientific" socialism or to create a "market" variant. Indeed, as the interplay between systemic economic crisis and social pressures forced Party leaders to consider new reforms, they turned not only to stories of partial success, but also sometimes to elements of once-repudiated programs and to progressively-inclined officials and scholars who had enjoyed greater influence during earlier reform campaigns.⁴⁹ All became essential components of the institutional residue which not only made imaginable and possible, but also justified increasingly radical experiments: reforms like the 1982 law, further liberalization of both the state and private sectors after '82, and ultimately, the transformation of the system as a whole.

Even reforms of immediate relevance only to state-sector firms were intimately, if indirectly, linked with subsequent reform of private property rights. In other cases, the linkage was more direct: old concessions became the basis for new reforms, like buried blueprints for change later rediscovered and adapted to new circumstances. Take the Party's acceptance of private plots in agricultural cooperatives and later, of increasingly commercialized household-plot production. Originally seen as necessary evils, these plots were to be tolerated only temporarily on the way to large-scale, "modern" agriculture, and in the meantime, were meant to be fully vertically integrated into state cooperatives. But the outcome was quite different: the plots came to be symbiotically integrated with the cooperatives even as a growing number produced directly for the market.

Some analysts understand the 1982 law as a straightforward, pragmatic extension to industry, construction and services of reforms which had met with reasonable success in agriculture.⁵⁰ This view, which reflects an intuitive grasp of the importance of a country's reform history for the success or failure of particular reform proposals, is accurate in one respect: the positive experience with household plots was a crucial factor in the acceptance of the 1982 statutes. But as we shall see later, just as immediate economic pressures explain the timing, and the

institutional residue of reform accounts for its radical content, the tactics, and even the language high-level officials used to harness a shared experience of reform to their purposes were also essential to the success of the '82 reform proposal.

And just as the history of reform led to the reintegration of reformers who had been marginalized in the recentralizing period of the 70's, workers' second-economy strategies compelled the socialist system to begin to internalize the true cost of highly-motivated labor. In short, as we will see, the system came to depend on those it had excluded: second-economy entrepreneurs and "radical" reformers.⁵¹

b) Internalizing an "externality": the true cost of labor and applied knowledge

The most rigid structural characteristics of the socialist system at times afforded workers the opportunity for resistance, and the rapid growth of the second economy in the '60's both enabled and manifested this resistance.⁵² From then until the 1982 reform, the second economy -- originally a coping mechanism for an experimenting state and a forcibly reorganized society -- served as socialism's silent counterpart to capitalism's adversarial bargaining. The second economy, in short, demonstrated the limits of rationality under a centrally-planned economy, much as unemployment indicates these limits under capitalism.

The classical-bureaucratic system, strongly characterized by administrative allocation of labor, was led to its limits by state attempts to render labor-power an externality. In capitalism, external diseconomies -- the negative pecuniary and non-pecuniary effects of firm behavior unconstrained by markets and well-defined property rights for values like clean air -- are internalized (assumed) by firms, if at all, as the result of public pressure typically embodied in legislation.⁵³ In socialism, though the state never fully succeeded in its attempt to externalize the cost of labor-power, it was workers who suffered the consequences of the lack of property rights of disposal over their time and energy -- or of rights poorly-defined -- and of firm behavior minimally constrained by markets. In a capitalist system, workers are a long way from being free to set the price of their labor power, which, narrowly defined, is the commodity they sell to capitalists. But, whatever the costs and risks, their relative freedom to relocate, to choose self-

employment, to work for or with friends, to obtain further training without need of official permission, or to switch professions is far greater than in the socialist system, where labor power could officially only be sold at rates largely fixed by the monopoly buyer: the state, represented by its firms.⁵⁴ Even in Hungary, where especially after 1968, workers were free to change jobs and relocate,⁵⁵ and firms to make their own investment and wage decisions,⁵⁶ serious hindrances to the institutionalization of smoothly-functioning labor markets remained. In the context of overdemand for labor, firms persisted in their efforts to hoard workers in a variety of innovative ways, even as these failed to satisfy their "labor hunger".

Paradoxically, despite the lack of organized collective bargaining through independent trade unions, this situation afforded at least the most skilled workers increased informal bargaining power as firms developed internal labor markets in the effort to keep them:⁵⁷ in effect, a kind of firm-level internalizing of the "externality" -- in this case a better approximation of the cost of skilled workers' labor-power. And although it was generally the specialized elite among workers who were able to bargain up their wages significantly, in the context of full employment and secular labor shortage (especially from the late 60's on), virtually all workers could, if they chose, conserve a significant portion of their energies for second-economy projects or other activities. Thus in various ways, workers maintained informal veto power over the only resource they effectively commanded: their own labor power.⁵⁸

At the macroeconomic level, firms' nearly unlimited demand for labor meant that serious tensions and distortions persisted. But by the early '60's, partly because of the existence of a large second economy, wage-fixing and restrictions on labor mobility had become untenable. Even the changes wrought by the 1968 New Economic Mechanism could not significantly moderate demand for labor, worsening labor discipline, or the reduction in the ratio of wages to living standards despite increasing wages. In the early 70's, "drastic" direct intervention in the labor market proved unsuccessful and temporary.⁵⁹ Thus the 1982 reform represented a mutually beneficial trade between the Party-state and the second economy. On the one hand, it allowed the former to lighten the burden of its accumulating incapacities by allowing private production to meet *consumer demand* that state firms were unable to satisfy. On the other, by establishing the property

right of individuals to freedom of disposal over their labor power, it accomplished a significant internalization in the socialist system of the "externality" -- the true cost of the highly motivated labor power and applied knowledge so essential to the entrepreneurial behavior it hoped to foster in state firms through market-simulating reforms. This became visible not only in the fact that the state allowed private enterprise on a much broader scale than before, but in a host of reforms beginning in the late 70's and extending into the late '80's, whose primary aim was to further the initiatives of the 1968 reform.

c) The Politics of Property Rights Reform: Identity, Tactical lessons, and Language

In 1978, against a historical background of official denunciation and persecution of unlicensed second economy activities, the Central Committee identified "the utilization of leisure time," by then an unmistakable euphemism for time actually or potentially spent working in the second economy, as the most likely source of improved living standards.⁶⁰ And in open contradiction of socialist ideology, the state legalized and, to a degree, fostered the expansion of private enterprise. Economic crisis goes some distance toward explaining this formal about-face, but by itself, is insufficient. Many of the economic pressures experienced by the Soviet Union, Czechoslovakia, Cuba or even the much-vaunted former GDR, were as severe or worse than in Hungary, yet these countries undertook no comprehensive reform of property rights.

The extent of the second economy made the content of the Hungarian 1982 reform plausible, while a combination of conjunctural and systemic pressures accounts for its timing. Fearful of the social consequences of price-hikes implemented in 1979 and thereafter, the leadership hoped that the increases would be tolerated if not accompanied by serious shortages. The economic crisis, however, made capital- or import-intensive solutions to recurring shortages more costly, and the writing on the wall was clear: they would soon be beyond reach even as temporary expedients.⁶¹ In addition, despite the fact that neither actually occurred on any significant scale, anticipation of wholesale reduction of subsidies to state firms and the possibility of bankruptcies led reformers to think of private firms in terms of potential job-creation in the event of state-firm lay-offs. The 1968 reform had attempted to rationalize resource allocation, render state

firms more flexible, and increase profitability and efficiency by linking investment and earnings to profits. While successful in some respects, profitability and efficiency did not improve substantially, nor did the reforms fundamentally alter the sources of growth, which remained primarily investment in plant and equipment.⁶² Although a number of specific reforms begun in '68 were also recombined and deepened in the early 80's, a significant expansion of the legal scope of the private sector was the one serious reform-option which remained untried, while time-buying strategies like taking on external debt only brought new pressures for adjustment and structural change. Faced, on the one hand, with the constant of bureaucratic resistance to structural change in the state sector, and on the other with a growing second economy, the sponsors of the 1982 reform believed that the "least costly" short-term "solution" was to pacify the population by legalizing the already widespread practice of "leisure-time" production. As for ideological consistency, it seemed enough to emphasize that although some of the newly-permissible forms were wholly private, they were all compatible with socialism because they were partnerships of individuals.

The reform itself, however, can only be fully explained by the history of reform, and related political and economic adaptations which emerged from the interplay between state and second economy. The relative toleration of reform experiments in Hungary probably had its very earliest origins in the determination of the communist leadership to prevent a recurrence of the society-wide violence of 1956.⁶³ The unspoken assumption was that in exchange for its political quiescence, the population expected an improvement in the material conditions of life; that there was, in fact, an unmarked but strongly felt consumption-frontier which necessarily set the broad parameters of economic policy. To be sure, these parameters were also determined by systemic pressures common to all socialist economies. But given the imperative of defending this consumption-frontier, together with the fact that Hungary is a small and relatively open economy, these same systemic pressures left the leadership with fewer degrees of freedom than the Chinese, Soviet, Czechoslovak or, for different reasons, perhaps even the Polish leaderships to avoid institutional reform.⁶⁴

However, all this amounts to necessary but not sufficient conditions for the implementation of institutional reform. Within these parameters, experience with reform and the

size and scope of the second economy by the late 70's had helped teach political leaders and academics alike new lessons about Hungarian social reality. The object of the lesson varied among groups, as did their initial adaptive responses. Party and state officials, for example, like their Polish counterparts, now frequently helped families and friends obtain leases on state shops or licences to open private ones. Indeed, in Budapest folklore, behind every fashionable boutique hid a powerful Party-member or government official. And whatever the accuracy of this perception of the bureaucrat-politician as incipient private businessman, the infiltration of the second economy into the state sector did much to change his identity as consumer, as well as his calculus of private interest.⁶⁵

If the official also happened to advocate reform, then he belonged to a distinguished minority which included both economists and members of the Party-state apparatus who had been associated with the stalled 1968 reform, and whose intellectual and moral authority was fortified by the severe accumulated economic pressures which account for the timing of the 1982 decrees. But officials had also learned the specific tactical lessons that would make them possible. It was high-level functionaries of the National Planning Office, after all, who set about the process of drafting a reform proposal which they perceived as politically risky and which one Hungarian sociologist described as "coup-like"⁶⁶ because it involved a small, specially-selected group of technocrats relieved of their regular duties, working in near-secrecy and with relative speed.

This process began with the establishment in 1979 of an outside "expert commission" including economists and sociologists who had undertaken extensive research on the second economy.⁶⁷ It continued in starts and stops over the next three years; only when the economic crisis of the early 80's further underscored the need for institutional reform was the work of integrating the second economy into the larger economy assigned top priority. Even afterward, it met at various points with resistance from the central economic management and within both the Party and government apparatus. Eventually, the process broadened to include the participation of other ministries (Finance, Industry, Labor, Justice) and culminated in a proposal which, despite the best efforts of the the reform's sponsors to avoid controversy, ultimately became the subject of intense debate within the Party and government. These debates and the public campaign⁶⁸ which

followed were conducted in an idiom carefully crafted to emphasize the innocuous, socialist nature of the reform. To this end, its sponsors took great pains to distance the "new" private sector to be "created" by the reform from the extant second economy -- until then the subject of official disapproval even as unofficial toleration increased. In this ideologically acceptable, sterilized public discourse, the "new" private sector was repeatedly referred to as a "helper" or "background" economy for the socialist firms: private partnerships -- especially the intra-firm work partnerships (VGMK) -- would be the "household plots of industry".

The economic success of the agricultural mixed model was particularly reassuring to the leadership. The plots, seen as "organically integrated" into socialist cooperatives, had not palpably upset the balance of domestic political power. For tactical reasons, the validity of the analogy, though occasionally questioned during 1981 debates within the state apparatus, was not seriously challenged. But the analogy was incomplete at best. Virtually all the household plots operated under the aegis of state cooperatives or other state institutions, and capital accumulation was severely restricted by their small size and because they were universally a part-time undertaking. Moreover, their "private" nature was ambiguous, since opportunities for expansion or transfer of the plots were quite limited.⁶⁹

Both the secretive "coup-like" methods employed by its sponsors and their efforts to head off potential discord within the Party-state apparatus suggest that government and Party leaders were aware that the proposed reform was an unprecedented ideological departure and a potential challenge to their authority from within their own ranks, even if most did not entertain the possibility that an expanded private sector might grow into a broader political challenge.

A few of the most fervent advocates of private enterprise may already have been looking ahead to a market-based system.⁷⁰ But they did not represent the norm. Middle-level officials of the National Planning Office who participated in the drafting of the proposal based on a carefully edited -- if not censored -- version of opinions expressed by the outside expert committee⁷¹ were "astonish[ed]" when in 1980, the Party's Political Committee approved further work on the reform proposal.⁷² Officials of the Planning Office knew that although both licenced and informal private entrepreneurship had been increasingly tolerated since 1968, it was not for

nothing that for as long as it felt able to do so, the Party had resisted the step of legalizing most pre-existing informal second economy activities and creating private partnership forms. In fact, at the eleventh hour the Party leadership allowed the project to languish because of a slight economic upturn: by the spring of 1980, the population had accepted the domestic price-hikes quietly, and the balance of payments improved with a rise in convertible currency exports. But in early summer, a further deterioration in the external balance showed that the reprieve had been temporary, and the leadership demanded a stepped-up pace from the commission assigned to work with the various government agencies and ministries to formulate what would become the 1982 reform. Some in the Planning Office assigned to the project were highly skeptical about the chances of such a proposal ever being implemented, and refused to believe that it had received the "political green light" from above. Others were afraid of later political reprisal, and one department head actually refused to sign "such a document, [saying] he did not want to be jailed for ten years...". Among the few officials with "informal knowledge" of the preparatory work underway, some "mocked" it ("who is backing you that you dare such things?"), others still were concerned about the betrayal of socialist ideals, and very few openly supported the idea, though some "kept their fingers crossed in secret".⁷³

The leadership's application of historically- and ideologically-laden language and symbol was a reflexive process, conciliating its claim that an expanded market sector based on private ownership could co-exist peacefully with the political status quo, and its tactical awareness that winning the larger Party and government apparatus over to this viewpoint would be difficult. But peaceful coexistence seemed plausible at all because most of the Hungarian leadership failed to grasp not only the operative connection between the economic and political realms -- so entwined under socialism as to approach an identity -- but also the fundamental relationship between work and politics.⁷⁴ Such a contention may at first glance appear paradoxical in the context of a system founded on the idea of the inseparability of the two. Nevertheless, despite relatively tolerant attitudes⁷⁵ the leadership of the Hungarian Socialist Workers Party, like its other East European counterparts, operated in a polity where the overt exercise of power had long been limited to a circle whose membership was almost hermetic. This circle was separated from the populace by a

deep mistrust; and secrecy became both cause and effect, as did mutual ignorance and the very network of "informers" whose task was to render transparent the motivations and actions of the opaque subjects of the socialist state. The upshot of this information structure based on communicative simulation was that while actions were generally known, motivations -- even if understood reasonably well by the more intuitive among Party leaders -- could easily be misread, downplayed or recast to suit both the ideological requirements of the moment and preferred institutional-political interpretations. If some officials and researchers were fully apprised of the potential political significance of profound changes in Hungarian society and in unofficial socio-economic practice since the mid-sixties, others were too insulated and fearful to surrender the illusion that society could be controlled indefinitely -- even though daily practice proved that "control" and dependence between the Party-state apparatus and the broader society ran both ways.

Indeed, by explicitly redefining both the legal limits and content of property rights, the Party-state effectively lost its three-decade battle to keep the second economy within boundaries tacitly deemed "acceptable". In principle, the 1982 reform could have been rescinded later, since it was not yet firmly anchored in the constitution and in the fundamental political changes of 1989.⁷⁶ In practice, it would have been extremely difficult to reverse. The formal private sector did face setbacks and obstacles after 1982, but it would have been impossible to take back the property rights granted by the reform without a new national program of expropriation.⁷⁷ And after the Party and the spokespeople of the various ministries had spent months publicly explaining the economy's urgent need for the private partnerships and the fundamental compatibility of the new "socialist market" with socialist principles, reversal would have further challenged the credibility of a system whose legitimacy was already seriously in question.

Not only the officials who drafted the reform or participated in its implementation, but also would-be entrepreneurs differed considerably in their interpretations of the potential economic and political significance of the '82 decrees. Hungarian sociological research and my own interviews with both academic and high-level Finance Ministry participants in the reform process suggest that many officials shared a sense of the immediate political risks involved vis a vis the wider Party organization and government apparatus: risks corresponding to what I earlier

characterized as the "narrow" conception of politics. But if they were aware of the broader socio-political significance of the reform, they eschewed discussion of the issue for a complex of reasons ranging from the tactical to the personal.⁷⁸ Accordingly, in 1981 Party debates, sponsors of the reform maintained that it was not a threat to political stability and would not alter power-relations in any significant way.⁷⁹ And, since the reform represented in certain aspects an *ex post facto* legalization of longstanding second-economy practices,⁸⁰ some officials and potential entrepreneurs alike mistakenly dismissed it as just another phase in the familiar cycle of repression and toleration of second economy activity. But in specifying a number of newly-permissible partnership forms and areas of commerce, the regulations opened up novel possibilities and increased the likelihood that, with diminished legal risk, far more people would engage in private enterprise. This did in fact turn out to be the case, but as we shall see, the result was a hybrid.

II. Second Economy Property Rights Recognized: Towards Broad Political and Economic Transformation

Prior to 1982, the private sector in Hungary consisted of a formal component -- agricultural household plots and auxiliary agricultural production,⁸¹ small (often one-man)⁸² licenced retail shops, service-sector businesses, craftsmen, and building-contractors -- and a large informal component which contributed to production in virtually all fields and frequently overlapped with state-sector as well as formal second-economy activities. Although measurement of the second economy has always posed serious difficulties, surveys indicate that by the mid-60's it played a major role in the real structure of production. This was especially clear in agriculture. In 1966, for example, household plots contributed 23% of total gross agricultural production, and 30% of the livestock were raised in the rural second economy. By 1972, about half the Hungarian population worked these small private agricultural units in their spare time; they contributed 31% of gross agricultural production; and half or more of total production in some areas (e.g., vegetables, pork).⁸³

1983 time-budget surveys of the second economy as a whole indicated that, taken together, licenced and non-licenced, agricultural and non-agricultural private production amounted

to a total time-input of about one-quarter of the work-time spent in the first economy by active earners, generated approximately a third of first-economy wages and about a fifth of the annual GNP. If we add incomes derived from bribes, tips, "gratitude money" paid to doctors and other professionals, and the use of state property, employees or officials for private gain, then the proportion of wages derived from the second economy by about three-quarters of the population amounted to at least two-thirds of wages paid in the first economy.⁸⁴ But however important the second economy's role in supplementing income and improving the supply of consumer goods and services, the opportunities for legal private capital accumulation on any serious scale were quite limited. On the other hand, the number of legally-registered small private businesses in no way reflected the true extent of private activity, which became part of the basis for the rapid expansion of the newly legal private partnership forms after 1982.

Against the background of this reality, the 1982 reform of property rights was at once plausible and radical, and could be conceived as part of a broader effort to stimulate market competition in the state sector. This effort included attempts at linking domestic and foreign prices more closely, consolidation of three industrial ministries into one to reduce the size of the bureaucracy, introduction to the state sector of new, smaller "independent" producing units, increased opportunities for private artisans to lease small units of state enterprises, and for state firms to enter into service contracts with individuals or private firms.⁸⁵ Regulations legalizing parts of the theretofore underground second economy were joined with measures to liberalize the extant legal private sector.⁸⁶ And by adding new forms of private and quasi-private economic partnerships, reformers hoped to create a background economy of flexible, small-scale firms which would increase the efficiency of large state-owned firms.

a) The second economy modernized: "small enterprises on a large scale"⁸⁷

Among the new partnership forms, all but two -- the enterprise work partnerships (VGMP's) and work partnerships (GMP's) -- were statutorily permitted to expand into businesses employing large numbers of workers. But private firms' high mandatory social security contributions for employees and, in general, systemic impediments to the growth, such as limited

access to bank credit and the lack of institutional means for issuing public debt, meant that relatively few second-economy firms actually employed large numbers of people on a full-time basis.⁸⁸ Oddly, despite the fact that the number of employees for several of the new partnership forms was not restricted, large-scale private operations (up to 500 employees) composed exclusively of individuals were not explicitly sanctioned until 1989, by which time there were at least a few private firms which exceeded this limit.⁸⁹ Also, prior to 1987, none of the partnerships or traditional small businesses were permitted limited risk, but bore unlimited liability: the law provided no protection for personal assets in the event of bankruptcy.⁹⁰

Nevertheless, the formal private sector expanded considerably, as private entrepreneurs were permitted, for the first time, to cooperate in partnerships. These partnership forms were added to, and sometimes used by entrepreneurs and businesspeople to recombine elements of the traditional, albeit now considerably liberalized⁹¹ formal private sector of agricultural plots, small retailers, craftsmen, manufacturers, construction contractors, restaurateurs, fruit and vegetable-sellers and providers of myriad other services.⁹² From 1982 on, authorities could no longer refuse a licence or otherwise prohibit any citizen choosing to work on his or her own account, or to found or participate in the new partnerships, as long as certain basic legal and professional preconditions were met.⁹³ The 1982 reform also ended restrictions on industrial production in the agricultural cooperatives.

The statutes which brought these new companies into existence took effect on 1 January 1982, and specified several new property-forms, among them: "business-work partnerships", civil law partnerships, and private cooperatives; as well as quasi-private "enterprise business work partnerships". The partnerships were excluded only from a few areas like banking and mining.⁹⁴

The business-work partnership, or GMK, is a work-partnership which was limited to 30 members, all of whom were required to be personally involved in the work of the organization and to contribute to its founding capital. It was founded with a memorandum of association among the members, who were allowed to employ an additional 10 "natural persons" (by 1987, 30), i.e., not legal entities. It enjoyed a low tax-rate for a time (e.g., 3% in 1984) and

was one of the most popular of the partnership forms. However, many GMK's transformed themselves into small cooperatives in order to increase their membership and enjoy certain advantages reserved for "socialist" property forms.⁹⁵ Since the 1989 Association Law ended the differential treatment of the small private cooperatives, most GMKs interested in expansion have converted themselves instead to limited liability companies (KFT's), or joint ventures. The GMK's membership, like that of the small cooperatives, ranged from classical entrepreneurs intent on producing internationally-competitive goods who left state firms to work full-time, to the more common part-time partnerships specializing in repair and maintenance, whether of cars or sophisticated state-factory equipment. Like small cooperatives and civil law partnerships, GMK's supplied a wide range of intellectual services, artisanal production, and skilled labor.⁹⁶

The civil law partnership, or PJT, resembled the GMK except that it could employ legal entities, professional advisors who were not financial partners, and non-members. Thus an architectural firm founded as a PJT could employ a software-design GMK, a small construction cooperative, and a small traditional crafts firm as well as individuals. It was required to have a minimum of two members but no maximum was specified. "Recreated" by the 1982 regulations from pre-existing statutes, PJT's were frequently founded on the "intellectual capital" of university graduates, usually in the capital city, and were often involved in software design or computer services. Also, the PJT was the only partnership form permitted direct involvement in retail trade, for instance through the leasing of state commercial shops, restaurants, or enterprise sections, or by forming retail partnerships. These were taxed at a much lower rate than PJT's involved in other lines of work.⁹⁷ Initially, PJT's were highly popular, because their foundation required no prior approval of the state-employer, membership was not limited, and no financial investment was required. But the high tax levied on PJT's not involved in retail trade or the leasing of state firms -- about 40% on profits until the 1989 Association Law -- reduced their popularity, and many of them were changed into GMK's. The membership of both GMK's and PJT's were free to invest, divide or dispose of any founding investment or profit as they chose.⁹⁸ After the 1989 Association Law most PJT's were transformed into investment companies.

Small cooperatives, as opposed to state-owned cooperatives which operated very much like state-firms, offered another new opportunity for private entrepreneurs, although as a property-form they were not wholly private, since their founding capital was indivisible. However, many small cooperatives found ways around this restriction.⁹⁹ They could be founded in two ways. A maximum of one hundred people could break off from a non-agricultural state-cooperative, taking equipment and capital with them. Or a minimum of fifteen individuals could create a small coop with a contribution of one-month's salary. The cooperative members could hire an unlimited number of employees.¹⁰⁰

The enterprise work partnership, or VGМК, was a partnership of skilled workers subcontracting services to their state-firm employers after regular working hours; using, for a fee, the firm's equipment; and, although the VGМК membership could not officially hire employees, often benefiting from the support services of less-specialized workers in the same firm.¹⁰¹ Its membership was limited to 30 employees and retired workers of the state firm, and the approval of the firm manager was needed for its establishment. The members' liability was limited to any original financial contribution (usually minimal) and incomes earned in the partnership.¹⁰² Although VGM's were intended as a kind of joint-venture between industrial firms and their employees based on unused capacity, with some exceptions it was more like a specialized "self-organizing work-brigade" than an enterprise in any real sense.¹⁰³ It also represented the leadership's wish to ensure the goodwill and cooperation of key groups of skilled workers who were not easily able to supplement their incomes by applying firm-specific skills to private part-time work in the second economy. The VGМК's worked as a stopgap measure to alleviate shortages, and to ease internal uncertainty for the firms themselves by, for instance, reducing bottlenecks, lessening the need for rush-work and dependence upon more expensive outside contractors. Some VGМК's concentrated their efforts in specialized, highly profitable small-batch production, others found ways to utilize formerly-discarded materials; still others designed and tested new products. They were paid out of the firm's costs account rather than from the wage-fund, thus avoiding centrally-imposed ceilings on wage-payments. Members generally earned at least twice and sometimes three to five times their salaries during regular hours, and as much as

four times the average hourly wage in industry. Some observers had high expectations for the VGMK's: they would function as a kind of "good virus" which, if allowed to spread far enough, might even change the internal structure of the state firms. Others were concerned about the potentially inflationary effects of relatively high wages paid to VGMK members by circumventing central wage-control.¹⁰⁴ However, VGMK's served numerous complex functions and had rather far-reaching effects despite the fact that they could not meet the unrealistic burden of expectations some placed on them.¹⁰⁵ On balance, they helped temporarily to sustain enterprise structure more than they helped directly to change it; but once hidden internal subcontracting schemes had been institutionalized as VGMK's, they exerted even greater indirect pressure toward altering the politics of state sector work than before. After the 1989 Association Law, VGMK's without outside contracts ceased to exist, and the rest, which now go by the acronyms "JGMK" or "KKT" (both independent legal entities), can cooperate with their firms as true joint ventures offering products or services for the market.¹⁰⁶

Another quasi-private partnership permitted from 1982 on was the "specialized group" operating in non-agricultural state cooperatives and small cooperatives. These were similar to the VGMK's, but no ceiling was imposed on membership, and the rules governing their taxation were simpler. They functioned independently to the extent that they were self-managed and kept their own books; but since the state cooperative was liable to the full extent of its assets for any losses incurred by the specialized group, the latter's autonomy was sometimes limited. Although most simply performed services for their parent state cooperatives just as the VGMK's did for their firms, a few did become large ventures with several hundred employees and significant capital. Some transformed themselves into independent small cooperatives; in fact, cooperatives were often comprised of several specialized groups.¹⁰⁷ Finally, the "AFESZ" specialized team was similar to the specialized team in the service and industrial cooperatives, but pursued both agricultural and non-agricultural activities within the framework of the state agricultural consumer and sales cooperatives.

b) Hybrid Economy, Quasi-Pluralist Politics

By legalizing the second economy and trying to channel private activity into the new partnerships, Party leaders achieved their short-term goal of stabilizing consumption levels, albeit as a consequence of the population's almost incredible self-exploitation: now Hungarians work the longest day in Europe.¹⁰⁸ In the longer term, this legalization had far-reaching, unanticipated consequences. The contention of some analysts that the 1982 reform of private property rights hardly altered the statist character of the Hungarian economy¹⁰⁹ is accurate only if we consider fixed capital assets or official measurements of the national product; and then only in the static sense. While somewhere between 80-90% of the means of production are still state-owned, it is estimated that the second economy -- in all its traditional and newer manifestations -- accounts for up to 30% of GDP.¹¹⁰ Poor in capital but rich in highly motivated and skilled labor power, this sector produces goods and services far out of proportion to its capital assets.

And yet, precisely because so many private firms remain small and undercapitalized even after 1982, one hears references in Hungary to the sector's "primitive", or "19th century" character. Even if this is a fair assessment of many individual firms operating against considerable odds, at base it reflects the lingering bias of both Fordism and doctrinaire socialism in favor of the large, mass-producing firm; and their view of small firms as little more than remnants of an antiquated past. It also reflects the fundamental fact that developments in the Hungarian second economy simply overtook observers. An eminent sociologist, for instance, expresses the majority view when he asserts that there are few horizontal links between private firms.¹¹¹ While it is true that the state sector remains the largest market for many second-economy firms, private firms increasingly turn to other private firms for parts, services, or advice. And by 1988-89, GMK's, small cooperatives, and independent craftsmen cooperated routinely in numerous ways which were important to their individual stability and growth-prospects. This cooperation ranged from simple barter deals (one firm's micro-computer repaid by the other's work on a rush project) and the subcontracting of overflow work, to informal information-sharing or the pooling of resources to make a financial contribution to Budapest's Technical University in hopes of having a better-trained workforce to hire some years later. In any case, once the 1989 Law on Association eliminated the legal, if not all actual, discrimination against private firms, as well as the barriers to

their interaction, the earlier establishment of forward linkages with state firms began to produce new forms of cooperation between the two sectors, such as joint ventures, which may also involve foreign firms. In some cases, it even happens that private firms establish joint ventures with the decentralized subsidiaries of state firms and use them as job-shops, instead of the other way around.¹¹²

The oft-voiced claim that second economy firms faced little or no competition is another half-truth. In fact, by 1988 some areas were already saturated (private taxi services being the most obvious example), while other firms faced considerably less competition. Nevertheless, some of the most specialized firms not only had at least half a dozen competitors by 1989-90, but had learned to compete cooperatively with some of them. In general, the higher the level of specialization and technical development, the greater the incentive for such behavior.¹¹³

In sum, private business expanded more rapidly and robustly than many officials expected,¹¹⁴ and its political-institutional consequences proved surprising. The seemingly endless round of amendments, modifications and subsequent reforms which the Ministry of Finance was forced to undertake between 1982 and '89 indicates that once property rights are granted to groups thereby newly legally enfranchised, the pressure to broaden those rights grows from its own logic. The balance of power between the ubiquitous subterranean second economy and the state had been changing prior to 1982 as well. However, as long as the renegotiation of this balance remained largely tacit, it was essentially stable within broad institutional limits. Formalization of this relationship upset the balance. Simply put: prior to 1982, the state could pursue more or less tolerant policies toward the informal sector, but the limits of its authority were substantially redrawn with the institutional reform that redefined the rights of second-economy participants. Socialist law, far from positivistic, nevertheless played an important role in fostering the political-institutional changes which grew from the '82 reform. For even though the law generally followed social reality, informal socio-economic practice, without legalization, could develop only so far and in certain directions. Moreover, once legalized on an expanded basis, the mediation of the internal contradictions engendered by the conflicting logics of private and state-firm activities pursued in a socialist framework became the official responsibility of the Party-state apparatus. These

contradictions took the form of pressing daily problems in need of immediate attention, usually from the Ministry of Finance, which issued decree after decree in the effort to resolve them. The net effect of such decrees was the broadening of second-economy entrepreneurs' property-rights and space for action, while blurring the lines of authority within various government institutions previously responsible for overseeing the small pre-'82 formal private sector.

The challenges extended beyond coordination of increasingly complex economic mechanisms *sensu stricto*. Once endowed with legal status, individual entrepreneurs and various organized groups pressed for further changes. Transmission-belt organizations, responsible for "representing" the interests of the small traditional legal private sector of manufacturers and retailers, were internally disrupted because the government changed the economic landscape overnight without specifying their new mandates.¹¹⁵ In 1987, entrepreneurs formed their own independent interest-representation organization which helped extract concessions vis à vis the private sector (e.g., on tax policy); and a year later, entrepreneurs formed a political party.¹¹⁶

Having partially internalized the cost of highly-motivated labor and its applied knowledge, as well as the accountability for the systemic contradictions this implied, the government set in motion a process which would culminate in an even more radical internalization: the 1989 Association Law, whereby it all but abandoned pretense at controlling the number and organizational types of private business.

Conclusion: The mutual absorption of extremes

Thus the 1982 reform of private property rights was a turning point in the history of Hungarian reform. A late manifestation of recurring reform cycles, it was insufficient to stabilize the economy, but further destabilized Party ideology, social attitudes and behavior, and proved incompatible with state-socialism as an institutional-political system. The legalization of private entrepreneurship on a wide scale represented an effective challenge to the state's claims on rights to control not only production but economic organization and association. The state had originally defined private property as an existential internal enemy. But all economic and political decisions subsequent to 1982 were made in the context of a significantly expanded and officially recognized

dual economy in a socialist state. Despite the conflicting logics of the two systems and mutual attempts at exploitation of one another's vulnerabilities, their increasing symbiosis resulted in significant new compromises on the part of the political leadership over the next seven years. Newly legal forms of economic association, ownership and work constituted the enfranchisement of new social groups on a very different political basis. Moreover, by enfranchising groups upon which it had, ironically, become partially dependent precisely because it had excluded them for so long, the state surrendered its exclusive right to initiate change.

Most profoundly, the relationship between the second economy and the socialist state led to the mutual absorption of two extreme conceptions of politics: the one a balancing of socio-economic interests, the other having to do with the formation of essential identity and the maintenance of maximal cohesion within the Party-state -- an imperative against which no other consideration could be properly balanced or weighed. In Hungary neither conception triumphed, for neither state-strategies -- ranging from repression to tacit toleration and reform -- nor the defensive oppositional strategies of second economy participants was entirely "successful".¹¹⁷

The process that culminated in the redefinition of property rights was also bound up with increasingly broad and diverse conceptions of self which stood in opposition to official norms, and thus undermined the very social categories on which the system rested. Hungarians, even as they despaired at their own belief in the possibility of infinite "corruption" within the context of an "unchangeable" system, were simultaneously drawn to what had been officially seen as "disreputable" second economy activities. Such activities, initially a route to subsistence, became for many subtle acts of defiance, and gradually a source of self-definition and esteem, encompassing the concepts of time, knowledge, and relation to work as property. As Hungarians became housebuilders, mechanics, software-designers, private marketers of their own produce -- indeed, as they became astute buyers and vendors of all manner of tangible and intellectual goods and services -- they also constructed parallel identities and quasi-institutionalized networks of high-trust alliances. Even as a majority retained positions within state-sector institutions, second economy production and consumption came to represent an incipient alternative politics so widespread as to leave virtually no one untouched.¹¹⁸ Over time, the informal and formal private

sectors merged, and a *sui generis* private market took shape. This hybrid private sector, which throughout its development contributed to the expansion of the range of economic and political choice for previously excluded groups, is still embedded in the remnants of a socialist economy, and thus faces discrimination even after further liberalization following from the 1982 reform.¹¹⁹ At the same time, however, it is once again recombining in unexpected ways with privatizing state firms.

Clearly, the outcome of restructuring efforts in the formerly socialist economies will be partially determined by the way these systems came apart, and by the legal and economic structures which remained in place when governments fell. Even as they are reshaped, these structures and the ideas on which they were built condition the parameters of possibility in each of the formerly socialist countries. The 1982 reform gave Hungary a head-start in rebuilding its private sector. And partly because this reform legalized indeterminacy in the relations between second- economy firms and a preponderant state sector, the former now face a range of possible futures. In the most pessimistic -- and rapidly vanishing-- possibility, the second-economy remains just that: indispensable but secondary. In the most optimistic, one crucial aspect of the letter of the law is implemented fully: guarantees of equal access to credit providing second-economy firms with the oft-promised "level playing-field" that would permit their expansion. Already committed to paper, such guarantees remain subordinated to the anomalies of the ongoing transformation of a formerly socialist system. State-owned, as well as some spontaneously-privatized former state firms, continue to crowd out smaller potential borrowers lacking access to the old formal and informal channels connecting state-firm managers to banks. Resolving this discrepancy between decree and practice matters for the same reason that the partial devolution of centralized control over economic development to local governments and communities matters: both are representative of the kind of institutional and political conditions necessary for innovative cooperation among private entrepreneurs or between private and state firms. The prospect of cooperation, in turn, holds out the potential for structural adaptation along the lines of remarkably successful economic models based partially on networks of small specialized firms, currently exemplified by regions like Baden Württemberg and Emilia-Romagna; or some regions of Spain, where the informal

economy has come above ground and profited from its bargains for clemency with the state.¹²⁰

Whether their experiences will persuade Hungarian experts and the government to try to transcend what one economist aptly labelled "macro-policy centredness"¹²¹ remains to be seen. The possibility is already incontestable.

¹ "Unreformable" because the single-party regimes which ruled them were seen as having the capacity both to impose and maintain totalitarian power. At most, they might "collapse suddenly". (see Arendt's 1958 edition, *Meridian*: New York, p. 510) Two of the classic formulations of totalitarian theory are Arendt, H. (1986) The Origins of Totalitarianism. London: Andre Deutsch; Friedrich, C. J. and Brzezinski, Z, K. (1965) Totalitarian Dictatorship and Democracy. Cambridge: Harvard University Press. See also Friedrich, C., "The Evolving Theory and Practice of Totalitarian Regimes", in Friedrich, Curtis and Barber, eds., Totalitarianism in Perspective: Three Views. London: 1969; and Schapiro, L., (1972) Totalitarianism. London: The Pall Mall Press.

² Janos Kornai distinguishes between three historical stages of socialism. 1) the "heroic", immediately following socialist revolutions, in which ethical coordination is for a time very important; 2) "classical", or "classical bureaucratic", which becomes "institutionalized, stabilized, and in fact comes to be the normal form of socialism", in which bureaucratic coordination of economic activity dominates; and 3) "reform" socialism, which in a minority of socialist countries followed classical socialism (Yugoslavia, Hungary, China and to some extent Poland), and in which market coordination has been introduced to varying degrees. See Kornai, J. (c) Bureaucracy and Market: Introduction to the Political Economy of Socialism. Lecture Notes of Economics 2000, Harvard University, Department of Economics printed transcripts: Cambridge. Volume I., 1986-87. pp. 30-36.

³ The literature on reform of socialist systems is far too extensive to provide even a representative list here. For a summary discussion of the concepts of "partial" versus "comprehensive" reform, or "perfecting" versus reform, see Bauer, T. (1988) "Hungarian Economic Reform in East European Perspective". East European Politics and Societies. 2:3, pp. 418-432. For a few interesting and fairly recent discussions which conclude that structural reform of socialist systems occurs, if at all, only against great odds, see Winiecki, J. "Obstacles to Economic Reform of Socialism: A Property-Rights Approach"; or Ickes, B.W., "Obstacles to Economic Reform of Socialism: An Institutional-Choice Approach", and the preface by Prybla, J.S., in The Annals of the American Academy of Political and Social Science: Privatizing and Marketizing Socialism. January 1990. Sage: London. See also Kornai, J. (a) "The Hungarian Reform Process: Visions, Hopes and Reality". Journal of Economic Literature Vol. XXIV (December 1986), p. 1689, for his most comprehensive assessment of the history of reform in Hungary. In the course of his intellectual development, Kornai would conclude that most reforms amounted to stopgap measures incapable of bringing about the deep structural changes needed to improve the efficiency of socialist economies.

⁴ Andrew Walder, in "States and Social Structures Newsletter", No. 12, Winter, 1990, p. 7, Social Science Research Council, New York.

⁵ If there are serious scholarly works which explicitly argue that Gorbachev is the *deus ex machina* behind recent transformations in Eastern Europe, I am not aware of them, although some, like Timothy Garton Ash, assign considerable importance to the "factor Gorbachev" even if they cite other causes as well--e.g., Ash's "factors Helsinki" and "Toqueville". See Ash, T. G. (1990) The Magic Lantern: The Revolution of 1989 Witnessed in Warsaw, Budapest, Berlin and Prague. Random House: New York. pp 140-142. I am referring, however, to the perceptible undercurrent in academic discussions, frequent references or free-floating allusions in otherwise more sophisticated academic works to the importance of Gorbachev as a kind of "Great Man", and the tendency of media accounts to portray him as prime-mover. Guiseppe di Palma notes that totalitarian theory..."consciously or subconsciously held sway" right up to 1989 (See his "Democratic Transitions: Puzzles and Surprises from West to East", a Working Paper in Harvard University's Center for European Studies East European Series, 1990). Totalitarian theory emphasized, among other things, the importance of leaders and their personalities -- an undercurrent which still appears frequently in both popular and academic discussion of socialist and formerly socialist

regimes. For a non-scholarly (and seriously misleading) account along these lines, see Gail Sheehy's The Man Who Changed the World: The Lives of Mikhail S. Gorbachev, (New York: 1991)

6 Inglehart, R.(1990) Culture Shift in Advanced Industrial Society. Princeton University Press: Princeton.

7 For an analysis of the effects of international economic trends and pressures, see Maier, C. "Why Did Communism Collapse in 1989?" East European working paper, Harvard Center for European Studies:1990. For an explicit analysis of the youth revolts as causal factor see O. Rumiantsev, "From Confrontation to Social Contract" in East European Politics and Societies, Winter 1991, Vol. 5. No. 1, Berkeley. However, Rumiantsev's article fits better into the second category of "mixed" explanations, because he emphasizes the role of the Prague Spring as well. See also Bozoki, A. "Critical Movements and Ideologies in Hungary", Sudosteuropa. 37:1988

8 For example, the demonstration effect of increasingly open borders; travel leading to increased expectations and sharpened abilities to discern differences in the living standards of neighboring countries.

9 See Hankiss, E. (a) Diagnózisok (Diagnoses) 1982, Budapest: Magveto Kiado.

10 To this last category belong also some fine recent efforts to focus explicitly on social groups acting both inside and outside official state institutions without assigning greater *a priori* importance to one or the other. See Nee, V. and Stark, D., eds., (1989) Remaking the Economic Institutions of Socialism: China and Eastern Europe. Stanford: Stanford University Press.

11 "Reformers" are mentioned in almost all accounts of socialism, and come in many packages. But whether progressive or conservative, sincere or opportunistic, the common goal of most non-party intellectuals or technocrats and Party officials was the preservation and improvement of the system, whether through some variant of market socialism or a refined, more serviceable version of its classical expression. But by the logic of the current consensus on the unreformability of socialism, reformers unwittingly hastened its demise by introducing incompatible market elements. Thus the cumulative result of their efforts was not reform but transformation. For a comprehensive analysis of reform currents in Hungary and an explanation of why, instead of deep structural reform, a system of indirect financial control developed through plan bargaining, see Kovács, J. M. "Reform Economics: The Classification Gap". Daedalus. American Academy of Arts and Sciences: Cambridge. 119:1 Winter 1990, and Kovacs, J. M. (1984) "A reformalkú sűrűjében" (In the thick of reform bargaining) Valóság. No. 3.

12 Vaclav Benda's "Parallel Polis" was first published in 1978 and circulated in *szamizdat* form. In translation it is available as Benda, V. (1979) Parallel Polis. London: Palach Press Bulletin. See also Skilling, H. Gordon (1981) Charter 77 and Human Rights in Czechoslovakia. London. And for a guide to the various concepts (e.g.: "second" vs. "independent" societies or polities, "parallel polis", etc), see Skilling, H. Gordon (1989) Szamizdat and an Independent Society in Central and Eastern Europe. Columbus: Ohio State University Press.

13 See, for example, Hare, P. "Economic Reform in Eastern Europe". Journal of Economic Surveys. 1987, 1:, pp. 25-34. Also see Bauer, *ibid*. Depending on the types of change we examine, Yugoslavia or Poland might be the better case to analyze. In the former, agriculture was never collectivized and a significant portion of the service sector remained in private ownership. Or, for a different but frequently-cited example: the Polish negotiated compromise of 1989 provided a model of peaceful political transition for Hungary, even though the end result in Hungary was different. The argument here is not that Polish (or Yugoslav) socialism changed less, or in less significant ways, than Hungarian socialism: in many dimensions, the Hungarians learned from the experience of both. The argument is only that, at the margin, formal Hungarian economic reforms were historically more 'radical' -- departed more explicitly from the Soviet model -- and sometimes, more comprehensive in scope than the Polish (but not the Yugoslav), which were nevertheless among the most radical in Eastern European experience.

14 In the debate over a 1982 reform of property-rights which is analyzed in this essay, one argument employed by progressives was that in providing the working class with increased opportunities to engage in private enterprise, the Party was not creating "capitalist entrepreneurs", but "worker-entrepreneurs".

15 Seleny, A. (a) "The Hungarian Second Economy as Political Arena". paper delivered at the November 1989 annual meeting of the American Association for the Advancement of Slavic Studies (AAASS), Chicago.

¹⁶ The state sector, by contrast, or "first" economy, encompasses state-owned firms, quasi-state-cooperatives, government agencies and registered non-profit institutions. Definitions of the second economy have varied significantly with the analyst's focus, assumptions, and ideological perspective. The simplified working-definition employed here draws on more detailed and comprehensive definitions and categories used by Gábor and Galasi, and Kornai. See Gábor, I. and Galasi, P. (1985) "Second Economy, State and Labour Market". in Galasi P. and Sziráczki, G. eds. Labour Market and Second Economy in Hungary. Campus Verlag: Frankfurt, and Kornai, J. (a) *ibid.* Kornai emphasizes that legality is not an analytically useful distinction for understanding the division between the first and second economies. I would add that it has never been and is not now a useful dividing line in the analysis of the Hungarian formal private sector/informal second economy. In fact, many researchers who speak of the Hungarian "private sector", or of the "second economy", usually either mean the same thing, or are emphasizing a factor (legality) which, at least to date, merits emphasis only if legality is the explicit focus of analysis (e.g., the number of legally registered firms). But such an analysis would almost certainly obscure more than it could reveal about the functioning of these firms or even about the degree to which they have actually operated legally or illegally, and would have little beyond statistical significance. A sharp distinction between established business, whether registered or not, and what I consider to be sub-elements of the second economy on which such businesses and the state sector frequently depend--e.g., gratuities, bribes, "guanxi" (connections)--would be artificial and misleading. Due to the fact of its operation in a predominantly socialist economy and to the inordinately complex and contradictory system of regulation to which it was subjected even after 1982, the formal second economy, or private sector--like the state sector with which it daily interacts--retains many features of informality. Thus, although in the section of this essay which deals directly with the 1982 reform and its aftermath, I sometimes refer to the "new legal partnerships", "private enterprises", or the "new private sector" to call attention to the newly legal segment of the second economy, these expressions should not be understood as implicit claims about fundamentally different practices of these new types of firms as compared to older, informal ones. Partly because legalization has not resulted in a cessation of informal, illegal or semi-legal activity, and partly because the private sector continues to operate in a predominantly socialist economy which will take many years to privatize, "second economy" still captures the reality better than "private sector"--a term which carries the implication of a sector operating according to some near-facsimile of neoclassical market principles.

¹⁷ It should be noted also that in East European parlance, the economy had always been "politicized", but in a very different sense. Specifically, the Party-state tended to make economic decisions on the basis of political considerations. Here I am referring to a "politicization" in the usual Western usage: that is, economic issues became increasingly subject to the influence of actors outside the party-state apparatus.

Secondly, I refer here mostly to *de facto* and not *de jure* privatization of state sector firms or their subsidiaries, although both kinds of privatization are linked to the extension of the second economy's unofficial and, after 1982, official role in the state sector. See, for example, Sabel, C. and Stark, D. (1982) "Planning, politics, and shop-floor power: hidden forms of bargaining in Soviet-imposed state-socialist societies". Politics and Society 11: 439-475; and Stark, D. (1985) "The Micropolitics of the Firm and the Macropolitics of Reform: New Forms of Workplace Bargaining in Hungarian Enterprises". Chapter 8 in Evans, P., Rueschemeyer, D., and Stephens, E. H. eds. States Versus Markets in the World System. Sage: Beverly Hills.

¹⁸ The responsibility for overseeing private business now lies with the Court of Registry. Sárközy, T. (1988) "Eloszo", A társasági törvény: Magyarázatokkal és iratmintákkal. (The Law on Association: Explanations and Sample Documents) Lang: Budapest. p 9.

¹⁹ Act on Economic Associations, Ministry of Finance, October 1988, Budapest, p. g. The 1982 regulations were hammered together from existing law, which was poorly suited to the needs of a developing private sector. By 1983, it had become clear that many contradictions and problems remained to be worked out, and numerous modifications followed. One example: the 1985 amendments specifying the right of private partnerships to bring suit, to bar a non-performing or dishonest member from the partnership, and to acquire property or interest in property. The latter had been a problem because the partnerships were not accorded juridical (corporate) status, so that if, for instance, a GMK of fifteen members wanted to buy a truck, the names of all fifteen had to appear on the title. This was not only cumbersome but caused bureaucratic and technical problems if one or several members left the GMK.

²⁰ Many restrictions, unresolved issues and legal ambiguities remained: e.g. limited partnerships for individuals were not permitted until 1987 and then only if at least one member had juridical status; the number of employees for some partnership forms was restricted; the manner and degree to which individual citizens could establish economic associations with private or state-owned firms was restricted until 1989. In addition, until then, certain types of private partnerships operated under a two and sometimes three-tier system of direct and indirect control: sectoral (e.g.,

retail vs. manufacturing); state administration (Ministry of Finance, the tax authorities, the economic police), and judicial (e.g. the court of registration).

21 The issue of rights under socialist law is complex for a number of reasons. To mention only one: in a single-party state, even laws based in constitutional or citizenship rights are subject to broad interpretation (not to say abrogation) and widely-varying implementation by the authorities. Although the 1982 regulations were part cause, part effect of a sociological and ideological sea-change, technically, they amounted only to a series of enabling acts issued by government administrative bodies (in Hungarian, "Kerretorveny").

22 Gianfranco Poggi analyzed the polarity, as well as possible commonalities, between the pluralist world-view exemplified by the American political scientist David Easton, and that of the German legal and political theorist Carl Schmitt, with his emphasis on the existential decision: distinguishing between friend and foe. See Poggi, G. (1978) Development of the Modern State: A Sociological Introduction. Stanford University Press: Stanford. As Poggi points out, Marxism can be understood as a radical variant of the Eastonian view: politics is essentially concerned with allocation by command. But for our purposes it is important to see that Marxist principles--as practiced in the socialist countries--also approached the Schmittian pole. To be sure, the protagonists of Schmittian politics are nation-states; and the identity-formation of their collectivities is inextricable from political struggle. In classical Marxian analysis class-identity is determined by the members' position in the division of labor, and long-run political outcomes are thus preordained. Nevertheless, the notion of an existential clash is central to the concept of politics itself.

23 See, for example, Hough, J. (1969) The Soviet Prefects: The Local Party Organs in Industrial Decision-making. Cambridge: Harvard University Press; Hough, J. (1977) The Soviet Union and Social Science Theory. Cambridge: Harvard University Press; and Skilling, G. and Griffiths, F., eds., (1971) Interest Groups in Soviet Politics. Princeton: Princeton University Press.

24 From the very start the state regulated class conflict through its policies of demobilization and remobilization of the labor force, allocation of opportunities for education, of workplaces and housing; as well as through redistributive fiscal measures. For a review of class-based theories as applied to socialist systems, see Szelenyi I. (1982) "The Intelligentsia in the Class Structure of State-Socialist Societies". Burawoy, M., and Skocpol, T., eds. Marxist Inquiries. American Journal of Sociology, vol. 88, Supplement, pp. S287-2327.

25 In response to systematic attempts to eliminate opposition and to "harmonize" society, politics took on many different, if muted forms. Just as the cultural realm appropriated distinctly political functions and meanings under socialism, when the space for official, institutionalized political participation was drastically narrowed, politics spilled over into other areas which in advanced capitalist countries can more easily be functionally and analytically separated from one another (even if at a deeper level they always remain connected).

26 In 1963, 1.9% outside agriculture, 2.1% among peasants. See Androka, R. (1990) "The importance and role of the second economy for Hungarian economy and society", unpublished paper. University of Economics: Budapest. p.4.. By comparison, when the Communists took power in 1948, about half the labor force was employed in small scale production. This sector actually grew after the war, partly because of the land reform which increased the number of smallholders, and partly because after the war small businesses could get on their feet more easily than large ones. See Donáth, F. (1977). Reform és forradalom. A magyar mezőgazdaság strukturális átalakulása 1945-75. (Reform and Revolution. The structural transformation of Hungarian agriculture, 1945-1975) Akademia Kiadó: Budapest. p.38-45. To take another, perhaps more representative example, in 1940, small-scale industry (under 100 workers) employed about half of all industrial wage earners and provided over a fourth of the industrial product. (This does not include the thousands of individuals employed in small retail shops or on small private farms.) Laky, T. (b). "The Hungarian Case". Paper prepared for the IV. World Congress for Soviet and East European Studies, Harrogate, England. July 1990. p. 4. Mimeo. Quoted by permission of the author.

27 Róna-Tas, A. "The Social Origins of the Transformation of Socialism in Hungary: The Second Economy". Paper delivered at the American Association for the Advancement of Slavic Studies (AAASS), November 1989. p. 17.

28 Children were not counted; on the other hand, a pensioner who could no longer work the land but was a full member of the cooperative received the plot and other family-members could work it. Frequently, families followed a two-track strategy: women were full members of the cooperative and men went to work in industry. The size limit on these plots was .57 hectare. Vineyards and household gardens were also left to their private owners, and peasants

were allowed to raise more animals privately than in other socialist countries. (See Andorka, *ibid.* p. 4., and Donath, *ibid.*) Only 14% of the private farms avoided collectivization by 1962, partly because the policies of the Kádár regime were aimed at achieving greater cooperation of the peasantry. Indications that the state would have to coopt peasants, and that dependence would run both ways appeared early on, and contributed to the expansion of the second economy. For instance, allowing peasants to keep a larger number of animals was crucial, because they sometimes slaughtered their cattle rather than give them up to forced deliveries. See Berend, I.T. (1983) Gazdasági útkeresés 1956-1965. (Searching for the Economic Path, 1956-65). Budapest: Magvető. pp. 287-288. In fact, between 1950 and 1951, the number of cattle decreased by almost 10% and the number of pigs by 22%. However, this was not wholly determined by the system of forced deliveries: animals were also secretly killed in these years simply as the result of food shortages. Figures are my calculations derived from data in Pető and Szakács (1985), A hazai gazdaság négy évtizedének története. 1945-1985., Vol. 1. (The History of Four Decades of the Domestic Economy) Budapest: Közgazdasági és Jogi Könyvkiadó. table, p. 210.

²⁹ Péter Galasi and György Sziráczi, (a) "The New Industrial Organization: review of Developments in the organization and structure of small and medium-sized enterprises", Country Report, Hungary. unpublished paper, Karl Marx University of Economics: Budapest, 1986. p. 3.

³⁰ Whereas in 1938 Hungary's manufacturing industry consisted of 3911 enterprises, by 1949, the number was 1632. The distribution within this total tells the real story. In 1938, the number of enterprises having 20 or fewer employees was 2089 (53.4%); by 1949 it was 527 (32.3%). 109 (2.8%) firms in 1938 had 500 or more employees, and 397 (10.1%) had between 101 and 500 workers; by 1949, 179 (10.6) had 500 or more employees, and 433 (26.5%) had between 101 and 500. The trend toward firms with between 101-1000 employees continued from '51 to '56, the number of small (100 or fewer employees) enterprises decreased substantially and the number of very large enterprises (1000 or more) continued to grow. Galasi and Sziráczi (a), pp 3-5.

³¹ Galasi and Sziráczi (a), p. 8.

³² "The number of artisans more than doubled and an opportunity opened up for the revival of small enterprises in the framework of small-scale private industry." Hegedüs, A. and Márkus, M. "The Small Entrepreneur and Socialism", in Acta Oeconomica Vol. 22:3-4, p. 275.

³³ Hegedüs and Márkus, *ibid.*

³⁴ Galasi and Sziráczi, (a) p. 9.

³⁵ Kornai (a). p. 1689. Enterprises were no longer given detailed annual instructions, and had more independence in making decisions about employment, investment production processes and product-mixes. But their position "remained" one of "budgetary dependence and compulsory operation". Entry, major reorganization (mergers, for instance), and exit [were] regulated by the state, and the "profits of highly profitable enterprises [were] redistributed toward low profit enterprises", so that "cost-insensitivity and over-demand for resources" were still prevalent. See also Galasi and Sziráczi, (a) p. 14; and Kornai, J. and Mátits, A. (1987) A vállalatok nyereségének bürokratikus újraelosztása (Bureaucratic redistribution of firms' profits). Budapest: Közgazdasági és Jogi Könyvkiadó. On the other hand, a type of price system did emerge with the '68 reform, and although the "quasi" must be emphasized--given, among other things, the complex, hybrid nature of labor markets and the level of subsidization and soft credit throughout the system--a degree of transparency was achieved. See Dobozi, I. "The Price Sensitivity of the Economy", in Clarke, R. A., ed. (1989) Hungary: The Second Decade of Economic Reform. Longman Group UK Ltd.: Harlow, Essex. p. 139.

³⁶ For example: calves born in the cooperative were sometimes sold to individual members who raised them on private household plots; the cooperative then bought them back, and sold them to a state enterprise. Because the cooperative was considered part of the socialist sector (though nominally in cooperative ownership it functioned essentially as a state-owned unit), it received a slightly higher price for the cattle than the peasants would, had they sold them directly to a state firm without the mediation of the state agricultural cooperative. The State cooperative farm typically received the premium and split it with the individual cooperative members who had raised the cattle on their household plots. Andorka, R. Author's interview, Harvard University Center for European Studies, May 1989.

37 The concepts were developed by Kornai, J. (b) in The Economics of Shortage. North-Holland: Amsterdam, 1980. For the elaboration of the concept of the soft budget constraint, see especially pp. 306-309; for investment-hunger, see pp 189-190, both in volume A.

38 See Antal, L. (1985) "About the Property Incentive (Interest in Property)". Acta Oeconomica. 34:3-4. pp.275-286, esp. p. 279.

39 The first independent trade unions were established in 1988. The first among these--the TDDSZ, or the Union of Democratic Scientific Workers--consisted not of "traditional" workers, but of academic workers.

40 In fact, there was no corresponding appreciable increase in the number of people employed in formal private small-scale industry between 1968 and 1971. This may have been in part because of a perception that the measures were only temporary. As if to support such a fear, the recentralizing trend which began in 1972 was "accompanied by a vigorous mass-media campaign against [the] legal private sector and other semi-private forms of small-scale economic activity." See Galasi and Sziráczi (a), pp 14-18.

41 These informal high-trust networks were, ironically, born of fear of the authorities. Producers, but to a lesser extent also consumers of second economy goods and services could be reported at any time by anonymous informers--a well-established, very common practice in Hungary which invariably led to investigation by the authorities. In an effort to mitigate serious risk, the window-washer typically worked only for clients referred to him by long-standing customers. The state-firm plumber informed his official customer that he would be "unable" to fix his client's leaking faucet anytime soon, because of "extreme difficulties", "shortage of parts", etc.; waited for the client to ask discreetly whether there wasn't "anything" that could be done and to express in advance his "extreme gratitude". By exchanging polite codewords, and ultimately depending upon the willingness of the plumber, it would be agreed that he would return after hours, whereupon the faucet would be magically repaired, on private account. And as Kornai has pointed out in a more general context, the logic behind the way these and other relations of exchange solidified in socialist sellers' markets was precisely the opposite of that prevailing in capitalist buyers' markets. See Kornai, J. (d) Bureaucracy and Market: Introduction to the Political Economy of Socialism. Lecture Notes of Economics 2001, Harvard University Department of Economics, printed transcripts. Vol. 3, 1987-88. pp. 306-309.

Thus the pre-'82 expansion of this informal sector, its partial legalization in 1982, and the fact that this reform of property relations resulted in a dramatic increase of private economic activity (both informal/illegal and newly-legal) against a historical background of cyclical repression was also partly the consequence of a process of institutionalization from below, which can only be understood by examining the micropolitics of the second economy, as well as its points of contact with the state sector and with larger, more visible processes. Detailed analysis of the informal institutionalization of the second economy is beyond the scope of this essay, but are treated in Seleny, A. (b) "The Hungarian Second Economy as Political Arena", dissertation in progress, Department of Political Science, MIT, Cambridge, MA. The process is also summarized in Seleny (a) *ibid.*

42 Hegedüs and Márkus cite two cases in the early 70's from the newspaper Népszabadság (People's Freedom). "An entrepreneur in Budapest who had not been granted an artisan's licence agreed with four cooperatives to run his screw-making machines under their auspices. 27 million forints worth of goods were turned out over the years and sold as products of the cooperatives. The cooperative managers shared in the profits. The small entrepreneur was sentenced to three-and-a-half years' prison and confiscation of property worth 100,000 forints." In another case, "the chairman of a cooperative farming on poor quality land introduced herb production (the court acknowledged his merits in this field). However, a [small] group within the cooperative, including the chairman, produced camomil [sic] in their household plots but harvested and processed it with the equipment of the cooperative. They distributed between themselves nearly one million forints collected for the essential oil. The chairman was sentenced to two year's prison and a fine of 10.000 forints." Hegedüs and Márkus, *ibid.*, p. 280.

43 On the attempt to restrict the agricultural second economy, see Andorka, *ibid.* p. 5. On the process and socio-political significance of its commercialization, see Szélényi, I. (1988) Socialist Entrepreneurs. Embourgeoisement in Rural Hungary. Wisconsin University Press: Madison.

44 De Fontenay *et al*, *ibid.* p. 10.

45 Andorka, *ibid.*, pp. 5-6, and De Fontenay *et al*, *ibid.*, p. 13.

46 Galasi and Sziráczi, p. 22. Hare explains that in the early 70's, hoping to upgrade its industrial plant, Hungary accepted western credits offered on easier terms because of the oil producers' excess liquidity due to high world oil

prices. But a vicious circle of problems ensued. Energy-intensive investments meant that the investments made with the credits were less profitable than they might otherwise have been. Together with the fact that much of the debt was not used for investment at all, but for maintenance of domestic consumption levels, this led to the accumulation of a larger hard-currency deficit in the context of the second oil crisis of 1979. In the early 80's, some of the large payments came due just as the Polish debt crisis intensified the banking community's worries about the creditworthiness of both Poland and Hungary. In late 1982 Hungary was for a time unable to negotiate new credits with western banks, and only "severe domestic restraint" restored the confidence of the banking community. Hare, *ibid.* p. 29.

47 For example, by solving specific problems, improving economic performance in a particular area, or at least conferring the impression that the authorities understood the system's weaknesses and had resulting problems well in hand.

48 I refer here to the various methods used to improve on the "manual" method of elaborating material, product, semi-product, manpower and financial balances. For an analysis of methods of planning in Hungary versus the Soviet Union, see Kornai, J. (c) Bureaucracy and Market: Introduction to the Political Economy of Socialism, Lecture Notes of Economics 2000, Harvard University, Department of Economics printed transcripts: Cambridge. Volume I., 1986-87. pp. 89-95. For more detailed analysis of the various methods and their efficacy, see Kornai, J. (e) Mathematical Planning of Structural Decisions. Amsterdam: North Holland, 1975.

49 Székacs, A. author's interview, September 1990, Ministry of Finance: Budapest. A number of people in the Ministry of Finance or its associated research institute (Pénzügykutató Rt.) who were associated with the 1982 reform and other 1980's reforms had also been involved between 1963-68 with the planning of the New Economic Mechanism.

50 See, for example, Hare, P. (a) "Industrial Development of Hungary Since World War II". Paper prepared for the February 1986 ACLS/SSRC Joint Committee on Eastern Europe Conference: The Effects of Communism on Social and Economic Change: Eastern Europe in Comparative Perspective. p. 35.

51 Kornai, (a) draws the distinction between "naive" and "radical" reformers.

52 István Gábor explains that the expansion of the second economy in the second half of the 60's was the result of several factors, including "the relaxation of the policy of isolation from the West", the consequent "consumption-oriented behavior", and "instrumental relationship" to work. Gábor, I. "Second Economy in State Socialism: Past Experience and Future Prospects", paper presented at the 3rd Congress of the European Economics Association, Bologna, August 1988.

53 External diseconomies of scale are generally understood as the beneficial or negative effects that the production activities of firms bring to bear on one another. However, I want to generalize the concept here to include the beneficial or harmful effects which a group of state monopolies--socialist firms--may have on a factor of production, in this case, labor. Here, there are several externality-generating activities that lower the production or utility of the externally affected parties, including maintenance of administrative labor markets prior to 1968, and thereafter, of firm-level and economy-wide wage controls by indirect means. But fundamentally, the externality-generating activity is the curtailment of workers' choice between self-employment and employment by the state--i.e., the effective abolition of private entrepreneurship. For an interesting discussion of externalities, including an elucidation of the long-standing debates over transaction-costs income-effects (e.g. Coase's theorem, whether the identity of owners matters, etc.) see Demsetz, H. (1988) Ownership, Control and the Firm: The Organization of Economic Activity. Volume I, especially chapters 2 and 7. Basil Blackwell: London.

54 Two distinguished Hungarian economists summarized the pre-'68 system in this way: "central economic management attempted to restrict the enterprises' and employees' freedom of action in the allocation of labour as well as in the determination of wages. It tried to diminish unplanned labour turnover through legal punishments against 'migratory birds', and those who quit their jobs without employers' authorization ('unjustified turnover')". The point of course, is not that capitalist labor markets function purely through the price mechanism, or that socialist ones function solely on the basis of allocation; either characterization would be overdrawn. The authors show that in socialist practice, labor allocation "from the outset included some elements foreign to the nature of a system of obligatory plan targets". The foregoing is simply meant to illuminate differences in the degree to which administrative versus price mechanisms controlled classical socialist labor markets, which, in practice for most

socialist workers, did amount to a difference in kind. See Galasi, P. and Sziraczki, G. eds. (b) Labour Market and Second Economy in Hungary. Campus Verlag: Frankfurt, 1985. p. 12

55 I am not suggesting that labor mobility was illusory--it was in fact quite marked, especially after the '68 reform: labor turnover increased by 74% between 1968-69. See Galasi, P. and Sziracki, G (c) "State Regulation, Enterprise Behavior and the Labour Market in Hungary, 1963-83. Cambridge Journal of Economics. 1985: 9. p. 206 But the impediments for many were considerable. Since housing, which was in drastically short supply, was frequently allocated by the firm, changing jobs was not always practicable. Secondary markets in housing (apartment exchanges) provided options for some. But much depended on skill-levels of the worker, and on the infrastructure not only of housing but of transport (e.g., much simpler to change jobs in Budapest without changing housing than to move from a provincial town or city and find housing in another city or in Budapest). Also, although the "public danger" of "work-shirking" (Közveszélyes munkakerülés) was treated less seriously after 1968, one sociologist notes that in 1984 more than 4,000 people were still convicted of this offence. He points out also that the "work-books" which revealed every workers' employment history to each potential employer strikingly resembled the pre-World War II "cselédkönyv", the work-book of landless peasants employed by large landowners and considered to be members of his household. : "Cseléd" literally means "domestic", or "servant". Just as the socialist worker's work-book (munkakönyv) had to be shown to the prospective employer or surrendered upon demand to the police, the cselédkönyv had to be turned in to each new employer. Róna-Tas, *ibid.* p. 9 n.7.

56 The 1968 reform abolished laws which punished workers for changing jobs, and firms were allowed greater freedom in the management of their labor supply and in the setting of wages. Labor allocation and wage differentials could now become the subject of overt bargaining between employees and state firms. But, "labour market processes could hardly have any influence on the level of earnings since central economic management, by various means, determined the extent and conditions of the increase in earnings both for the whole working population and for individual enterprises". Galasi and Sziraczki, (b), p. 14.

57 Galasi and Sziracki, (b), pp. 15-16.

58 For various perspectives on this and related themes see articles by I. Gábor, I. and Galasi, P.; Kertesi, G. and Sziraczki, G.; and Timár, J. and Kövári, G. in Galasi and Sziraczki, (b).

59 Hare, P.G., Radice, H.K., and Swain, N, eds. (1981) Hungary: A Decade of Economic Reform. George Allen & Unwin: London. On the ratio of living standards to wages, see pp. 49-53. On the outcome of labor-market intervention, see p. 52

60 Fekete, J. "Coup' as a Method of Management: Crisis Management Methods in Hungary in the Eighties", unpublished manuscript, 1990, p. 16. Fekete cites the Central Committee resolution of the Hungarian Socialist Workers' Party, April 19-20, 1978.

61 The assumption of a large foreign debt in the seventies and early 80's, for example, carried tremendous new costs of its own in the form of debt-service, pressure from international financial institutions and, by 1982, near-default.

62 Among the partial successes of the '68 reform: some enterprises, especially smaller and medium-sized ones, did become more flexible and market-oriented; and internal labor markets which developed after '68 had some side-benefits as well, since in the effort to retain workers, firms often tried to tie them to the firms through various informal incentives which sometimes included training programs that served to upgrade workers' firm-specific skills. See Galasi, P. and Sziraczki, G. (c) "State regulation, enterprise behaviour and the labour market in Hungary, 1968-83". Cambridge Journal of Economics. 1985: 9. pp. 203-219. On sources of growth, see Jerome, Jr., R.T. "Sources of Economic Growth in Hungary: 1950-1985". East European Quarterly. XXII:1, March 1988. Jerome argues that economic reforms in Hungary "did no more to change the sources of growth than did those in Bulgaria". p. 113.

63 Author's interview, September 26, 1990, with the economists István Gábor, Péter Galasi, and György Kövári, Budapest University of Economics. Gábor emphasized that the influence of 1956 was mediated through the positive historical experience of agricultural plots. See also Szelényi, I. "Eastern Europe in an Epoch of Transition: Toward a Socialist Mixed Economy?" in Stark and Nee, *ibid.* p. 221; and Bauer, *ibid.*, p. 426.

64 Poland and Hungary began with somewhat different institutional structures (especially in agriculture) and took significantly different routes to transform their economies and polities, so that direct comparison is difficult.

Significant institutional reform began later in Poland, and then proceeded quickly. The main arena of struggle in Poland was clearly the state firm -- which resisted significant institutional reform until 1982, when the enterprise reform law (rescinded by martial law) was reinstated. At that time, on paper at least, the law made state firms self-financing and granted autonomy to managers appointed by elected workers' councils. By 1988, the Ministry of Finance was free to alter the property-structure of firms. In the state sector, informal subcontracting arrangements were pervasive but not legalized as they were in Hungary in 1982. Similarly, the population's retreat to the Polish second economy after the imposition of martial law resulted in the rapid growth of this sector, but it was not legalized in a comprehensive manner as in Hungary. Earlier experiments with joint ventures, leasing schemes, and the (ambivalent) promotion of the foreign-owned Polonia firms notwithstanding, the private sector remained one based on concessions and licences, and a reform of the second economy on a scale comparable to the 1982 Hungarian law did not occur in Poland until 1990. Nevertheless, the Polish case is ambiguous, since by the late 70's, private (especially rural) business was growing as the number of leases and licences given out increased and, as in Hungary, state and Party bureaucrats followed a dual-track strategy of economic advancement by helping family-members and friends obtain licences for private business activities. In the early 80's the opportunities for private enterprise were broadened. In 1982, in the context of reforms aiming to decentralize state-firms, it became possible to start cooperatives or small private firms; and gradually thereafter, restrictions on non-state activity were eased (e.g. 1983 law on cooperatives and 1984 law on economic activity). Solidarity activists and supporters, for instance, fired from state firms in 1982-83, sometimes started private cooperatives to fund their political work. One of the best-known of these was the private consulting firm "Doradca", founded by Jan Bielecki with dissident researchers from the University of Gdansk in 1985. Also in the mid-80's, some state firm managers formed private joint stock companies concentrating on foreign trade by utilizing a section of the 1934 Commercial Code which had remained on the books. However, because in Poland demands for democracy were early linked to demands for economic reform, the progress of the latter was more turbulent than in Hungary. Author's interview with Jausz Lewandowski, then leader of the Liberal Democratic Congress, (now Minister for Privatization), at Harvard University's Center for European Studies, January 1990; and Mizsei, K. "Totalitarianism, Reforms, Second Economy: Logics of Change in the East European Economic Systems", paper presented at a conference on "The Effects of Communism on Social and Economic Change: Eastern Europe in Comparative Perspective", Bologna, June 1986. On Polish economic reform, see especially pp. 25-27, and on the expansion of the private sector, pp. 33-39.

65 Hankiss, E. (b) "Demobilization, Self-Mobilization, and Quasi-Mobilization in Hungary, 1948-1987". East European Politics and Societies. 3:1. 1988. p. 126.

66 In 1978, the National Planning Office undertook a major survey of the second economy, and the process of drafting a reform program which followed is characterized as "coup-like" by Fekete, *ibid.* pp. 15-16.

67 Among them were István Gábor, Péter Galasi, Pál Juhász, Tamas Kolosi, and Robert Manchin. Fekete, *ibid.* p.18

68 The purpose of the media campaign was to try to get people to accept the legalized second economy as a part of the plan to build a better socialism: it was necessary precisely because the public had become accustomed to rhetoric condemning informal private enterprise as corrupt, and its practitioners as "exploitative speculators".

69 The plots could be given back to the coops.

70 Author's interview, Sept. 26, 1990, *ibid.* This point was made by Péter Galasi.

71 Author's interview, Sept. 26, 1990, *ibid.* The opinions of Gábor and Galasi were not given much play in the document put together by officials from the Planning Office after the committee's two meetings. The economists had emphasized that although the liberalization of the second economy was desirable, the process itself would be fraught with contradictions, tensions and unforeseen economic consequences.

72 Fekete, *ibid.* p. 20.

73 From interviews conducted in the Planning Office by Fekete, *ibid.*, pp 21-22.

74 As mentioned in n. 73 above, some experts did speak out against the view that the second economy and the socialist sectors could be harmonized. For a compelling theoretical analysis of the relationship between work and politics, and West-European case studies, see Sabel, C. (1982) Work and Politics: the Division of Labor in Industry. Cambridge University Press: Cambridge.

⁷⁵ In a frequently-used metaphor, Hungary was depicted as the "merriest barracks" in the socialist bloc. The expression had its origins in, among other things, the relative abundance of foodstuffs, and in Kádár's famous mid-60's statement: "He who is not against us is with us." While the national trauma of 1956 was the original cause of increased tolerance for reform, some of the specific historical developments which account for this overall appearance of relative abundance and flexibility can be traced to the so-called alliance policy (whereby from the mid-60's non-party experts were incorporated into government agencies and often advised the government and the Party); the aforementioned cyclical tolerance of informal second economy activities; and by the mid-late 80's, tolerance, within narrow limits, of some informal religious and quasi-political associational activities. See Hankiss, (b) *ibid.*, and on the alliance policy, Bauer, *ibid.*

⁷⁶ Like almost everything else about the 1982 regulations, this too was somewhat ambiguous. Ultimately the day-to-day efforts to harmonize the complex regulations fell to the Ministry of Finance, although some types of firms were registered with the Court of Registry, bringing them under constitutional authority.

⁷⁷ In principle, restrictive regulations could have so strangled the private sector that expropriation would not have been necessary. But, although tax regulations, for example, did become increasingly burdensome after 1985, and some among the leadership seemed to see the private sector as nothing more than a cash-cow, events after 1982 show that once new rights are granted to social actors, the pressure to broaden them grows from the internal logic of enfranchisement.

⁷⁸ Fekete, *ibid.* p.16-20 explains that many bureaucrats did not even think the proposal would pass the Central Committee; and on pp. 23-24 shows that most in the Planning Office believed that the proposal would only be implemented in the long-term, if ever. Those who were aware that the proposal had received high-level approval believed that the authorities would be able to calibrate the pace and scope of the reform. Some even saw the reform either as a temporary expedient--a stopgap measure that could be rescinded at a future date--or simply accepted it as a mechanical redefinition of "acceptable" limits on private activity without questioning too deeply the potential significance of such redefinition. Second economy actors, on the other hand, either mistrusted the reform and/or found it economically disadvantageous to convert informal activities to legal ones, or welcomed it but seriously doubted any potential wide-ranging effects. By 1988, a few entrepreneurs with whom I spoke envisioned the possibility of overtaking competing state firms in quantity of production (having already exceeded them in quality), but saw the possibility as exceptional, applying only to a given product area or firm, and again, with little or no direct political significance. Author's interview, Futó Péter, manufacturer and exporter of candy, November 1988; Gerő Péter, Director of Colorplan, a manufacturing firm involved in the production of electrostatic painting equipment and a number of spin-off machines adapted from the original process, which have applications in medical and other fields.

⁷⁹ Interview, Székács, A. Ministry of Finance, *ibid.* Again, the evidence is conflicting. Some seem literally to have been caught in their own rhetoric, others appear to have applied language tactically, with utmost precision and care, in an effort to increase the chances that the reform package would be accepted by the wider Party membership.

⁸⁰ Notably the VGMK, which institutionalized earlier informal bargaining between skilled workers and state-firm managers.

⁸¹ After '68, state farms (as opposed to agricultural cooperatives), schools, etc. provided small plots of land to their employees, in order to retain their manpower, which otherwise "would have diminished rapidly in consequence of outmigration from rural areas". Andorka, *ibid.* p. 5.

⁸² Prior to 1982, the number of workers who could be legally employed on a full-time basis was between 7 and 11, including family-members.

⁸³ In 1972, about 23% of this was marketed, the rest was for household consumption. These plots produced 49% of the vegetables, 54% of grapes, "35% of the gross value of cattle husbandry and 55% of the value of swine husbandry". Andorka, *ibid.* p. 9.

⁸⁴ See Kolosi, T. "Jövedelem, kereset, társadalmi helyzet" (Income, Earnings, Social Position). *Társadalmi Szemle*, No. 10, 1983, and Gábor, I. and Galasi, P. "Second Economy, State and Labour Market", in Galasi and Sziráczi, eds. (b) *ibid.* pp. 130-131.

85 For example, small independent enterprises were formed by breaking off from a large trust or enterprise. The former were no longer subject to many types of detailed administrative interference and reporting requirements, and no longer received subsidies or access to materials through the parent organization, which, correspondingly, could no longer siphon off resources from the newly-independent enterprises. Also, prior to 1982, only a ministry, some other national agency, or a local council could found an enterprise. After 1982, enterprises could establish subsidiary companies. See Hare, P. (b) "The Beginnings of Institutional Reform in Hungary", *Soviet Studies*. XXXV:3. July 1983, pp.323-325; and Comisso, E. and Marer, P. "the Economics and Politics of Reform in Hungary". *International Organization*. Spring 1986. 4:40 No. 2. For the rationale behind the whole range of institutional reforms undertaken in the early 80's, and for a description of what he called the "menu" of models needed to introduce flexibility into the Hungarian economy, and the legal and organizational form of each, see Sárközy, T. "Vállalattípusok és a jog" (Enterprise Types and the Law). *Gazdaság*. 15:1, no. 3, 1982. pp 80-103.

86 Kornai notes that it was not just a matter of "repeal[ing] old legislation and introduc[ing] new laws", but also of the "relaxation in the enforcement of old laws and governmental directives". Kornai, J. (f) "Individual Freedom and the Reform of the Socialist Economy", presidential address delivered at the Second Congress of the European Economic Association (Copenhagen, August 1987). pp.14-15.

87 See Buky, B. "Hungary Tries Small Enterprises on a Large Scale". RFER Background Reports (Hungary), 12 October 1981.

88 The 1982 statute merely states that "as a rule, the size of small enterprises [and private cooperatives] will be smaller than that of enterprises in similar activities". See Laky (a) "Small Enterprises in Hungary--Myth and Reality". *Acta Oeconomica*. 32: (1-2) 1984. p. 43 Some private firms employed significant numbers of hidden workers. In 1988-89 I interviewed the managers or directors of several small cooperatives and GMKs which employed a hundred or more people on a part-time, piece-work basis without reporting them to the authorities or paying their social security contribution. Frequently these were women working at home. Summary reports of interviews forthcoming in Seleny, A. (b) doctoral dissertation, Department of Political Science, MIT: Cambridge.

89 See Laky, T. (b) "The Hungarian Case". Paper prepared for the IV. World Congress on Soviet and East European Studies, 21-26 July, 1990, Harrogate, England. p. 20 table 5 shows that in 1988 there were 16 small cooperatives and partnerships (GMK's, PJT's) that employed between 301 and 500 people; and 3 with 501-1000. This is a distinct minority, of course (19 out of about 130,000 using the categories of this particular study), and one analyst and participant in the 80's reform process wrote that since most GMK's and small cooperatives had not even been able to employ as many people as the 1982 regulations allowed, the 500 limit in the 1989 Law on Association represented more a political statement than anything else. Sárközy, T. (1989) *Ezt kell tudni a Társasági Törvényről*. (What You Need To Know About the Law on Association) Magyar Media: Budapest. p. 12. It should be said that the 500-employee limit did not apply to corporations. An individual who incorporates, or an incorporated firm, can join with other legal entities and hire unlimited numbers of workers.

90 However, by 1988 there were already 290 limited liability companies with a membership of 9621. Laky (b) p.16.

91 Licencing procedures were liberalized for artisans. In addition, their full-time personnel limit was increased first to ten, then thirteen, and by 1987, 30, and they could do business with state firms. Strict employment limits in retail trade were also lifted. See Laky (b), p. 18. Prior to 1982, private artisans could work together only in very limited numbers--five in services and two in other areas. (Róna-Tas, *ibid.* p.31.) The 1982 regulations lifted such restrictions and also encouraged cooperative ventures among entrepreneurs.

92 One 1984 estimate put the number of private artisans alone -- people who provided services or were involved in the small-scale production of goods like shoes, clothing, chemicals, plastics -- at 100,000-120,000. Laky (a) p. 39 and p. 46. Also, from the late seventies, state-owned shops and restaurants had been leased to individuals, and by 1988, there were about twelve thousand such leases.

93 The professional preconditions had to do mainly with minimum required investments for the various partnership forms and the presentation of a feasible business plan to the local authorities. The legal regulations were widely disseminated, "how-to" books began to appear in 1982-83, and officials from the Ministry of Finance gave frequent lectures and seminars on the new laws. Those held at the universities were mostly attended by lawyers and other specialists, but were open to the public. Officials also held such talks at many state firms and institutes. Author's interview, Székács, A. *ibid.*

⁹⁴ Some restrictions on international trade also applied, but I interviewed several small cooperatives and GMK's in 1988 which were involved in extensive and quite successful foreign trade with West European clients (primarily export of manufactured goods and processed foods to Austria and Germany). A minority of small traditional artisanal and retail businesses had also been involved in foreign trade. The practical difficulties, however, could be daunting, particularly the limited access to foreign exchange. Such businesses were only allowed to keep a certain percentage of foreign exchange earnings, so that any production process requiring significant hard-currency imports was likely to be at a disadvantage.

⁹⁵ Laky (b) p. 11.

⁹⁶ In 1982, there were 2,336 GMK's with 11,914 members; in 1988 there were 10,889 with 72,199 members. The share of full-time members throughout the period remained about 28-30%. Laky (b), pp.13-14. On the types of services performed by GMK's, see Laky (a) p. 47-48.

⁹⁷ 3% plus an individual tax in proportion to the members' incomes. Laky, (b) p. 15. Of course, it was not necessary to form a PJT in order to lease or rent a single state-owned restaurant or shop; individuals could do this as well, and as we have seen, individual artisans or retailers could also apply for licences to open their own shops. But according to Laky, after 1987, most PJT's were created exclusively to carry on retail trade or as restaurants/caterers, and because of the nature of their work, the PJT's by 1988 had the highest share of full-time employment among the partnership forms (77%). In 1988 there were 3,284 PJT's with 14,872 members.

⁹⁸ Laky (b) p. 46.

⁹⁹ Sometimes by avoiding the creation of indivisible capital, and simply sharing privately-owned machinery, vehicles, etc. informally. If indivisible capital was created, and a member wanted to leave the cooperative, he or she could be reimbursed from the profits of the business, i.e., bought out by other members.

¹⁰⁰ In practice, however, most employed fewer than 100. In 1982 there were 145 small cooperatives, all with fewer than 100 employees. By 1988 there were 2,847 private coops, of which 83% employed fewer than 100, 16% employed 101-300 people, and 1% (21 cooperatives) employed more than 301. Laky (b) p. 10-11.

¹⁰¹ As previously mentioned, informal relations continued within the framework of the newly-legal partnership forms. VGМК members would sometimes distribute "envelope payments" to non-members who assisted them on particular projects, much as their bosses had paid them informally for extra work prior to the establishment of VGМК's.

¹⁰² Laky (b) p. 40

¹⁰³ The majority of VGМК's were actually established not in the industrial enterprises, but in "research laboratories, state farms, design institutes, service companies and even cooperative farms". Construction was one area in which some VGМК's did operate as joint-ventures with their firms, rather than simply producing to meet firms' goals in their main lines of production, to maintain firms' equipment, etc. Laky (a) p.39. For an analysis of the VGМК's as "specialized work-brigade", see Laky, (b). p. 12 and (a) p. 50.

¹⁰⁴ Laky (a) p. 49-50. See also Csillag I. "Az új "vállalati" szervezet alapvonásai" (Basic characteristics of the new "enterprise" organization) *Valóság* 1983:7. VGМК's did, in fact, proliferate quickly. In 1982, 29,000 employees earned extra income from VGМК participation; by 1986 the number reached 268,000. For reasons having to do mostly with the new personal income tax law of 1988 and also with new tax regulations applying to state firms doing business with private ones, the number of VGМК's began to decrease in 1988. Laky (b) p.12.

¹⁰⁵ For analysis of the impact of VGМК's on state-firms and on workers' views of their roles at work, see Stark, D. "Rethinking Internal Labor Markets: New Insights from a Comparative Perspective", in the *American Sociological Review*, 1986, Vol. 51 (August: 492-504). See also Sabel, C. and Stark, D. 1982. "Planning, Politics, and Shop-Floor Power: Hidden Forms of Bargaining in Soviet-Imposed State-Socialist Societies". *Politics and Society* 11: 439-75.

106 JGMK's (Jogi gazdasági munkaközösségek) are civil law work partnerships, and "KKT's" (közkereseti társaság) are joint investment companies.

107 Laky (b) p. 13 In 1982 there were 501 specialized groups with 17,084 members. In 1988 there were 1530 such groups with 47,828 members and employees. Laky also notes that in 1987, "among the 10 partnerships with the most fixed assets 6 were specialized groups; from among the first 50, 13".

108 Economist Intelligence Unit. Hungary: Country Profile 1990-91. World Microfilms Publications, Ltd.: London 1990. p. 9

109 See, for example, Kovrig, B. "Hungarian Socialism: The Deceptive Hybrid". Eastern European Politics and Societies. University of California Press: Berkeley. p. 122.

110 Kovrig, *ibid.*, puts the figure at 98% of the means of production as public ownership in 1987; the true present figure is virtually impossible to come by, as state firms are in the process of being privatized, and the way many of them are being spontaneously privatized by former managers and enterprise councils places the concept of privatization itself in question. However, I base my calculation on figures of the value of state firms privatized in 1989, which amounted to about 2.5% of total state property, according to Petschnig, M.Z., (1990) Jelentések az alagútból III. 1990. (Reports from the tunnel) Pénzügykutató Részvénytársaság: Budapest. p. 83. If we include joint ventures, the primary means by which about a tenth of Hungarian firms have been privatized or partially privatized (The Economist, "Italy on the Danube", February 23 1991, p. 48) we would arrive at the more liberal estimate of 90% state ownership. However, for a revealing assessment of the particular brand of privatization taking place in Hungary, see Sajó, A. "The Struggle for Ownership Control: The New Content of State Ownership Forms in Eastern Europe". International Journal of the Sociology of Law. 18:1990. The estimate of second economy contribution to GDP is István Gábor's, quoted most recently in The Economist, *ibid.*

111 Szelényi, I. *ibid.* in Stark and Nee, p. 224.

112 The example is from the author's interview with a private firm followed over almost three years, which in 1990 formed a joint venture with a subsidiary of Medicor, the first Hungarian firm to be decentralized in 1987. Seleny, A. (b) *ibid.* This works in reverse, too. Sociologists David Stark and János Lukács encountered fictive "private" KFT's (limited liability companies) set up by state firms, to which workers referred as VKFT, (enterprise KFT), "signal[ling] that the VKFT have no more autonomy than the VGMMK". See Stark, D. "Privatization in Hungary: From Plan to Market or from Plan to Clan?" Working paper #90.2 on Transitions from State Socialism, Cornell University, Center for International Studies. p. 26, n.14.

113 Seleny, A. (b) *ibid.* The information is based on the author's Fall 1990 follow-up interviews with entrepreneurs originally interviewed in 1988-89. Some of this behavior appears to be predicated on surviving informal networks of trust (workers who knew one another in state firms and conducted informal business on the side together); some of it seems to be motivated by the universal need to adjust quickly to changing market conditions and demand fluctuations. See Sabel, C. *ibid.*, and Piore, M. and Sabel, C. (1984) The Second Industrial Divide: Possibilities for Prosperity. Basic Books: New York. For example, a Hungarian private GMK, originally licenced by a West German firm to sell (in 1983) and later to manufacture and adapt machinery and equipment developed by the German firm, faced significant competition by 1990, and was scrambling to develop new products and services to maintain its market share.

114 Fekete, J. (1984) Adalékok a Kisvállalkozás Jelenségrendszeréhez. (Contributions to the phenomenon of small enterprise) ELTE: Budapest. pp. 28-29, tells the story of a speaker from Budapest's Party Directorate of Education (MSZMP BPB Okt. ig.) who in 1981 assured his audience at the political economy department of Budapest's Karl Marx University that in 1983-84 they could expect about 100-150 small firms and cooperatives to be formed, and over the next 2-3 years, about 400-500 VGMMK's and GMK's. The actual numbers in March of 1984 were: 520 small firms and cooperatives; and 16,953 VGMMK's and GMK's together (to say nothing, of course, of the other private and quasi-private property forms).

115 The transmission-belt representative organizations included KIOSZ, the small manufacturers' organization, KISOSZ, the small retailers organization, and OKISZ, the small cooperatives' association. My evidence for the internal disruption of these organizations comes from interviews with the director of the Budapest office of KIOSZ and with middle-level managers there. See Seleny, A. (b) *ibid.*

116 The entrepreneur's party was never very large or powerful, since the entrepreneurs were not a unified political bloc in Hungary anymore than elsewhere. But in 1988, the Smallholders' Party re-established itself. It had been the strongest political party from 1945 to '48, and again advocated a strong private sector, especially the reprivatization of land. Over the next two years, the interests of the private sector began increasingly to figure in the platforms of the other major independent parties as well.

117 As we have seen, the State got much more than it bargained for, and the entrepreneurs less: the former lost "control" and the private sector, however dynamic, is still in some important respects a "second" economy, although this is changing.

118 It would have been virtually impossible by the late 70's to find anyone who did not spend some portion of their income on goods or services directly or indirectly produced in the second economy. However, it is not the contention of this paper that the second economy was the only locus of and incipient alternative politics: other informal groups--dissidents, religious associations, groups organized around shared intellectual interests or cultural pursuits--all helped build what Elemer Hankiss called the "second society". See Hankiss (a) and (b).

119 Notably in credit allocation and access to scarce inputs.

120 Benton, L. (1986) The Role of the Informal Sector in Economic Development: Industrial Restructuring in Spain. Unpublished dissertation, Johns Hopkins University: Baltimore. See especially chapter 3 on the electronics industry in and around Madrid.

121 Gábor, I. (1990) "On the Immediate Prospects for Private Entrepreneurship and Re-Embourgeoisement in Hungary". Unpublished paper. Budapest University of Economics. p.14.

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