Introduction

The countries of Eastern Europe and the former Soviet Union are engaged in the transformation of their economies, away from central planning and social ownership of the means of production and toward the use of the market to allocate resources and private ownership to provide effective stewardship over productive assets. The success of this transition depends to a large extent on developments in the industrial sector of these countries because industry is the largest employer and produces the largest share of output in their economies. Moreover, it is the success of the industrial sector in increasing productivity, restructuring production, and penetrating Western markets that will, to a great extent, determine the speed of transition and the social and economic costs that will have to be borne by these societies. It can be argued that it is in the industrial sector of these economies that the greatest distortions and shortcomings in resource allocation and managerial efficiency are to be found, the result of both mistaken domestic policies and the distorting effects of integration within the framework of the Council for Mutual Economic Assistance (CMEA).

The crucial role of the industrial sector is evident in the focus of policy makers on reforming and privatizing industry and in seeking out foreign investors and technology. At the same time, the industrial sector of the East European countries has had to absorb a series of shocks that have exacerbated the historical burdens placed on it by its communist past. On the domestic front, the demand for industrial output has been reduced in a number of ways. Price liberalization has led to outbursts of inflation, and although inflation has subsided in Czechoslovakia, Hungary, and Poland, real wages, and thus purchasing power and wealth, have declined. At the same time, relative prices of food and other basic consumer goods have risen with the elimination of consumption subsidies. As a result, because the demand for necessities is relatively inelastic, the share of household budgets devoted to purchases of industrial goods came under pressure. Tight domestic monetary and fiscal policies, combined with a slump in consumer demand and uncertainty about the future both in terms of wholesale changes in ownership and management and in terms of restructuring, have served to reduce investment sharply, thus reducing demand for machinery and equipment as well as for construction activity.

External shocks have also taken their toll. The collapse of CMEA trade, and particularly of the import demand of the USSR, had an incalculable effect on East European industry, some of whose sectors were almost totally dependent on the Soviet market. At the same time, as these countries began their reorientation toward the West, the rapid liberalization of their trade regimes brought a wave of new competition for East European industry as Western goods were free to enter East European markets.

Much of this story, including the effects of past legacies and the transition policies as well as of the temporary external shocks, is told by the aggregate data on industrial output, employment, and prices. In Czechoslovakia, industrial output fell by 3.5 percent in 1990 and then by 24.7 percent in 1991 under the double impact of the "big-bang" reform of January 1, 1991, and the collapse of exports to the USSR. In 1992 it fell by another 11 percent, although by the last two quarters the decline had been arrested and evidence of output growth began to appear. In Poland, the "big bang" of January 1, 1990, led to a decline of 14.2 percent in that year's industrial output, and the following year it fell by another 11.9 percent as exports to the USSR dried up. In 1992 there was no decline in industrial output, and, as in Czechoslovakia, signs of an upswing in industrial production were evident. In Hungary, industrial production declined steadily, falling 9.6 percent in 1990, 19.1 percent in 1991, and 10.4 percent in 1992. Interestingly enough, Hungary had no "big-bang" reform comparable to those of the other countries, although it shared with them the shock of the collapse of exports to the USSR; yet it suffered a decline in industrial output of comparable magnitude. Employment declines were everywhere less than the losses in output, but in all countries save the Czech Republic they exceeded 10 percent by 1992, having started from zero in 1989. The Czech Republic's unemployment level peaked at 4.1 percent in 1991, and in 1992 it was down to 2.1 percent. Inflation in Czechoslovakia and Poland peaked in the years of the "big bang," reaching 586 percent in Poland in 1990 and 58 percent in Czechoslovakia in 1991. It subsided rapidly thereafter, falling to 70 and 40 percent in the two following years in Poland and to 11 percent in Czechoslovakia in 1992. In Hungary, there was no "big-bang" price reform, and inflation continued at a moderate rate, rising from 28 percent in 1990 to 35 percent in 1991 and then falling to 21 percent in 1992.

Yet these aggregates reveal only part of the story. The other part cannot be expressed in numbers, because it is the human story of enterprise managers and workers attempting to deal with the unfolding events. Every firm in Eastern Europe is being forced to reassess its competitive strengths, its strategy for survival, its organization, and its role in the broader world economy. It is the outcomes of these individual decisions that will drive the trend of industrial output in future years.

This book uses two approaches in order to give a detailed portrait of Hungarian industry in the context of a sweeping transition in the political and economic system of the country. The first approach is relatively broad: basic indicators of macrolevel industrial performance are analyzed first for the 1980s and then, after a policy analysis for the same decade, for the transition years 1988–91. Exhaustive statistical material is provided to support the performance analysis as well as to help understand the policy assessment. Macropolicy issues influencing industrial development are also discussed. First we provide analyses of the policy issues of the 1980s that had the greatest relevance for industry, with a majority of these issues being related to the economic reform. It has to be seen that some of these topics—price reform, for example—have already lost their relevance. The analysis of the pre-1989 period is important not so much for the economic results obtained during that time as for the economic system that was created in Hungary and the consequences that unique economic system had for reform in the subsequent period. As we shall argue, the reform measures of the pre-1989 period were conceptually flawed and ineffective when judged from the standpoint of decisive improvements in economic performance. Yet they created an economic milieu that included considerable independence for state firms, a nascent private sector, and a certain comfort with non-*dirigiste* methods of influencing economic activity that permitted post-1989 policy makers to proceed in a way that would have been impossible in Czechoslovakia or Poland.

For the period after 1989, we take a different approach. We focus on the options of industrial policy in the new economic environment. This implies that reform has completely disappeared from the agenda due to the very fast changes of the political and economic scene in the country and that industrial policy has to be defined in more or less the same intellectual and interest framework as in "genuine" market economies.

The second part of the book presents the results of interviews with the managers of typical Hungarian enterprises. These interviews were carried out in 1991, with reinterviews, whose results we also report, begun in the spring of 1992. The interviews sought to elicit information about the problems Hungarian firms were facing and the measures that were being taken to deal with them. In some firms, strategies for survival and growth were in place, although only time can tell whether these strategies will be successful. Other firms had no strategies other than a policy of "drifting," continuing operations in the old way, incurring losses and depleting assets. While the lack of responsiveness of these drifting firms is some cause for dismay, it must be borne in mind that the birth and death of firms is a natural and necessary part of the renewal of the economy.

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