Privatization in Hungary: From Plan to Market or From Plan to Clan?*

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From Reform to Transformation

For nearly three decades, the conception of reform of the state socialist economies of East Central Europe was dominated by the search for the correct mix of plan and market within the state sector. By the mid 1980s a new conception of reform emerged in Hungary focusing on the small-scale private sector, as economists debated the correct mix of public and private ownership across sectors of the economy. The year 1989 witnessed, in both Hungary and Poland, a fundamental break with these conceptions of reform: rather than simply stimulating the expansion of the traditional private sector, policy makers began designing a variety of measures for the privatization of the public sector itself. Whereas previous debates addressed questions of how to *reform* the economic mechanism of state socialism, current efforts seek to *transform* the fundamental institutions and property relations of these societies.

This shift represents the speedy divorce, after a trial separation, between Hungarian economics and the enchanting concept of “market socialism.” The lesson of the last twenty years of reform experiments in Hungary, its economists now conclude, is that the dominance of public—that is, state—ownership is fundamentally incompatible with market coordination.¹ And, since there is no one in Hungary today who

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1. This is not the place to explain the rapidity or the depth of the conversion from reformation to transformation. For an account of the “plan-market discourse” and its continued legacy, despite rhetorical shifts, in the contemporary period see János Mátyás Kovács, “Reform Economics: The Classification Gap,” *Daedalus* 119:1 (Winter 1990), pp. 215–48. The first major critical salvo against the assumptions of reform economics was fired by István Gábor in “Reformok, második gazdaság, államszocializmus: A 80-as évek tapasztalatainak felölelési és

speaks with any credibility against market coordination, virtually every party and every economist argues favorably for privatization of state property as the necessary road to marketization.

But if there is widespread consensus among economists, politicians, and policy analysts about the necessity and desirability of privatization in principle, there is considerable disagreement about how best to carry out such a program. From early 1989 to the present (May 1990), the privatization issue has been fiercely debated in Hungary's scholarly literature, newspapers, business press, and popular media. This paper seeks to clarify the main issues in that debate.² Rather than summarizing the policy packages of different political parties or of particular economists, my aim is to distill the major analytic dimensions that structure and shape that discursive field. I argue that the privatization debate can be analyzed along four independent dimensions:

- foreign versus domestic ownership;
- spontaneous privatization versus privatization controlled and directed by state agencies;
- institutional versus natural ownership; and
- concentrated versus dispersed ownership.

összehasonlító gazdaságtani tanulságairól" (Reforms, second economy, state socialism: Speculation on the evolutionary and comparative economic lessons of the Hungarian eighties), *Valóság* 6 (1986), pp. 32–48. János Kornai further challenged the illusions of reform economics, but refrained from making the link between markets and private property in "The Hungarian Reform Process: Visions, Hopes and Reality," in Victor Nee and David Stark, eds., *Remaking the Economic Institutions of Socialism: China and Eastern Europe*, Stanford University Press, 1989, pp. 32–94. The fundamental question of ownership was raised in the scholarly literature by Márton Tardos, "A tulajdon" (Ownership), *Közgazdasági Szemle* 35:12 (December 1988), pp. 1405–22 (which has appeared in English as "Economic Organizations and Ownership," *Acta Oeconomica*, 40:1–2 (1989), pp. 17–37) and by János Kornai, "A tulajdonformák és koordinációs mechanizmusok affinitása," *Valóság*, 33:1 (January 1990), pp. 1–15 (forthcoming in English as "The Affinity between Ownership Forms and Coordination Mechanisms: The Common Experience of Reform in Socialist Countries," *Journal of Comparative Economics*).

2. Materials for this presentation are drawn from the Hungarian business press, from lengthy discussions with Hungarian economists, from interviews with managers and employees at several large Hungarian enterprises conducted in January 1990 (in collaboration with János Lukács), and from interviews with officials of the outgoing government, the Hungarian Socialist Party, and leading figures in the major opposition parties conducted in January and April 1990 (in collaboration with László Bruszt).

These four dimensions are not reducible to each other, i.e., a position along one does not imply a particular position along another. Institutional ownership, for example, could be spontaneous or controlled, concentrated or dispersed.³ A comprehensive delineation of the various permutations would thus yield a grid on which we could map the particular policy packages of various models of privatization. My task here is not to locate competing actors (parties or persons) on such a map but to chart its principal axes and identify the major points of orientation.

To this end, the rhetoric of exposition in this paper is dialogic. But this is not a dialogue between the analyst and the observed so much as between stylized interlocutors within the Hungarian debate itself. That is, the logic of exposition in this paper is to counterpose arguments along the various dimensions presenting, at one moment, the strongest case for a given position and, at the next, the strongest criticism from the countervailing position. The resulting dialogues between these stylized interlocutors constructed below read at times like heated conversations among actual participants, but it should be emphasized that our method here is not reportage or documentary. Instead, the positions are analytically constructed and the expository dialogue a device to explore the central problems of privatization. By repeatedly taking alternative sides, we appreciate the merits of each position and thus portray the full perplexity of the dilemma and the rich complexity of the debate.

For all too many Western observers, the severity of the economic crises in the countries of East Central Europe appears as an open invitation to offer policy prescriptions for measures to bring about the full marketization of these economies. At the same time, the dramatic changes being proposed elicit equally well-meaning advice from other Western observers who, with an equal dose of paternalism, urge caution on Polish and Hungarian policy makers perceived to hold naive views about "the market." The perspective adopted in this paper differs from both of these tendencies: Rather than advocating or deploring marketization, it takes as its starting point the terms of the Hungarian debate itself. But the consistent pursuit of such a strategy yields conclusions unanticipated at the outset. By presenting not only the arguments

3. Some combinations of positions along the various dimensions are logically or practically improbable. A particular policy package favoring foreign-controlled-dispersed-natural owners, for example, is highly unlikely.

for various positions but also the serious criticisms against each position, a careful analysis of the debate reveals not only the compelling desire for marketization but also the enormous obstacles to achieving it. Indeed, it suggests the need to question the underlying assumption, shared by all the participants in this debate, that privatization will inevitably yield extensive and comprehensive marketization. Private ownership might indeed be necessary for thorough marketization, but it may not be sufficient. Institutions that are appropriate for the stable reproduction of market relations might prove inadequate to secure the *transition* to a market economy.

Political Context of the Debate

The period under analysis here begins in the final months of 1988 and concludes with the formation of a new government in May 1990. It thus includes the waning months of rule of the Hungarian Socialist Workers Party (MSzMP) which, challenged by economic crisis, enormous foreign debt, and the open formation of opposition parties, responded with a series of dramatic moves in the fields of foreign policy (asserting increasing autonomy from the Soviet Union), economic policy (opening the country, in principle, to large-scale direct foreign investment), and domestic policy (with the expressed commitment to “multiparty elections”). From the vantage point of Western observers these measures seemed innovative and daring. From the vantage point of hardline leaders in Czechoslovakia, Bulgaria, Romania, the GDR, and factions in the Communist Party of the Soviet Union, they appeared precipitous and threatening, yielding too much too soon. But from the vantage point of the Hungarian domestic scene—where opposition forces were uniting in an umbrella federation, where the party’s base was crumbling, and where high-level civil servants, enterprise directors, and members of Parliament were openly defecting from party discipline—these and other measures appeared increasingly desperate, a case of too little too late.

Yet unlike Czechoslovakia, Romania, and the GDR, in Hungary the party-state did not collapse. Rather, its demise was negotiated. On June 10, 1989, six days after the electoral debacle of the Polish United Workers Party and six days before the scheduled public ceremony for

the reburial of Imre Nagy and his associates from 1956, the leadership of the Hungarian Socialist Workers Party announced its willingness to negotiate with representatives of nine opposition groups to establish conditions for contested elections, competitive political parties, and parliamentary governance. These new rules of the political game were the product of an enormous negotiating machinery involving twelve subcommittees (six on political questions, six on economic topics), over 500 participants, and some 300 negotiating sessions that took place during the summer and concluded in mid-September, 1989. In the aftermath of these roundtable negotiations, a referendum in late November shattered the hopes of the new Hungarian Socialist Party that its leader, Imre Pozsgay, would be elected as the country's President, and postponed Parliamentary elections until the spring of 1990. These elections were won by the Hungarian Democratic Forum (MDF), which formed a coalition government with the Independent Smallholders and the Christian Democrats in May 1990.

The three month duration of the roundtable negotiations and the almost eight month hiatus between the signing of the roundtable agreements and the formation of a new government meant that the initial phase of regime-transition in Hungary was a protracted affair. More importantly, for purposes of this paper, the negotiated transition to democracy had the consequence that the debate over economic transformation occurred in a kind of political vacuum.

From June 1989 to May 1990, the institutions of the Hungarian state faced a peculiar type of legitimation crisis. By sitting down to negotiate in earnest about competitive elections (in hopes that it might yet emerge with a plurality of the citizens' votes), the reform faction of the Communist party signalled the exhaustion of the paternalistic principles upon which the old authoritarian order had claimed legitimacy. Yet a constitutional government freely chosen, grounded on new legitimacy claims based on civic principles, had not yet been elected or installed. New political institutions existed on paper, but they were not yet functioning. Old figures of the previous government remained in office, but these were caretakers at best, with little authority to take decisive action.

Hungary in the latter half of 1989 and the first half of 1990, however, was decidedly not an instance of dual power so much as a

devolved or dissolved power. For there was no national organization even remotely comparable to Poland's Solidarity. The membership of Hungary's youthful independent trade unions numbered in the thousands, and the opposition parties (newly legalized as a consequence of the roundtable negotiations) had not yet taken root in society. As public opinion polls conducted at the time revealed, trust in the opposition parties actually declined during the summer months of protracted negotiations and, near their conclusion, a majority of the voting-age public was at a loss to name even a single opposition party.⁴ This crisis of political authority, meanwhile, was combined with an explosion in the public sphere as dozens of new periodicals appeared at the most commonplace kiosks, and investigative reporters of even the formerly government-controlled newspapers and broadcasting stations pursued stories with a competitive fervor unprecedented in Eastern Europe.

The debate over privatization thus took place in a context in which the formal mechanisms of governance of the old order were decomposing, while the political and societal institutions of a new configuration were only in formation. Through the new (and revitalized) media the debate was addressed to a public eager for information but still largely unorganized. If "society" was reclaiming space from "the state," this was a civil society in infancy. As citizens, Hungarians could hear alternative representational claims from the new opposition parties, but patterns of party identification were weak to nonexistent. As workers, they were still unrepresented; and the considerable number among them in part-time private economic activity were not organized and lacked formal channels to represent their interests.

The future course of the privatization debate, subsequent to the formation of a new government in May 1990, will take place under different circumstances. At the center of the new political context will be, of course, the coalition government of the MDF, Smallholders, and Christian Democrats as well as the evolving role of the Free Democrats, Young Democrats, and the new Socialists as parliamentary opposition parties. No less important than competition among the new political elite is the vital question of whether the nascent Hungarian civil society will emerge from incubation as a mature and healthy democratic soci-

4. For a comprehensive analysis of public opinion polls conducted in the four years preceeding the election see László Bruszt and János Simon, *A lecsendesített többség* (The Silenced Majority) (Budapest: Társadalomtudományi Intézet, 1990).

ety. It is not the purpose of this paper to speculate about this new context, but rather to spell out the issues around privatization as they have emerged in debate over the past eighteen months. For although the political context will doubtless change, the issues, problems, and dilemmas revealed in that debate will remain.

The Major Dimensions of the Privatization Debate

I. Foreign versus Domestic Ownership

As a small country with a relatively high percentage of its gross national product involved in foreign trade, the Hungarian economy has long been accustomed to strangers in its midst. But for the better part of the postwar period, foreign participation in channeling and directing resources came from the East in the form of COMECON trading agreements that designated some part of the output of key industrial branches for ruble export. The detente of the late 1960s and early 1970s brought a different set of foreign participants as Hungarian authorities financed partial reforms—and later forestalled more radical reforms—with ever-increasing infusions of Western credits. Mounting hard currency debt triggered institutional arrangements for debt management: membership in the IMF and the World Bank. Yet, despite repeated campaigns of “retrenchment” to curb imports and stimulate exports, the balance of payments worsened and foreign debt roughly doubled during the '80s. By the end of the decade, the \$20 billion hard currency debt found Hungary with one of the highest per capita foreign debts in the world. Whereas membership in international monetary institutions had signalled increased autonomy from Moscow at the outset, by the decade's close it marked increased dependence on Washington and Bonn.

It was in this context that the first shots in the privatization debate were fired not by laissez-faire liberals of the opposition parties but by senior officials in the Ministries of Finance, Industry, and Commerce of the Communist government itself. On June 21, 1988, Karoly Grosz remarked in a meeting to business leaders in San Francisco: “We would be very pleased if perhaps you would purchase some of our enterprises . . . even if they became 100 percent foreign owned.” The new Party Secretary's comments echoed softly at first in Budapest, where

economic researchers broached plans for debt-equity swaps in the Hungarian business press during the summer and early autumn of 1988.⁵ But the real opening salvo came in a press conference on January 31, 1989, when the Minister of Industry mentioned a list of fifty-one Hungarian state enterprises marked for sale to foreign buyers. Within days, reporters were following the story of how Minister of Commerce Tamas Beck was travelling through Western Europe with this same list of fifty-one firms to look for buyers for enterprises constituting about one quarter of Hungarian industrial production.⁶ In the ensuing eighteen months hardly a handful of firms on that list actually made it to the "auction block," although in the same period numerous other Hungarian firms did find foreign buyers. More important than the fate of those specific fifty-one enterprises (on a list that initial observers found highly arbitrary) was the debate on foreign ownership provoked by the awkward moves of the Grosz government.

Proponents of policies intended to yield a significant proportion of foreign ownership in a privatized Hungarian economy argued first that the hard currencies generated by the sale of state enterprises promised a sure means to begin reduction of the country's debilitating foreign debt. Such revenues could be used as immediate resources to avoid defaulting or rescheduling loan payments in the short run. More strategically, a sizeable infusion of capital from the West was necessary to modernize Hungarian industry, for only then could it produce commodities at world market standards for hard currency exports to reduce the debt in the long run. Hypothetically, industrial modernization might be financed through more loans and more credits. But even if the favorable political climate inclines Western governments to support such measures, the available funds from commercial institutions (already worried about the size and composition of Hungary's debt) would not be sufficient for the enormous project of modernization (and, in any case, would not come without strong strings attached).

Direct foreign investment, proponents argue, has the additional advantage of bringing benefits unobtainable through further loans and

5. *Magyar Nemzet*, July 21, 1988 and *Figyelő*, Sept. 22, 1988.

6. See *Figyelő*, Feb. 16, 1989 for this list and for interviews with apparently startled enterprise directors who claimed to have learned that their firms were marked for sale through radio reports or from telephone calls from their West European customers or suppliers.

credits: Western firms bring new technologies, new products, access to advanced research and design, better marketing techniques, expanded access to Western markets, and modern managerial skills. Of course, Western managerial talent could (at least hypothetically) be employed by Hungarian firms with aggressive hiring practices, and new products and technologies could be acquired through licensing and leasing arrangements. But, proponents argue, such measures (attempted without significant payoffs in the recent past) are no substitute for the intense involvement in strategic decision making and day-to-day management that accompanies direct foreign investment. Technological and organizational modernization can best be achieved if Western firms have an equity stake in the profitability of their Hungarian properties. Finally, direct foreign investment has an additional effect: over and above the immediate inputs of new managerial skills in foreign-owned firms and the consequent demonstration effects of this know-how to domestically owned firms, the market orientations of Western management (presumed to be cost-sensitive, competitive, and profit-oriented) will provide a much needed disciplining effect to reshape orientations in the period of transition to a real market economy.

Assuming for the moment that these benefits can be realized, why should Western firms find prospects in Hungarian acquisitions? Logically, the first and most obvious answer from proponents had to be that the selling price will be attractive. But (and now some of the criticisms) this raises the equally obvious question of how to determine the value of the assets to be sold. The typical answer from mainstream economists, that “the firm is worth whatever someone is willing to pay for it” or “let the market decide,” are problematic where there is not yet a market—and where, in fact, the explicit motive for the sales is to *create a market*. Additional complications in determining worth arise from the fact that the accounting practices of Hungarian and Western firms differ. But even where these can be squared in technical terms, there remains the problem of which measure of worth to use. Should one look at the book value? If so, by calculating amortization or replacement costs? Alternatively, one might with considerable merit argue that a better measure of a firm’s worth is its profitability, or its volume of sales, or projections of these under new management, and so on. The difficulty of determining a “fair price” leaves the agents who conclude these sales open to the charge

of undervaluing the firm's assets and squandering the nation's resources. Such charges are especially likely when the agents and the general public are entirely unaccustomed to such transactions.⁷

Proponents of direct foreign ownership are not easily dissuaded by charges of undervaluation. Hungarian authorities can negotiate firmly, they maintain, because Western investors will be willing to pay a fair price for enterprises with real growth potential. Hungary's literate labor force, with training in science and mathematics relatively higher than in comparable developing countries, presents one of the major attractions, especially since it can be employed at wage levels lower than in South Korea and Taiwan. For American and Japanese investors, moreover, as the GE-Tungsram deal and the Suzuki venture illustrate, Hungary provides a convenient platform for export to Western Europe. And because the domestic needs are so obvious and the benefits so promising, direct foreign investment should be actively courted with liberal tax holidays (five years when the foreign partner brings considerable new capitalization). In turn, critics with more nationalist pride than global perspective bridle at the comparison to developing countries. The more realistic among them question whether Hungarian-made products will enjoy favorable tariff access to EC markets and observe that officials at the World Bank have voiced concern that tax holiday incentives may be excessively generous under terms in which the lower limit of "considerable" new capitalization to qualify for the five year holiday is set at only several hundred thousand dollars.

Whether the deals were fair or the incentives too liberal, Hungary was relatively successful in attracting new foreign investment. According to estimates of the Hungarian National Bank, in 1989 (under the Grosz regime and the later caretaker government of Miklos Nemeth) direct foreign investment in Hungary totalled approximately \$300 million compared to a cumulative total of only \$200 million in the previous decade. But we should emphasize that the yardstick here is past performance rather than absolute standards, as the volume was doubtless less than proponents desired and more than detractors feared.

The most vocal opponents of direct foreign investment raised two

7. This unfamiliarity leads to repeated calls in the daily press for establishing "fair prices" for selling state enterprises through competitive bidding—as if a deal in the hundreds of millions of dollars (for which there is typically only one actually interested, qualified buyer) could be conducted in the same way as the auction of farm equipment.

fears above all others: foreign ownership would lead to widespread unemployment and the surrender of national economic sovereignty. Defenders of foreign ownership conceded that layoffs were indeed the first step that could be anticipated with new management. But they maintained that although the proximate timing of unemployment might be determined by the change in property relations, its inevitability and eventual overall level would not be the product of new market forces so much as the grim legacy of the old state-socialist economy which had wastefully kept workers in outdated, inefficient, and unprofitable enterprises. As for national economic sovereignty, the choice was not between state socialism, which had protected economic independence, and a new capitalist or hybrid economy, which would sacrifice it. The sacrifice of independence had already been made by the previous regime, and society was already paying the cost as four-fifths of the country's hard-earned convertible currency profits were going annually to pay the interest on the accumulated debt. If it is not to slip into economic oblivion, Hungary must fully enter the world capitalist economy. But such an entry at this moment necessarily implies constraints; will they be imposed by foreign creditors or by foreign investors? Proponents of foreign ownership regard the latter as preferable: better to be constrained by foreigners with a direct ownership stake in the performance, efficiency, and profitability of Hungarian firms.

The most articulate critics of the first phase of privatization to foreign owners took these arguments into account but questioned whether the presumed benefits were actually forthcoming. The use of such revenues to reduce foreign debt and counter the state's budget deficit, for example, seemed dubious in the initial phase, when the proceeds of privatization were retained by the firm itself. Second, the supposed benefits of new management seemed equally illusive under circumstances in which the enterprise elite of the old order were using the measures of privatization to retain managerial positions in the restructured firms. Third, critics questioned whether the haphazard pattern of foreign sales reflected any coherent policy strategy. In particular, foreign ownership might be part of a strategy to curb the inordinate power of monopolistic firms in any number of industrial branches; yet there was little indication that sales were motivated by this intent or that they would have this effect. In general terms, because almost all participants in the debate agreed that some significant level of direct

foreign ownership was desirable, disagreements centered on the timing, pace, patterns, and forms of privatization. It is to these issues that we turn.

II. Spontaneous privatization versus privatization controlled and directed by state agencies

If the desperate search for convertible currency by the incumbent Communist government triggered the debate about direct foreign investment, the search for career stability by incumbent enterprise directors stimulated the debate over “spontaneous” versus “controlled” privatization. To understand the conditions in which enterprise directors began to move unilaterally, we must briefly elaborate how the specifically political vacuum of mid 1989 was not a legal vacuum, and how the negotiated transition of political power was not a negotiated transition of economic power.

The roundtable negotiations that opened in mid-June 1989 signalled the end of the monopoly rule of Hungary's Communist party. In over three months of intensive negotiations, representatives of the ruling and major opposition parties hammered out the new rules of the political game covering the Constitution, registration of political organizations, election procedures, the mass media, and the disposition of the coercive apparatus of the state. But although negotiations in six economic subcommittees (charged with property relations, antitrust regulations, budgetary matters, and the like) were held parallel to the political discussions, no decisive agreements were reached on the economic front. The problem was not that the committees were deadlocked, for in fact the experts representing the various sides of the negotiations shared a common discursive framework which should have made consensus possible. The failure to rewrite the rules of the economic game rested more in the organizational composition of the negotiating partners. The political rules could be restructured because the key actors with a stake in the newly redefined political field were all at the negotiating table. The rules of a new economic order, however, could not be rewritten because the key actors in the economy were decidedly absent.

The actors in the roundtable were the “would be parties” of an anticipated competitive polity. Rather than mutually denouncing dis-

parate legitimating claims to represent “society,” a precondition for progress in the roundtable negotiations was that the organizations on each side temporarily suspend claims to speak “in the name of society” and that the personalities in the negotiations speak as representatives of political parties.⁸ It was in this capacity that they could reconstruct an electoral system in which society would have its chance to “speak.” The economic negotiations, by contrast, were paralyzed by this very framing of the roundtable structure in which the “parties to negotiation” were exactly that—parties, not capital and labor, not peak associations, not corporate groupings, not employers’ associations, not trade unions.⁹ There could be no decisive and binding agreements about economic matters in the roundtable context because the negotiations did not include the key economic actors with the greatest stake in the new rules restructuring the economy. Most notably absent was any representation of the directors of the large public enterprises; not party to the negotiations, they were not bound by the process and outcomes of the roundtable.

If the virtual exclusion of any organizations other than political parties was one precondition (and the peculiar distinguishing feature) of the Hungarian roundtable negotiations,¹⁰ a second was the agreement at the outset that the existing Parliament, chosen (one hesitates to use the term “elected”) under entirely different circumstances, should pass no legislation that would preempt the ability of the subsequent, newly elected Parliament to carry out its mandate. The immediate objective of this preliminary agreement was to prevent the existing Parliament from adopting any measures that might outflank or deflect the *political* agreements struck in the roundtable, but the restriction held in principle for *economic* questions as well. Thus, from the outset of the negotiations until the convening of the new legislature in May 1990, Parlia-

8. This presentation is a gross oversimplification of the dynamics of the negotiations which were driven by the constant tension of competing representational claims on numerous dimensions. For a more complete elaboration of this analysis see László Bruszt and David Stark, “The Negotiated Transition to Democracy in Hungary,” in *Working Papers on Transitions from State Socialism*, Cornell Project on Comparative Institutional Analysis (forthcoming).

9. The contrast with Poland’s roundtable negotiations is obvious but worth noting if only to suggest one of the major differences in the dynamics of negotiations in both countries. On politics and privatization in Poland see especially Jadwiga Staniszkis, *The Dynamics of the Breakthrough in Eastern Europe: The Polish Case, 1988–89* (forthcoming).

10. An analysis of the role of the “Third Side” in the negotiations, the satellite organizations of the Communist party (the official trade unions, official women’s organization, etc.) confirms rather than disproves this contention. See Bruszt and Stark, “The Negotiated Transition.”

ment was not simply passive but seemingly handcuffed. Nor could other branches of government act with any greater capacity, as the Communist party's claim to represent the interests of stability and national sovereignty was shattered when subsequent events throughout Eastern Europe in the autumn of 1989 demonstrated that this final "historic mission" had been relegated to history. The state-socialist economy, criticized for decades as too tightly controlled by the state, now found itself in a situation where the already fuzzy lines of control were spinning from ambiguity to near dissolution. In such circumstances, enterprise directors, as the most powerful agents in that economy, could act with unparalleled independence. Their most decisive actions were in the new arena of privatization.

These remarks should not imply that the Hungarian economy was "out of control." The caretaker government of Miklos Nemeth succeeded in gaining some degree of legitimate authority by asserting increased independence from the flailing renamed Socialist Party with heightened appeals for a technocratic managerial style. Nor should they imply that enterprise directors acted illegally. It was not necessary for them to entice the existing Parliament to pass new laws since the combination of two disparate and unrelated pieces of existing legislation gave them ample room for manoeuvre. These two laws formed the legal basis for "spontaneous privatization."

The first piece of legislation, innocent in itself, was the 1984 Law on Enterprise Councils. This act had formally transferred some ownership functions from ministries to the newly created Enterprise Councils. Appropriately named, these bodies bore no resemblance to authentic Workers' Councils: with half of their membership appointed by management, they were thoroughly controlled by enterprise directors. No serious scholarly study of the Enterprise Councils indicated that this law had made any difference in the actual management of firms or the overall operation of the economy. Indeed it had not—until it was combined with the second piece of legislation, the Law on Business Associations enacted January 1, 1989. This legislation included provisions for establishing joint stock companies and limited liability corporations. Unlike the later Law on Transformation of May 1989, the Law on Business Associations did not anticipate and made no provisions for the actual transformation of state enterprises into privately held corporations. But it contained one important clause that allowed state enter-

prises to found shareholding corporations (RT) and limited liability companies (KFT). This clause provided the critical legal vehicle for spontaneous privatization of state enterprises.

The basic steps in the process are as follows. First, the Enterprise Council, exercising its ownership function in the state enterprise, creates one or more of the new property forms. These *new* companies issue share capital, and then proceed to exchange these shares for the assets (land, buildings, equipment, etc.) of the state enterprise. The state enterprise now holds shares, to be sure, but it has been stripped of its actual assets which have become the property of its own creations—the new limited liability corporations. In a further twist, the new companies next issue bonds (at fixed returns) that are purchased by the original state enterprise *with the shares* which the state enterprise had acquired in exchange for its assets. In the pure case, the state enterprise has become a virtual shell: it holds bonds *but the assets and the shares* are now held by the “private” corporation(s). These shares can then be sold to other Hungarian firms, to foreign corporations, or to private persons.

Such schemes obviously provide considerable opportunity for abuse, especially because the original “owner” with the authority to decide on the terms of the various transactions outlined above is the Enterprise Council. What’s going on, critics charge, is that senior management—who report to no board of directors, or trustees, or stockholders, but only to the Enterprise Council, which is in their pocket—are *able to choose their own owners*. Sometimes they choose foreign owners on terms favorable to the buyer, permitting them to maintain their current positions or to gain controlling interests in a profitable venture carved out of the original state enterprise. The difficulty of evaluating the assets of the firm gives enterprise managers considerable room for manoeuver in negotiating such contracts and provides some immunization against charges of “squandering” resources. In other cases they choose *themselves* as the new owners. Take the process outlined above. Add a new first step in which the Enterprise Council votes large bonuses for senior management. Include in the final step that directors use the bonuses to buy shares in the new corporations or limited liability firms. Moreover, in addition to enterprise management, the elite from the party-state apparatus are also taking advantage of the transformation process. In these “nomenklatura buyouts,” apparatchiks with no prior industrial experience or expertise in production or marketing

are bailing out into quite profitable ventures. As Hungarian workers told me, “instead of *perestroikists* we find *parachutists* holding shares in our new units.” Spontaneous privatization is thus a process whereby political capital is converted into economic capital.¹¹ Critics contend that it is a way for the old oligarchy—the apparatus and their managerial functionaries—to salvage its power.

Opponents of spontaneous privatization advocate the creation and strengthening of central agencies to manage and coordinate the transformation of state property. Pointing to abuses of decentralized ownership claims by Enterprise Councils on behalf of enterprise management, they argue for the recentralization of the ownership function in the disposition of property. If privatization is not brought under public control, they maintain, its consequences will be merely for private gain and not the public good. Thus, the search for a more “rationally directed” process of transformation reaches a curious conclusion: in order to denationalize property, it is first necessary to renationalize it.

Throughout the latter part of 1989 much of the public and professional debate about privatization centered on the organizational features of various proposals to establish an agency responsible for overseeing the transformation process. With public opinion incensed about the most well-publicized cases of pilfering of national resources, with courts refusing to register some of the most shady deals, and with the major opposition parties on record against uncontrolled privatization (although some more vigorously than others), the lame-duck Parliament finally asserted itself and produced the Law for Defense of State Property in January 1990. This legislation outlined a set of high-sounding objectives, but the government still lacked an organizational instrument to put policies into effect. Throughout this entire period, the office of the State Commissioner on Privatization issued guidelines and directives, but cases were decided on an ad hoc basis and, not uncommonly, reversed by some other body claiming jurisdiction. The

11. The conception of social fields (of many varieties and not simply the economy) as organized around distinctive forms of “capital” and the notion that these forms can be converted from one social form to another are key components of the social theory of Pierre Bourdieu. See for example his *Homo Academicus* (Stanford: Stanford University Press, 1988), and “Forms of Capital,” in John G. Richardson, ed., *Handbook of Theory and Research for the Sociology of Education* (New York: Greenwood Press, 1986), pp. 241–258. For a creative elaboration of this idea for the contemporary East European setting see Elemér Hankiss, *East European Alternatives: Are There Any?* (forthcoming).

maze of contradictory regulations meant that conforming to the relevant legal codes in a particular case was an uncertain process at best.

A State Property Agency was finally established in March 1990 with full responsibility for coordinating privatization. But appointment of its permanent director, composition of its staff, and delineation of its real political mandate had to wait until the results of the run-off elections in early April and the formation of a new government. Thus, at the time of this writing, the composition of the Agency's board of directors and its major policy lines were still unclear. In general terms, the principal task of the Agency is to exercise prepurchase rights over state enterprises to be organized into corporations. Before any sale, the Agency must approve a transformation plan prepared by the enterprise including the percentage of revenues (or value of land) that goes to local governments and the percentage of discounted shares issued to enterprise employees.

For our purposes here, the detailed features of the new property agency are less interesting than the general debate about the role of central authorities in coordinating and controlling the process of transformation. For their part, enterprise managers and some economists who are critical of centralized control argue that the new state agencies are just new bureaucratic organizations. Why should we assume that they will manage social property any better than the old ministries? At best, these agencies spring from budget hunger; at worst, as an organizational imperative, they will start to accumulate property. Speaking derisively of a "ministry of ownership," they contend that the old central authorities, faced with the prospects of "empty ministries," have found in bodies like a national trust fund the means to salvage their power.

Proponents of centrally directed privatization respond that the new asset agency will be accountable to a new, democratically elected Parliament. Its task will not be to accumulate property but to dispose of it. If spontaneous privatization is not slowed down, there will be no property left for the new state to transform in a rational manner.

The proponents of spontaneity: Slow down? Already the current pace is not fast enough. A rapid transition is urgent. If we have to wait for new institutional controls and for the new Parliament to act this year, and then again in the next year, and so on, it will already be too late. "Radical pragmatists" within the camp of spontaneity assert: So what if there is some squandering? It is a small price to pay for the transition to

a more efficient system. Put it on the bill as one more, but the final, cost of forty years of communist misrule. What does it matter if the former managerial elite become the new owners? What matters is not the person but the role and the criteria for making decisions. Any real, profit-maximizing owner is better than no owner at all. And the sooner the economy's resources are managed according to such criteria, the sooner tax revenues, wages, and national wealth will increase.

The position favoring controlled privatization counters that squandering does matter. The revenues from privatization are a one-time event. This opportunity for reducing deficits and repaying debt will not be repeated, and so these revenues must be maximized. It is true that timing matters: hasty measures to bring too many firms onto the auction block all at once will drive down selling prices.

Advocates of spontaneity accuse the proponents of central controls over the "maximizing" utopia of wanting to have their cake and eat it too. It is impossible simultaneously to maximize the selling prices of state enterprises, to maximize long-term efficiency, cost reduction, antimonopoly practices, access to foreign markets, maintenance of full employment, etc. We can only optimize, and the most optimistic policy is the one that gets the economy moving quickly from publicly owned redistribution to privately owned market coordination. The centralizers are moralistic and short-sighted. In the name of national interests they focus on short term revenues. And in so doing they hinder the private initiatives that hold the only promise for long term prosperity. Of course privatization will involve private gain—for if enterprises did not go into private hands, it would not be transformation and, if it did not promise gain, then who would buy them? We must make a break with the old ideologies in which "collective interests" smothered "private interests" to the detriment of any rational economic interests. It is the pursuit of private gain that will bring public benefits. Proponents of these unnecessarily restrictive central controls should cut the demagoguery and simply admit that they oppose privatization.

Advocates of centralized coordination respond emphatically that their opposition to spontaneous privatization is not opposition to private enrichment per se but outrage at such enrichment based on the private appropriation of public property through insider deals at less than a fair price. By giving insiders a distinct head start in the race for state assets, they contend, spontaneous privatization discriminates

against entrepreneurs who are equally or perhaps even more worthy to manage these resources. When the rules of the game are written by those already in positions of economic power, they will privilege only a limited set of interests. Only by equalizing opportunity (or at least by eliminating the opportunities for insider dealing) can there be any assurance that the economy's resources will be managed by the most capable. State regulation in the process of transformation is not anti-theoretical to the market but necessary for the transition to it. Slower, more deliberate, and controlled privatization will improve the chances that the state's former assets will be managed by those who can prove their abilities in the newly emerging market institutions rather than by those who demonstrated that they could climb to the top in the old institutions of the state socialist economy. Such will be the more certain path to prosperity in the long run.¹² Thus, critics charge that it is the shortsighted perspective of the position of spontaneity that makes them oppose the principles of a liberal market.

With the passage of the Law for Defense of State Property and the establishment of the State Property Agency it might seem that the dimension of spontaneous versus controlled privatization is of only historical interest since the centralizers seem to have won the battle. But there are still numerous avenues for evading central controls. To take only one example, enterprises are obliged to file transformation plans with the new agency only when the value of the contract exceeds thirty million forints. The creation of a medium to large size limited liability company (KFT) is usually safely under this minimum and therefore falls outside the agency's jurisdiction. Technically, an enterprise could sequentially form several (perhaps even a dozen) KFT without interference by the central authority. Such a manoeuvre would not only evade constraints from the top but would also avoid potential conflicts from the bottom: workers in the new KFT are not protected by collective contracts negotiated by unions with the state enterprise and the units are not governed by Enterprise Councils. Whereas Enter-

12. Critics also fear that the spontaneous privatization which characterized the first wave of selling state enterprises also ultimately threatens Hungary's ability to attract foreign capital. Public outcry at the disclosures of insider deals (e.g., the now infamous cases of the APISZ stationery chain and the HungarHotel chain) forced state authorities to cancel these contracts. Such episodes increase the risk calculation of the potential foreign buyer. Privatization that is legitimate, because more controlled, will increase rather than threaten the business confidence of foreign investors.

prise Councils were the marionettes of management in the earlier period (when no independent political or trade union organizations existed at the workplace), in the new political setting they might become a source of uncertainty for senior management.¹³

The debate about spontaneous versus controlled privatization, moreover, still continues over the operational meaning of the term “control.” Control can refer to direct coordination, but it can also imply the much less directive processes of post hoc oversight and monitoring. In the light of current public opinion, policy lines with a more spontaneous stripe will go on record as supporting “control”—in hopes that it will be of the latter variety. In the best of worlds they could have their preferred strategy *and* the patina of legitimacy. Such an outcome is not unlikely if the directors and staff of the regulating agency are drawn from the ranks of the regulated (not uncommon in regulated industries in the West) or if the career trajectories of this same staff carry them up to the boards of directors of the companies whose transactions they currently approve (not uncommon in our own military-industrial complex). If so, privatization would be monitored, but the transformation process would be only slightly more controlled and slightly less rapid than in the first wave of privatization. The danger, as we shall see in the following section, is that the kind of economic system that may arise from such privatization would not only have the old oligarchy at its helm but may well have more in common with the old shortage, soft-budget constrained economy than with dynamic market economies. That is, the fastest privatization might actually not be the road to a real functioning market but a costly detour.

III. Institutional versus natural owners

Given the ratio of public assets to private savings (most estimates are that private domestic savings, even with credit, could buy only about

13. The creation of numerous fictively independent KFT as satellites around the large state enterprise is not hypothetical but was encountered in my collaborative field research with János Lukács. With an allusion to the semiautonomous internal subcontracting units that operated until late 1989, known by their Hungarian initials as the VGMK, workers refer to the fictively independent satellites as “vallalati-KFT” (enterprise KFT) or simply, “VKFT.” With this allusion they signal that the VKFT have no more autonomy than the VGMK. The difference is that whereas the VGMK were the organizational stronghold of skilled manual workers and production line supervisors, the VKFT are the creation of senior management.

10 percent of current state assets), and given the weight of convertible currency foreign debt, rapid sales of state enterprises would tend to favor foreign buyouts. As for domestic ownership, rapid privatization would tend to yield patterns of *institutional ownership* of two broad types: 1) endowments of nonprofit institutions such as hospitals, educational institutions, and foundations; and 2) intercorporate holdings in which banks, insurance companies, and industrial enterprises hold shares in other Hungarian corporations.

In the first type of institutional ownership, nonprofit institutions receive endowments in the form of shares issued by former state enterprises. That is, the Hungarian state would designate hospitals, foundations, educational institutions, organizations conducting medical or other basic research, and similar institutions as (substantial) holders of newly privatized firms. Proposals range from a master plan to achieve property transformation by means of endowments granted by the privatization agency, to more gradual approaches in which enterprises would be encouraged (perhaps in cooperation with local and provincial government) to include nonprofit institutions in the transformation plans they submit to the State Property Agency. In either case, nonprofit institutions which had formerly received virtually all of their revenues from the state budget would now look to the dividends from their shareholdings in Hungarian firms to finance part (or perhaps even all) of their operations.

Endowing nonprofit institutions promises to accomplish the core objectives of privatization: it creates knowledgeable stockholders independent of enterprise management who have a direct interest in the long-term profitability of their holdings. To the extent that their revenues from the state budget are reduced in proportion to anticipated portfolio earnings, endowed institutions have a pressing stake in increasing the value of their shares. Unwilling and unable to tolerate poor performance, they will use their voting rights as shareholders to remove incompetent managers or sell those stocks for shares in firms with more promising returns on investments. Curiously, nonprofit institutions in the public welfare sector become the organizational means to secure profits from enterprises in the industrial sector. Institutional investment carries an additional advantage because the smaller number of investors, relative to millions of individual shareholders with employee stock ownership schemes or universal citizen grants (discussed in the

next section), makes for a more manageable stock exchange during the turbulent transition period. Moreover, privatization through nonprofit endowments is a potential solution to problems of legitimation discussed in the previous section. Endowments create economic actors with a private interest in profitability; but the recipients of those profits are institutions that provide public goods and services. By expanding the range of beneficiaries of privatization, endowments thus increase the political support for the overall process of transforming property relations.

In principle, endowments could encompass a very sizeable proportion of the privatized assets in the Hungarian economy. But there are a number of serious objections raised by opponents of institutional ownership that should be considered. First, where are the financial planners with experience in portfolio management? The greater the number of endowed institutions, the greater the need for these skills. Second, where are the organizational routines—the complex incentive schemes that evolved over decades to deal with principal-agent problems in the relationship between endowed institutions and professional property managers? These professionals and these routines can, of course, be produced over time; but the problem is that they are needed now, in the transition period.

More importantly, public institutions (like state industrial enterprises) in redistributive socialism are accustomed to reading the bureaucratic signals of budgetary infighting rather than the market signals of the stock exchange. Transplanting institutional arrangements that work relatively smoothly in market economies may not be the means to achieve functioning market institutions during the transition.¹⁴ In particular, a successful transition to endowments requires striking a delicate balance in weaning nonprofit institutions from the state budget: Too abrupt, and they will be forced to make high-risk investments in hopes of immediate returns; too slow, and they will remain tied to the

14. Some proponents of institutional ownership advocate endowments in which 50 to 100 percent of the institution's operating funds are generated by its shareholdings. Such proposals ignore the long evolution of the most visibly successful endowed institutions—the elite “private” universities of American higher education. Such institutions have very diversified holdings. But they also have very diversified sources of revenue. Income from endowment typically covers about twenty-five percent of the annual budget of elite private universities, with the remaining income generated by alumni contributions, student tuition, large donations, and grants from the federal government and private foundations. Such institutions can have an interest in the *long-run* profitability of their endowment because they “walk on many legs.”

pursestrings of the state, paying too little attention to the performances of the shares in their portfolios. The current crisis of the Hungarian state budget inclines the seesaw in the former direction. Decision makers will find it hard to resist the opportunity to achieve two policy objectives with a single program—privatization and deficit reduction. As a consequence, the leaders of newly endowed nonprofit institutions are likely to find that their resources through the old budgetary lines have been cut much more drastically than the actual earnings from their new shareholdings can make up. This poses the probable danger that nonprofits will invest in risky stocks that promise short-term payoffs to cover the sudden shock of the reduction of revenues from the state budget. Moreover, even if they were to choose a more cautious investment strategy, the primitive state of the stock market and the lack of any track record of a corporation's shares make it all but impossible to identify blue-chip stocks with proven performance. This increases the likelihood (already high due to the paucity of professional skills and the pressures for short-term gains) that a considerable number of the endowed nonprofits will suffer serious losses on the stock market rather than enjoy a stable increase in their revenues. These institutions will revert to polished skills of budgetary pleading; and local, provincial, and national government officials will face the difficult choice of bailing them out or closing hospitals and educational institutions.

An equally likely scenario is that a given nonprofit institution, faced with choices in investing its endowment, will put it all into one (or only a few) corporations. Such an investment strategy would raise goose bumps on a seasoned portfolio manager, but the decision might not be irrational in the current Hungarian setting. Given the general lack of knowledge of the stock exchange and the necessarily poor information about corporate performance under the new economic conditions, it is entirely likely that a given hospital, for example, will invest in a prominent local firm where the hospital's board of directors are acquainted with enterprise management. (That the newly endowed hospital will choose its trustees from among local notables with some economic experience only increases the likelihood of this strategy.) At first glance, the choice of tying a major part of one's operating budget to the success or failure of a single venture appears extraordinarily risky. But if almost any investment at this point in time is objectively risky, why not venture with a known and proximate entity? If the enterprise is in

danger of failing, then all the better that the trustees of the endowment can walk arm in arm with representatives of enterprise management and the enterprise union to threaten simultaneous plant closings and hospital closings in requesting subsidies from local or provincial politicians and state officials. Such are the basic ingredients for reproducing soft-budget constraints in the transition to a market economy.

The second type of institutional ownership—intercorporate ownership—is found when Hungarian firms (banks or insurance companies, for example) buy shares issued by other state enterprises in the process of transformation. Formulated earlier in the 1980s,¹⁵ the initial concept of institutional ownership was that a relatively small number of banks (or other holding institutions), independent of the state and in competition with each other, would have a greater interest in the profitability of their holdings than the currently responsible ministries. As owners, they would have a real stake in imposing tougher performance criteria. Long popular in an influential circle of economists, the concept of institutional ownership has only been realized in the most recent period. Its rapid evolution now finds a twist—in the form of *institutional cross-ownership* as companies purchase or exchange shares with each other.¹⁶ Your company issues shares, mine issues shares; we buy each other's, plus those of a third, and we appoint each other (along with representatives of the commercial bank that lends credit and owns shares) to the boards of directors of the newly transformed enterprises. The results, critics argue, is not the shift from plan to market but a shift from plan to clan.

Opposition to such institutional ownership is based on the following argument: the problem with the old system was not merely that it lacked owners and lacked markets but that its organizational structure of industrial concentration gave the huge enterprises monopoly posi-

15. Intellectual guidance in the concept of institutional ownership came from Márton Tardos, the leading reform economist of the previous decades. In the more recent phase of transformation he has provided leadership as founder and director of the consulting firm Financial Research Incorporated, as the leading economist for the Alliance of Free Democrats, and as co-Chairman of the international Blue Ribbon Commission. Tardos is currently a member of Parliament and Deputy Chair of its Economic Committee.

16. A clause in the law establishing the State Property Agency might further stimulate such cross-ownership: share capital issued but not purchased within three years after the transformation of a state enterprise automatically becomes an asset of the State Property Agency. To avoid assets falling into the hands of the Agency, firms could exchange these shares for the shares of some other enterprise.

tions. Institutional ownership will not change that organizational structure. If anything, cross-ownership and interlocking directorates will produce even more powerful mega-organizations. Banks that issue credit *and* own shares, moreover, will be all the more encouraged to assist these firms in lobbying for subsidies, favorable import licenses, and lenient regulations.

The problem with the old system, moreover, was not that it didn't have incentives or that it didn't involve risks, but that the objective incentives were all there *to take risks with other people's money*. Institutional ownership will not change that structure of incentives and risks: the impersonality of state ownership is simply replaced by ownership that is "private" in name only because it is equally impersonal. The solution to the problem of monopolistic power is to break up the large firms and sell the leaner pieces to genuine entrepreneurs. The solution to the problem of incentives and risks can only come about when state property is in the hands of *natural owners*—individuals or partners who risk losing their personal property if the venture fails.¹⁷

On both counts, the preferred solution points to strengthening and expanding the existing private sector that had slowly emerged in the previous fifteen years in the shadow of the central plan. At present, advocates concede, production in typical units of this "second economy" is necessarily small in scale and, although some private entrepreneurs have adopted advanced technology, the overwhelming majority have been so hampered by the absence of credit and by state-imposed limits on capital accumulation that their equipment and techniques are far from state of the art. Nonetheless, by their proven inclination to take real risks and by their demonstrated ability to take advantage of every market opportunity, these energetic entrepreneurs are the best candidates for the more ambitious tasks of managing the economy's resources. To release this energy, the first state policy in the new era of transformation must be massive deregulation—the elimination of all

17. The most articulate critic of institutional ownership and the most fervent advocate of "natural" ownership is Hungary's leading economist, János Kornai. See *The Road To a Free Economy: Shifting from a Socialist System, The Example of Hungary* (New York: W.W. Norton, 1990). This book, Kornai's first major policy statement (following numerous books of analytic criticism of the state socialist economy) was published as a "passionate pamphlet" in Hungary in 1989. Too "liberal" for the more étatist, nationalist circle around the Democratic Forum, too "étatist" for the more pro-spontaneity circle around the Free Democrats, and too brilliantly independent for just about everyone else, the book was immediately attacked from almost every quarter.

administrative codes that artificially restrict the growth of this potentially dynamic and truly private sector.

Critics of such proposals, with a mixture of condescension and impatience, inquire: "This is all well and good for restaurants, car repair, and urbane boutiques. But what about the large industrial enterprises?" Proponents of natural ownership respond without hesitation that they very much do intend their proposals to apply to manufacturing as well as services. In anticipation that transferring industrial assets to natural owners will be a lengthy process, their proposals contain a second plank to deal with large state enterprises that will remain for some time under public ownership: corresponding to deregulation of the private sector they advocate *re-regulation* of the state sector. "Liberalization," the relaxing of controls on public enterprises, continues to suffer from the illusions of market socialism that markets can be simulated either through state policies or institutional ownership. Until such time as real market coordination exists, liberalized measures that give enterprise management more room in setting prices and wages will only lead to shortage-flation—the worst combination of shortage (under soft-budget constraints) *and* inflation. Instead, under the stricter controls of re-regulation, managers of state enterprises (who are still risking the citizen's money) will be made more accountable to the democratically elected government responsible for guiding the economy in the transition.

Deregulation and re-regulation must furthermore be combined with additional measures to promote the transfer of economic resources to genuine entrepreneurs. With reference to the January 1989 Law on Business Associations which prohibited administrative codes that discriminate against one or another property form, advocates of natural ownership argue that policies regarding taxation, credit, and the sale of state assets should not be "property neutral." That is, it is not enough for the state to be committed in principle to equal opportunity, for such abstractions only hide the underlying reality that the powerful stand in privileged positions. To promote a real private sector, private entrepreneurs must be treated preferentially: They should receive credit on more favorable terms, face lower taxation, and stand first in line for contracts to manage the smaller, disassembled parts of former state enterprises.

Advocates of institutional ownership inquire with puzzlement: do we want the model for a new economy to be based on the capitalism of

the nineteenth century? First, take a look at many West European economies and you will find a predominance of institutional ownership. It has not blocked their development. Second, of course we have interlocking directorates. How else to create a stable set of intertwined financial and industrial institutions capable of surviving in a rapacious world economy? As for your pejorative label—"clans" were a feature of the old system in which the elite of the party apparatus and the economy worked hand in glove. It was planning and clanning that went together; our ties are based on business logic and not the bonds of party loyalty. On second thought, perhaps the clanlike attribution is not so mistaken—provided it refers not to some Southern European mafia but to the cohesive networks of trust, cross-ownership, and stable subcontracting that made possible the Japanese miracle. In the modern world economy, the strategic choice is not between clans or markets but of clans for markets.

Advocates of natural ownership respond: Your insights about institutional ownership in Western Europe are valid enough, but inapplicable to the problems at hand. In the typical economy of Western Europe, quite a sizeable portion of the production to this day comes from units with fewer than 100 employees, and the habits of calculation throughout the economy come from a deeply ingrained market logic. In Hungary, by contrast, ninety percent of the economy's assets are state-owned, and habits and routines that have become second nature were shaped for four decades under the logic of soft-budget constraints. To transform that economy it is not enough to select new institutions; new habits must be cultivated as well. Because these cannot be created from above, we must start from where they are already manifested—in the existing second economy, where habits of risking one's shirt, of thrift and industriousness are commonplace.

You were right, they continue, to note that clans were a key feature of the old regime, but it is exactly the similarity in patterns of old and new networks that we see as hindering market development. And it is these clan networks, combined with deeply ingrained habits shaped by soft-budget constraints, that cause us to fear that under conditions of institutional ownership firms will continue to look to the state for subsidies, and that their inordinate size will give them the means to blackmail the new state in the foreseeably long period of economic difficulties to come. It is for this same reason that your Japanese anal-

ogy is inappropriate. Rapid institutional privatization might create a twentieth century form alright, but one not prepared for the flexibility that will be required in the twenty-first century. Rather than emulating Japan (entirely improbable in any case, given the vast differences in wealth, technology, and position in the world economy), we would do better to look to Italy, where smaller scale production responds flexibly to rapidly fluctuating markets. Slower privatization might yield leaner firms of real entrepreneurial, innovative character, more capable of such flexible adjustment.

The institutionalists: all this talk about “natural owners” is just so much romanticism about the petite bourgeoisie. You might see habits of thrift and industriousness in the existing second economy, but one could equally point there to habits of corruption, of tax evasion, of extracting monopoly rents in totally artificial “market” conditions reproduced by the absurdities of state socialism. Propose deregulation if you like, but the habits of your pseudoentrepreneurs will incline them to erect new barriers to entry rather than fostering real competition. In any case, your nineteenth century virtues might have been appropriate for that century but not for the leap to the advanced technological society of the computer age. We Hungarians live in the modern world. Our managers are sophisticated business professionals who travel in international circles. We can’t afford to wait for the development of our own middle class, for there is no need to reproduce the road to capitalist development step by agonizingly slow step.

“But that is what we must do,” respond the advocates of natural owners, and they continue: Those who talk about magnificent leaps into the future should think twice before accusing others of romanticism. We have heard these phrases about “bold experiments” and “leaping over stages of history” before—during the late forties and fifties from visionaries with no less confidence than your own. But see how our economy has suffered from those sweeping gestures. Society is not prepared to be the dutiful subject of another experimental leap. The failure of Leninism was that it posited abstract historic interests and tied those to a class. But because that class, the proletariat, did not yet exist in the countries of the East, the state had to create it while the party ruled in the name of those abstract interests. We should not repeat that mistake by positing an abstract interest in private ownership before a sizeable propertied bourgeoisie really exists in our society.

A propertied middle class is not some "test-tube baby" that can be artificially created. At best we can adopt policies that encourage healthy growth or alternatively, as with your plans of pseudoprivatization, we can choose policies that will stunt it. But the road to a market economy will be traveled by a propertied middle class or it will not be travelled at all.

IV. Concentrated versus dispersed ownership

At first glance, this final dimension of the privatization debate appears simply derivative of the three dimensions discussed above. Although it is difficult to find any participants in the debate who advocate concentrated ownership per se, the predominance of foreign and/or certain patterns of institutional ownership would suggest more rather than less concentration in proprietary relations. Similarly, those who give high priority to a speedy transition are inclined to opt for more concentrated ownership under conditions where the private savings of the population are inadequate to purchase more than a small fraction of the assets of the large state enterprises. We shall see later in this section, however, that there is an alternative position in the debate which holds that the greatest dispersion of ownership in the initial phase of privatization could actually be the most rapid means to achieve the goal of marketization. Likewise, we shall also see that at least one variant of institutional ownership, employee stock ownership, is congruent with dispersed rather than concentrated shareholding.

Although the Law on Business Associations which took effect on January 1, 1989 did not explicitly justify concentrated ownership, it had the practical effect of promoting concentrated rather than dispersed wealth in the Hungarian economy. In the first place, the new legislation establishing joint stock companies set the minimum price of a share in such ventures at one million forints. This stipulation, of course, was compatible with predominantly institutional ownership and could be seen as dictated by ideological considerations at a time when the party-state was still uncomfortable with ownership by private persons. But although few individuals or families had the resources (whether as cash reserves or collateral) to make such investments, not all were so excluded. The tendency to encourage private accumulation within a narrow stratum was accelerated, moreover, by a second administrative measure:

Hungary's new personal income tax code allowed families to exempt part of their income from taxation when they participated in the new joint stock companies. To benefit from this particular investment tax credit, however, a family would have to be able to afford the one million forint minimum *and* have a yearly income high enough to make the exemption meaningful. The peculiar combination of the two measures meant, in fact, that the estimated 6,000 families who qualified on both counts would be able to reinvest almost without cost as the credit/exemption in one tax year would provide the means for the purchase of additional shares in the next, thus qualifying for further tax credits, and so on.¹⁸ Since the language of tax loopholes confronted no linguistic barrier at the Hungarian frontier, the rich could get richer there, too.

The dispersed ownership position is not opposed to investment credits and tax exemptions but argues that these are going to the wrong units. Rather than offering tax shelters to the domestic elite and luring foreign investors with promises of easily repatriated profits, this position proposes tax holidays and more liberal credit to those Hungarians who have already demonstrated a practical interest in private ventures—the sizeable proportion of the population actively participating in the second economy. In contrast to a development strategy based on the prosperity of the 2,000 or perhaps (more generously) 20,000 wealthiest families, this strategy links the prosperity of the economy to the viability of capital accumulation among some two million families who have already invested time and resources in small-scale, often part-time private production in agriculture, services, and industry. Ivan Szelenyi is among those who have argued that such a policy of dispersed ownership is not simply justified on moral grounds but makes good economic sense.¹⁹ Emulation of the South Korean or Taiwanese model of mass production based on

18. János Lukács, "A gazdaság demokratizálási utjai: a munkavállalók részvénytulaj-donlásáról a magyar piacgazdaságban" (Ways of democratization of the Hungarian economy: On employee stock ownership plans in the emerging Hungarian market economy). (Unpublished manuscript, Hungarian Academy of Sciences.) Lukács' paper includes the precise income levels and the basis for the estimate cited above. See also, János Lukács, "Vertical Disaggregation and Privatization in Hungary: Organizational Consequences." (Paper presented at the Conference On the Social Economies of Inter-Firm Cooperation, Social Science Center, Berlin, June 1990.)

19. See Ivan Szelenyi, "Eastern Europe in an Epoch of Transition: Toward a Socialist Mixed Economy?" in Victor Nee and David Stark, eds., *Remaking the Economic Institutions*, pp. 208–32; *Socialist Entrepreneurs: Embourgeoisement in Rural Hungary* (Madison: University of Wisconsin Press, 1988); and "Alternative Futures for Eastern Europe: The Case of Hungary," *EEPS* 4:2 (1990), pp. 231–54.

cheap labor would not only sacrifice national economic sovereignty but would actually ignore the opportunity to capitalize on those areas where the Hungarian economy has some potential for comparative advantage, namely, in labor-intensive products (especially, but not limited to, high-quality foodstuffs). This image of a "garden Hungary," or Hungarian craft production, builds on the skills and ingenuity already displayed in Hungary's second economy. To be successful it would require, at the very least, that current second economy producers shift from their present part-time, income maximizing orientations utilizing household labor to full-time, capital-accumulating orientations employing wage labor. Szelenyi contends that his field observations and survey research among Hungary's rural entrepreneurs provide evidence that the energies, ambitions, and capacities for such a shift do exist and could be realized provided that long-standing restrictions on small-scale production be lifted, credits liberalized, and taxes reduced. His fear is that policies in the latter part of 1989 and early 1990 were moving exactly opposite to the desired direction and that, if these continue, they will strangle the million geese that could lay small, but nonetheless golden eggs.

As outlined above, a strategy for development based on the transformation of the existing second economy into a legitimate, dynamic, entrepreneurial private sector leaves aside the question of the transformation of the large state enterprises. Indeed, some might argue that positions similar to Szelenyi's are outside the boundaries of the privatization debate since their primary emphasis is not on the disposition of assets currently held by the state.²⁰ Such a criticism stands behind an alternative conception of dispersed ownership that aims to

20. We should note here a terminological difference in the existing literature on "privatization." Whereas scholars studying East Central Europe use the term to refer to the transformation of state enterprises into privately held assets, Sovietologists use the same term to refer to the growth of a private sector (cooperatives and other, typically smaller scale ventures) alongside the centrally directed economy. East European scholarship has not agreed on a single term for this latter process ("privatization" is not used in this sense), and the expressions utilized are typically more cumbersome ("expansion of the traditional private sector," "transformation of the second economy," etc.). To the extent that such development indirectly transfers resources from state-controlled to privately-controlled activities and significantly alters their relative proportions, one might meaningfully speak of a "privatization" of the economy. Such conceptual problems cannot be resolved by terminological fiat. But the two processes should not be confused. The analytic distinction is useful if only to highlight that it is possible for "privatization" in the second meaning to occur without a fundamental transformation of property relations in the state sector; and similarly, that "privatization" in the first (East European) meaning might take place without unfettered development of small-scale entrepreneurial activity.

expand the beneficiaries of participation in private ownership *within the sphere of the large, formerly state enterprises* without necessarily expanding the circle of entrepreneurs outside it. In Hungary, as in Poland, the main organizational vehicle for widening such participation has been the proposal for employee share ownership.

Proponents of Employee Stock Ownership Programs (ESOPs)²¹ argue that the obvious alternative to “nomenklatura buyouts” are employee buyouts: Workers’ investments of skills and energies in their firms give them rightful claims to equity in these same companies, and they should be eligible to purchase such shares at discounted rates. Addressing the problem of limited savings among the general population, ESOP advocates propose that the government should encourage (and subsidize if necessary) lending institutions to provide financing for these employee buyouts at favorable interest rates with delayed repayment schedules. These loans would be repayed from future dividends, and soon enough, employee shareholders with a direct interest in the value of their holdings would come to see the connection between performance, profitability, and the economic viability of the firm in which they hold a stake. This interest in profitability would stimulate performance both directly at individual workplaces and indirectly through the institutions of shareholder councils in which employees would monitor managerial performance and promote a more efficient, participatory organization of work. Proponents of ESOP schemes emphatically stress that employee buyouts should not be restricted to failing firms. They further argue that not all plants targeted for closing under industrial restructuring are economically unviable, and that the performance gains foreseeable under ESOP management might yet demonstrate that viability. Moreover, because employees would have a stake in long-term profitability, they would have an interest in converting facilities to new product lines in order to keep their jobs at the same enterprise, even if this meant that their production would then be in a

21. The leading proponent of ESOPs in the Hungarian setting has been János Lukács, an industrial sociologist at the Academy of Sciences, who carried out field investigations at the employee-owned Wierdon Steel factory in West Virginia after being introduced to the ESOP concept while on leave at the Institute of Industrial Relations at Berkeley. Together with a group of lawyers and economists, Lukács established a foundation, *Rész-vétel* (the artificial hyphen creates a double meaning in Hungarian as “shareholding” and “participation”) in early 1990 to disseminate information about employee ownership and provide technical advice to managers and workers interested in establishing ESOP schemes.

different, but perhaps related, industrial branch. Thus, in addition to equity issues and the stimulation of performance, dispersed employee share ownership would reduce the currently anticipated high levels of unemployment in the immediate transition and provide an avenue for employees to retain their workplaces over the long run.

Detractors of the ESOP alternative are quick to suggest the “free rider” problems inherent in the hypothesized connection between employee shareholding and worker performance. Why should any worker in a firm of several thousand employees believe that the value of his shares will increase because of his own improved performance? In fact, if that value might increase even if one slacks, doesn’t this encourage one to coast while hoping that others will work harder? ESOP advocates, in turn, point to the existence and even growth of employee shareholdings in large enterprises in Western economies, contending that improved performance will come from better work organization due to management’s accountability to worker-owners, rather than from the individual psychology of game theory. The detractors counter that organizational studies of ESOPs in the United States and elsewhere indicate that the relationship between employee ownership and enterprise performance is ambiguous at best,²² that the recent growth of ESOPs may be as much attributable to managerial strategies to avoid hostile takeovers as to any profitability gains, and that there is no shortage of evidence from Japan or West Germany that better work organization and close cooperation between workers and managers is possible without employee ownership. For these and other reasons, economists such as János Kornai and Márton Tardos, while not dismissing employee ownership entirely, have limited their endorsement to smaller firms, especially in crafts (as in the famous Herend china factory), where human capital is dominant in the production process.

But the strongest criticisms of ESOPs in the Hungarian context are directed at those elements of employee shareholding that are perceived by economists to slow down the desired consequence of privatization, namely marketization. Employee ownership, they argue, will limit the

22. The most comprehensive survey of the literature on ESOPs in the United States so concludes. See Michael A. Conti and Jan Svejnar, “The Performance Effects of Employee Ownership Plans,” in Alan S. Blinder, ed., *Paying For Productivity: A Look at the Evidence* (Washington, DC: The Brookings Institution, 1990), pp. 143–181.

mobility of capital and retard the emergence of a real labor market. Further, it will delay industrial restructuring. Together with the enormous foreign debt (which employee buyouts will not reduce), the other catastrophic legacy of centralized mismanagement is the multitude of technologically obsolescent factories, incapable of competing in domestic markets, much less meeting international standards. Is it in the national interest, or in anyone's interest, to continue to produce steel (or similar products) when it is vastly cheaper to purchase it abroad? The continued operation of aging plant and equipment will only place a further burden on an already sagging economy; delays in industrial restructuring today will only prolong and perhaps exacerbate the agony tomorrow.

ESOP advocates respond that such macroeconomic policy-making ignores the human factor. The human material of the production process, workers, are not commodities that can be displaced from their communities and shunted from one worksite to another. With their roots in particular locales and their investments in particular firms, workers' rights to remain in their given workplaces should be defended. Employee ownership provides a means to do this. Industrial restructuring will proceed apace because workers who have an interest in the value of their shares will have every incentive to make rational choices about company changes.

The detractors counter that it is the well-intentioned illusions of employee shareholding that ignore the human factor. Workers will not have an interest in the value of their shares (a fraction of their total earnings) so much as in the value of their skills and compensation for their labor. Institutions that delay the creation of a free labor market will delay the time when workers can bargain to receive the market value of their labor. Institutions that delay restructuring will keep some significant segment of the labor force in jobs where the pay is low because productivity is low. As for the bitter pill of unemployment which necessarily accompanies plant closings, which one is preferable: a certificate and a voice in a failing company that depends for survival on continued subsidies and more worker sacrifices, or a comprehensive program of job retraining that allows workers to add new skills to the old in restructured enterprises with better prospects of economic viability?

At this point the proponents of employee shareholding pull out their

trump card. It is because we share the goal of marketization, they argue, that we advocate employee share ownership. For we too are thinking about the long term—not the viability of individual enterprises, but the political stability of the new economic system that results from the transformative process of privatization. Systemic stability will rest, in the long run, on the perceived legitimacy of the privatization process. Private property that is perceived by workers as illegitimately appropriated will not be secure. For four decades workers were told that they were the owners of Hungarian industry. It was demagoguery, to be sure. But what shall we tell them now? That they are to be excluded from the opportunity to purchase the property that they see as, in some sense, rightfully theirs? Stability requires legitimacy; legitimacy requires equitability; and equitability in this case requires equity—equity in their own enterprises.

The detractors: yes, questions of equity and equal treatment are at the core of the ESOP problem. Under your proposals every worker has the same right in principle to purchase discounted shares—but only in the firms in which they are currently employed. Is it equitable that one worker can apply for credit to purchase a worthless certificate in an inefficient run-down plant while another (perhaps with the same skills and the same level of performance) can participate as a shareholder in a technologically sophisticated plant recently modernized under the old system of state subsidies drained from the enterprise of the first? Why should employment in a particular firm translate into equity in that firm? And what about employees in the remaining public sector working in hospitals, schools, and state administration? Where is their equal treatment? ESOP schemes will not solve the problems of the old system, but perpetuate them—for they are not an alternative to *no-menklatura* buyouts but a complement and partner to them. In both cases, incumbency in a position serves as the basis for an ownership share. So we shall not be surprised if partial buyouts by enterprise directors and partial buyouts by employees work in tandem rather than in opposition. The further consequence will be to perpetuate the old system of favoritism and subsidies as the new block of managers and employee-shareholder-voters in particular firms will make it all the more difficult for government officials to ignore their special pleas in the inevitable times of business downturns.

These same issues of equity lie at the core of the position advocating the most dispersed ownership through the mechanism of *universal ownership grants*. According to proponents of such schemes,²³ the political revolutions that are sweeping aside the old regimes in Eastern Europe provide a unique historical opportunity to rebuild a social order on principles of equality and justice. Because the collective wealth of the Hungarian economy is the product of the work of the entire society, this wealth should not be sold to the highest bidder, or parcelled out on the basis of current employment, but distributed to everyone. The plans for such distribution differ in technical details, but the essential feature is that the government should privatize the assets of state enterprises by issuing certificates representing an abstract ownership right to all citizens. These certificates would not in the first instance be tied to particular firms (that is, citizen Kovács would not directly receive a share of Malev Airlines nor would citizen Szabó immediately receive title to a share of the former Lenin Steelworks). Instead, these certificates could be held as bonds (to be redeemed later at some fixed or variable interest rate) or, more importantly, could be converted directly into ownership shares in particular firms, banks, or mutual funds. With each citizen free to convert his certificate into shares in the company that he sees as having the most promise, the universal ownership arrangement would not only solve the problem of equality in equity but would also be the most rapid means to create a capital market governed by investor confidence.

Those skeptical of the universal grants schemes point first to the enormous technical difficulties of coordinating the conversion of certificates into ownership shares. The existing securities exchange in Budapest consists of several personal computers. And even if all the technological requirements of a central stock exchange were in place, where are the thousands of experienced brokers needed to handle the heavy volume of transactions involving millions of individual investors? Others note that the resolution of these difficulties would merely distribute the assets of the society without attracting the foreign capital that is needed to modernize the economy. Critics also charge that universal shareholding chases an illusive equality—for all citizens are not equally

23. The major proponent of universal share grants in Hungary is István Sik-Laky, an economist who was an earlier devotee of the schemes of entrepreneurial socialism of the iconoclast, Tibor Liska.

capable of making informed decisions to convert certificates into discreet investments. Leaving aside questions of unequal access to information, what about children or the aged? Who should be responsible for their holdings? Advocates respond that this is a minor detail that could be handled by depositing their certificates with professionally-managed mutual funds, or as bonds that could be redeemed at the age of maturity. More significantly, won't the larger part of the citizenry, especially in times of such enormous economic difficulties, immediately sell their shares for much needed income? Equality of shareholding and dispersion of ownership might last only a few months at best—and the flood of shares sold for meager but needed short term benefit would so depress prices that those only relatively more wealthy at the outset could quickly gain ownership rights over most of the economy. In anticipation of such developments, some proponents of universal shareholding advocate special temporal conditions: a certain part or percentage of the shares of each citizen cannot be alienated for income for some specified period, etc. But critics quickly note that the citizens of state socialism will easily find unofficial means to sell shares, and that the discounted rate in such informal sales will mean that the neediest will receive even lower value for their initial (abstractly equal) certificates. Other proponents of the grants scheme allow that some concentration of ownership cannot be administratively curbed and should, in fact, be expected in the first phase of transition to capital markets. They maintain, nonetheless, that the initial distribution of state assets will include a much wider sphere of participants in market transactions, which encourages market development and will produce broader popular political support for privatization.

For some opponents, this political component is a vice rather than a virtue of universal shareholding. János Kornai, for example, argues that citizenship grants create “the impression that Daddy state has unexpectedly passed away and left us, his orphaned children to distribute the patrimony equitably. But the state is alive and well.”²⁴ On similar political grounds, others contend that even if we assume the most optimistic scenarios of universal shareholding, the dispersed ownership that would result might be congruent with oligarchic control of the economy rather than act as a check on it. If the organizational structure

24. Kornai, *The Road to a Free Economy*, p. 82.

of large public enterprises remains unchanged and unchallenged by smaller (and genuinely entrepreneurial) ventures, diffuse formal ownership could make it all the easier for corporate insiders (directors and bankers) to control business strategy with an even smaller bloc of shares.

Will Privatization Yield Marketization?

The starting point of this essay has been the now widely shared assumption across virtually the entire spectrum of current Hungarian economic thinking that marketization can be achieved through privatization. The purpose of these final pages will not be to challenge the goal of marketization but to raise a different question: will privatization in the contemporary Hungarian setting actually lead to thorough marketization? The process of privatization having only recently begun, it is much too early to answer our question on the basis of empirical evidence from case studies, surveys, or the analysis of statistical materials. But it is not too early to formulate preliminary hypotheses sparked by the privatization debate and to indicate promising lines of research for a critical assessment of competing theories about the transition(s) from state socialism.²⁵

An initial analysis of the privatization debate points to the following preliminary hypothesis: institutions that are appropriate for reproducing market relations will prove inadequate for securing the *transition* to a fully marketized economy. This proposition is the close cousin to a proposition that we might distill from recent comparative economic analysis as the following: success in the world economy can be achieved by institutions that seem improbable from the standpoint of conventional economic thinking (whether because “anachronistic” or simply outside the categories of analysis).²⁶ In both cases the propositions rest for support on the argument that a narrow focus on

25. For an analysis of competing models of the transition see David Stark, “Six Models in Search of an Economy: Hypothesized Roads to the Market in the Transition from State Socialism,” *Working Papers on Transitions from State Socialism*, Cornell Project on Comparative Institutional Analysis (1990).

26. See especially Michael Piore and Charles Sabel, *The Second Industrial Divide: Possibilities for Prosperity* (New York, 1984); and Charles Sabel, “Flexible Specialization and the Re-emergence of Regional Economies,” in Paul Hirst and Jonathan Zeitlin, eds., *Reversing Industrial Decline*, (New York, 1989), pp. 17–70.

institutions ignores how powerful social groups can subvert institutions and neglects how social networks outside a narrowly economic analysis can provide resources to achieve economic goals. The twin propositions suggest that rather than simply analyzing the institutional features of the economy, studies of privatization should focus on social groups and the characteristics of their networks of affiliation that impede or facilitate marketization.

Economic transformation of the scope desired in contemporary Eastern Europe calls for a dramatic reallocation of existing economic resources—a transfer of resources from one institutional form where they appeared underutilized (or wastefully misutilized) to another that promises more efficient and effective utilization. Proponents of such change act with the hope that unhesitating commitment to restructuring will itself stimulate the inputs of some new resources necessary to get the new system in motion: new sources of credit and investment from abroad, new energies from individuals whose talents were not productively realized under the earlier system, and a fresh reserve of goodwill and patience from the citizenry at large. But the existing resources that are at once the most sizeable and the most uncertain (as to their future operation) are the informal networks of interaction that operated quite apart from officially sanctioned ties whether in the interstices of bureaucracy or outside it altogether. Will the informal networks that “got the job done” despite institutional barriers in the earlier system promote marketization, or will they inhibit it? In the contemporary Hungarian setting the most promising candidates for research on such networks are those indigenous social groups that have already demonstrated the greatest interest in privatization: 1) enterprise directors and the related circle of key organizational actors likely to participate in patterns of institutional ownership (whether spontaneous or controlled), and 2) private entrepreneurs and the related circle of small-scale producers in the existing second economy (whether relatively more concentrated, as in Kornai’s schemes, or relatively more dispersed, as in Szelenyi’s).

Turning first to the enterprise directors, what will become of the invisible network of interaction among these agents who were responsible for directing the day-to-day operations of enterprises during the final years of the old regime? Will these ties serve as a basis for marketization

or will they, even if unintentionally, subvert it?²⁷ An initial proposition to orient research might be: the networks of enterprise directors under conditions of institutional ownership will be too clanlike to achieve thorough marketization in the Hungarian setting.²⁸ Forged under conditions of soft-budget constraints, these cohesive networks of trust and friendship will promote dynamism in the short run; but when times get difficult, they will be used to defend perceptions of “interests” shaped by long-standing habits and routines inimicable to marketization. The proposition is not intended as a prediction or forecast, for the outcomes of transformative politics are always uncertain. Perhaps some combination of enough direct foreign investment and enough real private entrepreneurs will produce an environment in which the clan networks of institutional owners become the organizational vehicle for dynamic market competition. In the immediate future, our research should investigate the characteristics of these networks—their density, their extensiveness, the symmetry or asymmetry of ties, their similarity to old patterns, their centralized or decentralized clustering, their stability or relative fluidity, and other aspects of their patterns.²⁹

Networks among Hungary's existing small-scale producers are equally worthy of study. The preliminary conclusion of István Gábor, Hungary's leading expert on the second economy, is that these networks (of low density and extensiveness, lacking trust and cohesion) are almost the reverse of those among enterprise directors. Gábor makes these observations in a recent paper that offers a “pessimistic” reading of Szelenyi's and Kornai's views of small-scale producers in the existing

27. The question itself raises difficult dilemmas for policy-making in the transition period. One “solution,” of course, would be to replicate the errors of the previous reign of terror which, recognizing that similar agents under the old order had skills and knowledge necessary for the new, alternately persecuted and courted “bourgeois experts” while placing them under the surveillance of political commissars. New loyalty tests will obviously not solve the problem today, nor is there some instrument that could spot “genuinely entrepreneurial” directors from a questionnaire. To give the current directors an entirely free hand risks the danger that they will produce an economy little different from the previous one; to tighten restrictions risks the self-fulfilling prophecy that they will be forced into their old ways as protection against distrustful adversaries.
28. The network embracing enterprise directors is “clanlike” to the extent that its density (with actors linked to a multiplicity of agents who are also linked to each other) and its extensiveness (covering a broad scope of actors in diverse fields) makes coordinated action possible even without a coordinating center.
29. On the methodology of network analysis developed by economic sociologists in the United States see Mark S. Mizruchi and Michael Schwartz, eds., *Intercompany Relations: The Structural Analysis of Business* (Cambridge, 1987).

private sector.³⁰ Like the latter authors, Gábor is a strong critic of institutional ownership, but he is much less sanguine than they about the prospects for dynamic marketization in this sector. Gábor's skepticism originates in the premise, drawn from recent work on the "Third Italy," that flexible small-scale production requires not only competition but also cooperation.³¹ He notes that Italian small-scale manufacturers (competing in the same product lines) are often tied to each other through old trade-union connections, reinforced by political parties, and supported by local governments. Not uncommonly, producer associations in a given locale hire marketing experts for information about new products and designs. All the participating small firms receive the information (too costly for any single unit) and then compete for a share of the market. Stability of employment in the industrial district cannot be guaranteed, but it is secured to a considerable degree by the fact that entrepreneurs who capture large orders often augment capacity by subcontracting parts of these orders to competitors in the same district. Other research on the Third Italy further traced these patterns of cooperation to long-standing institutions that protected society from complete penetration by the market.³² In this lies Gábor's deepest pessimism: state socialism prohibited the spread of the market in the past, but it also virtually eliminated any institutions of civil society that might form the basis for such cooperation in the near future. The networks of Hungary's small-scale producers are so restrictive they provide little basis for cohesion and coordination. These networks are too close to the nuclear family, and their patterns of trade are too close either to large enterprises or to the final consumer (with relatively few purchase and supply links *within* the sector itself). Formulated in terms of the previous proposition, Gábor's observations could be restated as: the networks of private entrepreneurs under conditions of natural ownership are not clanlike enough to yield comprehensive marketization.

Again, the proposition is less predictive than illustrative of the kinds

30. István Gábor, "On the Immediate Prospects for Private Entrepreneurship and Re-embourgeoisement in Hungary: A Pessimistic Meditation in the Wake of Ivan Szelenyi's Prognosis of Continuity and János Kornai's Program of Discontinuity," *Working Papers on Transitions from State Socialism*, Cornell Project on Comparative Institutional Analysis (1990).

31. See, for example, the collection of essays in a recent special issue of *Economy and Society* 18:4 (November 1989).

32. Carlo Trigilia, *Grand partiti e piccole imprese* (Big Parties, Small Firms), (Bologna, 1986); and "Small firm development and political subcultures in Italy," *European Sociological Review* 2:3 (1986), pp. 161–75.

of hypotheses towards which to orient further research. Research on small-scale producers would shift attention from the *individual's* aspirations for entrepreneurship to the features of *localities* that inhibit or encourage marketization. In such an ecological model, entrepreneurship is less a function of individual motivation than of social relations in a particular field. How, for example, do localities differ in linkages among small-scale producers along lines of credit, marketing, supply, etc.? Will competition among political parties at the local level and the fact that local governments will face constraints in self-financing yield new patterns with some diversity across regions? Gabor's pessimism may prove warranted; alternatively, local governments may find enough social resources to put together programs for cooperative competition. But until further research indicates profound changes in the interactions and orientation of enterprise directors in Hungary's largest firms, and those of the micro-entrepreneurs in its smallest units, the prospects for comprehensive markets are far from bright. If twenty years of experience with reforms demonstrated that markets are not possible without private ownership, the next decade of experiences with transformation in Hungary might yet demonstrate that private ownership is not sufficient to create thorough marketization.