"Implicit" Development Strategies in Central East Europe and Cross-National Production Networks

Ellen Comisso
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Ellen Comisso is Professor of Political Science at the University of California at San Diego.
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Not entirely without reason, East Europeans have been prone to view the region's long and short-term political evolution in terms of various "national tragedies" suffered at the hands of any number of larger and more powerful entities centered outside the region's borders.[1] Similarly, economic development--and especially the lack of it--has often been regarded as the result of decisions made by external political and economic actors in pursuit of their own interests, with scant concern for local consequences, sensibilities, or welfare. Not surprisingly, then, one encounters a certain amount of local skepticism about the ability of either economic agents or governments in ex-CMEA states to influence the terms on which East-West integration occurs.[2]

That both political and economic interaction between western and eastern Europe has expanded dramatically in the wake of the 1989 regime changes is undeniable. Indeed, by 1995, over two-thirds of the foreign trade of the four "Visegrad" countries (Poland, Hungary, the Czech Republic, and Slovakia) was with European Union members, compared with about 20 per cent a decade earlier. Moreover, much of that massive trade reorientation is directly traceable to policy decisions made by post-socialist East European governments, whether it was the agreement to put Comecon trade on a hard currency basis (a key factor in the trading bloc's collapse in 1991), the dropping of trade barriers to facilitate import competition, the signing of Association Agreements with EU, or most recently, the submission of applications for formal EU membership. Hence, policy choices and changes of ex-CMEA states themselves have clearly had an effect on the direction and quantity of the region's trade and ties since 1989; their impact on the quality of trade, the economic and technological benefits of trade, and particularly the degree to which increased East-West interaction takes the form of the cross-national production networks so significant in Asian trade and development is a somewhat different question.

In fact, the quality of economic relations between EU and ex-CMEA economies appears to be quite different from the trading arrangements which characterize East Asian NICs. The

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[1] See Piotr Wandycz, The Price of Freedom (New York: Routledge, 1992); Ivan Berend, "The historical evolution of Eastern Europe as a region," in E. Comisso and L. Tyson, eds., Power, Purpose and Collective Choice (Ithaca: Cornell University Press, 1986), pp. 153-71; Joseph Rothschild, Return to Diversity (New York: Oxford University Press, 1988); Jeno Szucs, "Three Historical Regions of Europe," in John Keane, ed., Civil Society and the State (London: Verso, 1988), pp. 291-333.

[2] For example, see Andras Inotai, "From Association Agreements to Full Membership? The Dynamics of Relations between the Central and Eastern European Countries and the European Union," Institute for World Economy Working Papers, No. 52 (Budapest: June 1995).

differences are partly captured in some of the key features of the most recent phase in the growth of East-West trade.

First, foreign direct investment (FDI) has been relatively slow to arrive: "...the annual influxes into the Central East European [CEE] countries [in the 1990s] remained lower than Singapore's alone," and over half of it went to a single country, namely Hungary.[3] Moreover, unlike initial investments in "third tier" Asian countries, taking advantage of differential factor prices (i.e., lower labor costs) does not seem to be the primary motive of foreign investors. Rather, "Western firms seek access to the market and expansion of their business."[4]

Second, "the trade of the Visegrad countries has remained predominantly inter-industrial, although there has been a shift toward intra-industry trade more recently."[5] In this regard, it appears that to the degree intra-industry trade has developed, it has been largely in the form of the outward-processing trade (OPT), and concentrated in labor-intensive light industry (clothing and footwear in particular). Only in Hungary has the OPT share in engineering increased significantly since 1992; the main factor here would seem to be the greenfield plants for the assembly of automobiles established by several major western producers. As we shall see, the benefits of the OPT trade for the ability of domestic firms to move into higher value-added activities have been ambiguous, while newly constructed western assembly plants have typically used western, rather than local, suppliers.

Third, despite an initial export boom, the Visegrad countries on which this analysis focuses are all running trade deficits with EU partners, and financing those deficits is becoming increasingly problematic. Thus, the rapid expansion of East-West trade has been asymmetrical in two senses. On the one hand, if nearly 70 per cent of Eastern Europe's foreign trade is with EU, the proportion of EU's foreign trade with Eastern Europe is much smaller, even in the individual cases of Germany and Austria.[6] On the other, while CEE exports to EU have tripled over 1992-5, CEE imports from EU have quadrupled. In addition, exports remain concentrated in relatively traditional sectors: metals, fuel and minerals, and wood products in Poland; raw materials and

[3] Gyorgy Csaki, Magdolna Sass, and Andrea Szalavetz, "Reinforcing the Modernization Role of Foreign Direct Investment in Hungary," Institute for World Economy Working Papers, No. 62 (Budapest: March 1996), p. 7.
[4] Klaus E. Meyer, "Direct Foreign Investment in Eastern Europe: The Role of Labor Costs," Comparative Economic Studies 37 (Winter 1995): 83; see also Hans Peter Lauker and A. J. Venables, "Foreign direct investment in economic transition: the changing pattern of investments," Economics of Transition 4 (October 1996):331-47.
[5] Andrea Elteto, "The Role of the Trade Balance in the European Union and the Central and Eastern European Countries," Institute for World Economy Working Papers, No. 73 (Budapest: December 1996). Elteto notes further, "In both Poland and Hungary, the trade surplus in clothing exactly mirrored the deficit in yarns...." (p. 12)
[6] See "Eastern Promise," The Economist, April 17, 1997, p. 77.

less processed goods in the Czech Republic; agriculture, apparel and clothing, food and beverages, and basic metals in Hungary.[7] Only to the degree foreign-owned firms have begun to operate in the region have exports started to shift into more sophisticated products, with the automobile industry being an important example in all three countries. As for imports, it may be tempting to attribute trade imbalances to imports of capital goods needed for modernization, but in fact, "the trade deficit in consumer goods exceeds the deficit in intermediate goods in Poland from 1989, in Czechoslovakia from 1991, and in Hungary from 1993."[8]

All in all, then, the situation in even the states that are generally thought to be in the forefront of "The Transition" appears to be rather different from the "third tier" Asian development stories. The reasons for this are multiple. They reflect different starting point and cultural traditions, both of which have militated in favor of rather different development strategies on the part of CEE governments. Finally, and not to be minimized, the reaction of western firms to the region's attempts at transformation appear to reflect different motives and patterns of interaction from those of Asian counterparts.

Different Starting Points

Our inquiry will focus on Poland, the Czech Republic, and Hungary for several reasons. First of all, their geographic position alone suggests that to the degree links between enterprises in eastern and western Europe form, they are likely to begin in these states. Or, put somewhat differently, if cross-national production networks are not present in these three states, they are unlikely to be present in major countries elsewhere in the region.[9] Second, to the degree domestic policy decisions affect the quantity, quality, and scope of inter-enterprise cooperation, Poland, the Czech Republic, and Hungary have undergone the most thorough economic, political and legal reforms in the area. Along with Slovenia and some of the Baltic states, they have become the models other countries in the region are exhorted to imitate. Although the reform process in even the Golden Triangle is still far from complete, the respective patterns and

[7] On Poland, see Economist Intelligence Unit, Poland: Country Profile, 1996-7, p. 39; on the Czech Republic, see idem, Country Profile:Czech Republic, 1996-7, p. 24; on Hungary, see OECD, OECD Economic Surveys: Hungary 1995 (Paris: OECD, 1995), p. 76.

[8] Elteto, "Trade Balance," p. 18. See also Table 8, p. 36.

[9] Slovenia, bordering Italy, and Estonia, with ties to Finland, may be exceptions here; we omit them from this analysis primarily for reasons of time and space. It should be noted that as part of the Yugoslav economy, Slovene enterprises were always far less insulated from west European economic currents than enterprises within CMEA-member states.

directions of change are relatively clear at this time, such that one can at least describe them as variants of a distinctive "model." Finally, to the degree this analysis broadly seeks to shed light on EU enlargement, it would seem to make sense to concentrate on the leading candidates for inclusion and examine how and why they came to acquire this status and how it affects the links between producers.

As we shall see below, the elements making up an "implicit" development strategy vary somewhat among each of the states in our sample, but all differ rather substantially from the path taken by states in Asia in all "tiers." Whether one points to taxation and budgetary issues, the proportion of national income that passes through government hands, recruitment into key state agencies, human capital concerns and social service provision, industrial policy or trade and regulatory practices, the so-called

"Asian" model(s) of development has--for better or worse--not figured prominently in either the thinking or the decisions of policymakers anywhere in Eastern Europe.[10] On the contrary, the model of development to which at least the Central European trio we are examining appears headed is that of the West European welfare state, Germany and Austria being the primary examples emulated.[11]

Part of the reason for the choice of models is, of course, cultural, historical, and geographic. Germanic influence in the area is long-standing, dating back as far as the invitations of medieval kings to German settlers for the purpose of populating and modernizing their realms. Indeed, the population of cities in the area was predominantly German until the nineteenth century, and the start of modern economic growth occurred in the framework of the imperial states of the Hohenzollerns and Hapsburgs, with capital contributed by banks headquartered in Berlin and Vienna.[12] In a certain sense, the role of the German and Jewish populations of Central Europe in the area's initial modernization was reminiscent of the role played by the overseas

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[10] For a lament of this state of affairs, see Alice Amsden, Jacek Kochanowicz, and Lance Taylor, The Market Meets Its Match: Restructuring the Economies of Eastern Europe (Cambridge: Harvard University Press, 1994).

[11] See Jeffrey Sachs and Andrew Warner,"Achieving Rapid Growth in the Transition Economies of Central Europe," HID Development Discussion paper No., 544 (July 1996), mimeo; "Tigers or tortoises?" The Economist , October 26, 1996, p. 98.

[12] See Norman Davies, God's Playground: A History of Poland, Vol. 1 (New York: Columbia University Press, 1984); Gale Stokes, "The social origins of East European politics," in Daniel Chirot, ed., The Origins of Backwardness in Eastern Europe (Berkeley: University of California Press, 1989), pp. 210-53; David F. Good, ed., Economic Transformation in East and Central Europe: Legacies from the past and policies for the future (London: Routledge, 1994); Ivan Berend and Gyorgy Ranki, East Central Europe in the Nineteenth and Twentieth Centuries (Budapest: Akademiai Kiado, 1977).

Chinese communities in Asia more recently, in which informal networks of family, ethnicity, and cultural ties were critical in reducing transaction costs, risks, and uncertainty. As these historical relationships have manifested themselves in the CEE states since 1989, it is entirely understandable that new commercial, financial, and corporate codes and the legal forms and rights surrounding private ownership tend to be local adaptations of German codification. The heavy reliance of enterprises on banks for financing--as opposed to raising capital through equity offerings--is partly a reflection of this framework.

A second reason for the tendency to turn westward for economic and policy models is related to the level of development attained in the CEE states by 1989. Unlike "third tier" states in Asia, Central European states may have been "misdeveloped," to use Paul Marer's felicitous phrase,[13] but they were not underdeveloped. This can be seen from Tables 1-9. Those tables reveal both rapid modernizations in Malaysia, Thailand, Indonesia, and to a lesser extent, the Philippines in the 1980s, together with little change n the economic structure in Hungary, Czechoslovakia, and Poland during the same decade. At the same time, however, significant differences between the two groups persisted, despite the stagnation in the East European set. The social indicators of modernization--urbanization (Table 1), infant mortality (Table 2), literacy rates (Table 3), and life expectancy (Table 4)--remain higher in Eastern Europe. The economic indicators--per capita GDP (Table 5), the employment structure of the labor force (Table 6), the sources of GDP (Table 7), and even telephones and road density (Table 8 and 9) all reflect differences between industrializing and industrialized economies. Hence, the CEE economies in 1990 were not starting from a position in which resources and capacities had first to be created. Rather, substantial capacities were already present, and the task was determining how to redeploy and reorient them and who should be the prime mover in the process: the public sector and the state or the private sector and a relatively open and competitive market.

The third difference between the CEE states and the East Asian economies that influenced policy choices and strategies in the former is, of course, the experience of state socialism. On the one hand, the disintegration of the ruling Leninist party in 1989 meant that a central mechanism of regulation in the state socialist economy was no longer present, making a continuation of the old system impossible. On the other hand, the strong repudiation of the past on which opposition parties and movements rode to power in 1990 entailed a deep determination

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[13] See Maurice Ernst, Michael Alexeev and Paul Marer, Transforming the Core (Boulder: Westview Press, 1996).

to drastically reduce the role of the state in the economy, it be as an owner of assets, a regulator of prices, or a source of subventions for favored activities. The desire to establish an economy based on "self-regulation" in response to the hierarchical direction of the past was a key factor in the relatively liberal pattern of measures adopted in Poland, Czechoslovakia, and Hungary to deal with the immediate economic crisis. Accompanying it was a national aspiration to "rejoin Europe," a project which entailed distancing both the state and the economy from the Soviet Union and Russia.

At the same time, however, the bulk of the population had become accustomed not only to the full employment economy and subsidized price structure of socialism, but also to a substantial array of social services, many of which were distributed through the workplace. If anything, reliance on state-provided social services--especially pensions--increased as the "transition recession" began. While reform of social service delivery became a hot political issue, abandoning their provision altogether was not a viable political option anywhere. Hence, even as the state began to relinquish its role as a direct producer in favor of a more limited one of simply enforcing a framework for voluntary transactions, its centrality in the supply of social welfare remained more or less intact.

The legacies of socialism at the level of enterprises was equally substantial. Large, vertically integrated, monopolistic enterprises were the norm, and secondary sector activities--especially in heavy industry--were typically in a privileged position vis-à-vis primary and especially tertiary sector development. Especially in Poland and Hungary, cutbacks in investment in the 1980s meant the capital stock was badly in need of modernization, and depreciation rules combined with the sellers' market so typical of the shortage economy had encouraged keeping outdated equipment in operation everywhere. Firms thus contained substantial, if antiquated, productive capacities together with human capital reserves concentrated on the production and engineering side of manufacturing.[14] It was the economic side of the production process that had received short shrift in state socialism, with marketing and sales departments absent even in companies that had some experience producing for western markets. In effect, the internal structure of enterprises mirrored the larger structure of the

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[14] See, for example, Slavo Radosevic, "Science and technology capabilities in economies in transition: effects and prospects," Economics of transition 3 (No. 4, December 1995): 424-59.

economy: an exaggerated attention to supply and production of physical commodities at the expense of economic activities catering to transactions, consumption, and demand.

As for the private sector, it was non-existent in Czechoslovakia, but increasingly vibrant in Poland and Hungary as the 1980's drew to a close. In the latter cases, limits on legal employment and other restrictions tended to keep private firms small, and the most obvious opportunities to exploit were in the service sector, where private entrepreneurs tended to congregate.[15] Yet even in Poland and Hungary, the health of the burgeoning "second" economy typically depended heavily on the operation of the state-owned "first" economy as long as socialism survived.

The story of cross-national production networks--or in practice, their relatively limited appearance to date--is in large part the story of the reaction of these two very different types of enterprises to policies aimed at opening markets, creating competition, expanding trade with the west, and controlling inflation while maintaining as much as possible of the old social safety net intact.

"Implicit" Development Strategies: Country Analyses

"Development" in each of the three countries in our sample has by and large been defined by post-socialist governments along two dimensions. First, it is seen as a process of "westernization," involving increased trade and political involvement with western countries, culminating with membership in NATO and EU. A corollary of this process is a distancing from the "east," manifested by the precipitate collapse of CMEA and especially Soviet trade, despite the difficulties the loss of traditional buyers caused so many East European firms. Second, "development" has been equated with the creation of an economy based on competitive markets and private ownership, a so-called "normal" economy in which a clear boundary separates the public from the private sphere.

As such, indicators of progress towards these goals have not centered around the traditional elements associated with "development" elsewhere, such as economic growth, the structure of employment, the sophistication of the technological base, or increased living standards--factors which have only very recently become of concern to policy makers. Instead, evaluations of the past few years have frequently defined "progress" in terms of a rather peculiar

[15] In Poland, however, agriculture was never collectivized, and most land was farmed by small peasants.

set of variables: declining rates of labor force participation, increased unemployment, a declining share of national income originating in industrial and manufacturing activities, a drop in real earnings, increased income and wealth disparities, and other such counter-intuitive measures.[16] Such an anomalous situation makes sense only once we realize that overcoming socialism and moving out of a Soviet *cum* Russian sphere of influence are perceived by policymakers as the core tasks much more than combating underdevelopment is, for both economic and especially political reasons.

As a result, if transition/transformation strategies have varied somewhat within the three states in our sample, they have all centered around the Holy Trinity of Liberalization, Stabilization, and Privatization together with a massive reorientation of trade from East to West. We begin with a country by country summary of the main policy steps and results. We shall then move to compare them in the context of the responses of domestic firms and the degree to which East-West production and financial networks have emerged in each state.

Poland: Favoring the Small[17]

The characteristic that distinguished Polish post-socialist economic policy from that in Czechoslovakia and Hungary was the feature that earned it the title of "shock therapy": namely, the immediate and simultaneous introduction of liberalization and stabilization in a single package of policy measures adopted by the Sejm in 1989. Economic policy since that date has largely been a process of tinkering with and modifying some of its elements to make it more palatable to the highly vocal domestic interests harmed by its effects--agriculture and the

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[16] See Andrea Szalavetz, "Measuring the Restructuring Performance of Firms in the Transition Economies," Insitute for World Economics Working Papers, No. 69 (Budapest: September 1996).

[17] The sources I have drawn on in compiling this account include Ernst, Alekseev, and Marer, Transforming the Core, pp. 31-79; Benjamin Slay, The Polish Economy: Crisis, Reform and Transformation (Princeton: Princeton University press, 1994); Simon Johnson and Gary Loveman, Starting Over in Eastern Europe (Boston: Harvard Business School Press, 1995); David Lipton and Jeffrey Sachs, "Creating a Market Economy In Eastern Europe: The Case of Poland," Brookings Paper on Economic Activity 1 (1996): 75-147; Stanislaw Gomulka and Piotr Jasinski, "Privatization in Poland, 1989-1993: policies, methods, and results," in Saul Estrin, ed., Privatization in Central and Eastern Europe (London: Longman, 1994), pp. 218-52; Simon Johnson and Marzena Kowalska, "Poland: The Political Economy of Shock Therapy," in S. Haggard and S. Webb, eds., Voting for Reform (New York: oxford University Press, 1994), pp. 185-242; Kazimierz Poznanski, ed., Stabilization and Privatization in Poland (Boston: Kluwer, 1993); S. Estrin, J. Brada, A. Gelb, and I. Singh, eds. Restructuring and privatization in Central Eastern Europe:Case Studies of Firms in Transition (Armonk: M. E. Sharpe, 1995), pp. 267-445; Andrew Berg, "Does Macroeconomic Reform Cause Structural Adjustment? Lessons from Poland," Journal of Comparative Economics 18 (June 1994): 376-410; George Blazyca, "The Impact of Elections on Economic Policy in Poland," Europe-Asia Studies (January 1996) ; OECD, Poland;, 1994; Economist Intelligence Unit, Poland: Country Reports, 1991-6 (London: Economist Intelligence Units, various years); and Ronan Lyons with Peggy Simpson, "A Survey of Poland," Business Central Europe 5 (February 1997): 37-48.

peasantry being the leading examples--without altering the core strategy embodied in the 1990 package. Not surprisingly, this has led to a lively debate over whether the resumption of growth in 1992 was due to the initial Balcerowicz plan or to the modifications subsequently made to it.

The Balcerowicz "shock therapy" was adopted under circumstances unusual even in Eastern Europe at the time: near hyper-inflationary conditions, the "honeymoon" period of the region's first non-communist government in 40 years, and lingering uncertainty over how the Soviet Union would react to the regime changes on its borders. The package of measures that went into effect on January 1, 1990 has been widely discussed elsewhere; we limit our account to its main elements.

The "Big Bang" of January 1, 1990 involved a 40% devaluation of the zloty to a fixed rate that would serve as an anchor for other macroeconomic measures and domestic prices, virtually all of which were freed the same date (the exceptions were for fuels, transportation, utilities, and housing). Major cuts were made in government spending, including the virtual elimination of producer subsidies, coal being the only major exception. The goal of fiscal policy was to reduce the budget deficit from 8-10 to 1 percent of GDP in 1990. Equally important to efforts to dampen inflation was a stiff excess wages tax (the highly unpopular *popiwek*) imposed on all state enterprises; real wages thus fell 25 per cent from their 1989 levels. Significantly, the *popiwek* did not apply to private firms, enabling them to compete with SOEs on quite favorable terms for qualified labor. Monetary policy was also sharply restrictive, as positive real interest rates came into effect and banks' reserve requirements increased. The result was a "near cessation of bank lending in the first two months" of the program,[18] and the consequent increase of "forced" lending by enterprises to one another. Finally, foreign trade underwent a major liberalization: not only were quantitative restrictions on imports and exports removed, but also tariff rates were set at exceptionally low levels.

The package certainly succeeded in its basic goal of "monetizing" the economy, which almost overnight moved from one in which individuals flush with cash queued up in front of stores with empty shelves to one in which stores were well stocked but potential buyers lacked the income to make purchases. But there was also a sharp decline in output, with GDP dropping by 12 percent in 1990 according to official estimates. It was followed by a further shock in 1991, when CMEA trade plummeted and unemployment began to mount to double-digit levels. And

[18] Ernst, Alekseev and Marer, Transforming the Core, p. 82,

while inflation was brought under control, it remained substantial, such that the undervalued zloty quickly appreciated in real terms, an additional factor contributing to the poor export performance of 1991. Indeed, practically the only silver lining in the 1991 cloud was the government's agreement with the Paris Club that reduced the heavy hard currency debt of about $45 billion by about half.

By the end of 1992, however, the economy had bottomed out, and growth resumed, reaching levels as high as 5 per cent in subsequent years. Moreover, the structure of the new Polish economy differs in significant ways from its socialist predecessor. In contrast with the past, the most successful (i.e., profitable) emerging branches are labor-intensive, consumer-oriented, and heavily populated by small and medium sized firms. The OPT trade has certainly played a role here: while clothing and footwear manufacturing have expanded, textiles and lumber industries are operating at sharply reduced levels. Employment in services has expanded, while the proportion of the labor force in industry has declined. Both the direction and composition of foreign trade have reflected the change as well: Germany replaced the Soviet Union as Poland's single largest trading partner, and by 1995, EU as whole accounted for two-thirds of foreign trade, up from 25% in 1987. Whereas the electrical and mechanical engineering sector had dominated exports previously, the collapse of CMEA reduced its relative weight in exports by some 40%.

Finally, and perhaps most important, the domestic private sector appears to be the driving force behind the resumption in growth. Thus, despite the relative decline of industry in GDP, the share of the private sector in industrial sales increased from 16.2% in 1989 to 37.4% by 1993. Investment by smaller, typically private, enterprises has increased substantially, and there were other signs that different patterns of economizing were taking root between the state and private sectors as well:

State-owned firms have managed to increase labor productivity by 11 per cent almost wholly by decreasing employment by some 10 per cent, but in the private sector labor productivity has increased by around 20 per cent at the same time that employment has increased by 13 per cent.[19]

Economically, then, the radical and sudden combination of "all at once" liberalization and stabilization proved--to the surprise of many Poles--quite successful. Politically, however, it was

[19] OECD, Poland, 1994, p. 53.

extremely unpopular, producing a wave of political fragmentation in the legislature and a series of fragile coalition governments. One consequence was that the recurrent controversies and conflicts even within governing coalitions made it impossible to move forward systematically on Phase II of the original program, namely, privatization. Disagreements surrounding the mass privatization program were a key factor in bringing down the Suhocka government in 1993; the new SLD government then procrastinated on its implementation. Thus, the program has only gotten into operation this year, with the number of enterprises involved reduced from original projections. Overall, by 1996, relatively few large enterprises had been sold to either private domestic or foreign investors. And despite a relatively liberal law on foreign investment passed in 1991, FDI has been slow to arrive, particularly in light of the size of the domestic market and relatively favorable labor costs. The reasons for this reluctance vary, and include Polish labor's reputation for militancy, resistance by some of the enterprise councils to ownership by a foreign entity, the continued political debate over how privatization should be done, and the conditions Polish governments at various times have felt obligated to attach to sales.

Nevertheless, if direct sales of major enterprises and banks have been few and far between, this does not mean that privatization has not occurred on a fairly significant scale in other ways. In fact, Poland appears to have a *de facto* privatization strategy, built largely on the burgeoning small-scale enterprises that have emerged in the last decade. First of all, between reforms made in the 1980's and the fact that agriculture was always more or less in private hands, Poland actually had a private sector that accounted for 30 per cent of national income even in 1989. Secondly, "small" privatization--the auctioning off of thousands of retail shops, restaurants, repair shops, and other small services--occurred very rapidly, thanks to the highly decentralized method employed.[20] Third, early deconcentration policies caused many large SOEs to split into smaller units, facilitating spin-offs into private ownership. In addition, a considerable portion of assets transferred from state to private hands have occurred by "liquidation" sales and leasing, either to independent entrepreneurs or to private companies formed by the management and employees of the unit concerned. Finally, a speculative bubble that occurred on the Warsaw stock exchange in 1993-4 gave potential investors--local and foreign--a taste of the possibilities that could be realized by backing small start-ups and encouraging them to grow in order ultimately to take them public; hence, even if the bubble itself eventually burst, it encouraged

[20] See Ivan Major, Privatization in Eastern Europe (Hants: Edward Elgar, 1993), p. 118.

outsiders to invest in promising small ventures. The "implicit" privatization story in Poland is thus one of allowing the highly dynamic small business sector to expand through absorbing formerly state-owned assets and putting them to more productive use.

Indeed, Poland’s basic development strategy is very much one of building on new start-ups and clearing away obstacles to their development. As far as the large, traditional SOEs are concerned, here we come to the second consequence of the political unpopularity of shock therapy.

The basically neoliberal and non-interventionist strategy favored by the architects of the "Big Bang" soon proved unsustainable both politically and even economically. For example, the first year of the program actually witnessed the balanced budget it had aimed for. But the causes for the small surplus turned out to the same factors, which quickly caused it to go into deficit. That is, the undervalued zloty combined with price liberalizations and inventories piled up from 1989 allowed enterprises to pass on hefty price increases, which turned into high profits despite a precipitous drop in sales. The excess wage tax also made its contribution to profitability, as labor costs did not keep pace with inflation and still-controlled energy prices lowered production costs as well. But for the government, insofar as large portion of its revenues were derived from enterprise taxes, it has a one-time only windfall.

In 1991, the situation was reversed: the now overvalued zloty encouraged import penetration, domestic demand continued its decline, and for many SOEs, profitability evaporated, in most cases never to return to 1990 levels. Not only did the tax base decline, but SOEs frequently simply failed to pay taxes at all in order to meet even reduced payrolls and maintain the minimum liquidity needed to keep their operations going. At the same time, rising unemployment and the decision of many individuals to opt for early retirement over a potential layoff put increased pressures on expenditures.

As a result, the balanced budget aspirations of the stabilization program had to be abandoned, and the main effort came to be directed more to controlling the size of the deficit than to eliminating it. The introduction of the personal income tax in 1992 and a VAT in 1993 diminished the budget’s vulnerability to enterprise profits without entirely eliminating it; thus, the ‘back door" industrial policy contained in allowing some of the larger SOEs to accumulate tax arrears has continued.[21] Only very recently have the problems of some of these enterprises come to be addressed directly by the government through an explicit industrial policy of consolidation and restructuring, another departure from the original shock therapy program. Thus, an Intervention Fund was created in 1993 for enterprises whose restructuring would be "socially sensitive," and in the same year, programs were begun in coal, steel energy, and agriculture with shipbuilding, defense, and heavy chemicals to follow.

Nevertheless, the overall structure of government expenditures has shifted significantly away from subsidies and investment in favor of debt service and social welfare maintenance. The social costs of the transition have caused expenditures for social services--especially pensions--to rise considerably, even as wages of state employees have lagged. As a result, payroll taxes have made a significant contribution to labor costs.[22] At the same time, it is worth noting that if some of the larger SOEs have received a back door subsidy in their accumulation of tax arrears, the private sector has often escaped paying taxes and social security contributions altogether.[23] Hence, if explicit industrial policy has targeted the socialist behemoths, implicit industrial policy has worked to the advantage of small business.

The impact of monetary policy has been similar. Interest rates have remained high and more or less positive in real terms, and after 1991, bank-lending policy became increasingly risk-adverse. As a result, credit to the enterprise sector declined in 1992 and again in 1993--while credit to the budget mounted. The cutback affected SOEs disproportionately, since unlike the private sector, profitability rates after 1990 provided little in the way of retained earnings to be used for restructuring or modernization. And even when the banks resumed lending, it was largely to cover working capital needs, not to finance investment. The government's adoption of an industrial policy was thus partly forced on it by the reluctance of the banking sector to take the initiative. Meanwhile, one way in which the state enterprises sought to cover their immediate

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[21] Ernst, Alekseev, and Marer report , "Out of 25 firms in a sample, 13 were in arrears on tax payments...." Transforming the Core, p. 102. Note that there may have been some economic justification for this behavior as well. As it turned out, the "dividend tax" on enterprise assets was skewed against the more modern firms, whereas the sectors that had been underfunded under socialism had a relatively lower tax burden, "one explanation for their success during the transition period." Marek Belka cites a study which showed the tax burden was correlated with the age of machinery, literally disadvantaging the more technologically sophisticated enterprises. In M. Belka, "Food Processing/Chocolate and Sweets: Drops," in Estrin, Brada, Gelb, and Singh, Restructuring and Privatization: Case Studies, pp. 344-57.

[22] Note that in this respect, Poland is similar to Hungary and the Czech Republic. See below. The excess wages tax (*popiwek)* on enterprises was eliminated by 1995.

[23] The number of enterprises per capita is higher in Poland than in many West European countries. One suspects that "phantom" enterprises set up largely for purposes of tax evasion are part of the explanation here.

liquidity needs was by leasing or selling facilities to private entrepreneurs, another factor in the latter's expansion.

Finally, foreign trade policy was modified after 1991. The first change was to move the currency to a crawling peg system in late 1991; abandoning the fixed exchange rate may have removed an anti-inflationary anchor, but it also facilitated export growth. Other changes in trade policy were more directly in response to popular discontent and protest. Farmers were the first to mobilize, receiving concessions as early as mid-1990. Tariffs--on manufactured as well as agricultural commodities--began to shift upwards, rising to average levels of 15-20% by 1994. Significantly, duties are higher on finished products than on raw materials and intermediate goods, thereby favoring the OPT trade, the many small firms that sprung up to assemble electronic goods (from radios and TVs to computers) from imported components, and other small producers relying on imported inputs. Fiat's decision to purchase FSO was also contingent on tariff protections for domestically made cars.

Nevertheless, how much protection--and for how long--Poland can provide for domestic producers remains rather limited due to its Association Agreement with EU, its accords with EFTA and the new CEFTA, and its adherence to the Uruguay round. Hence, the basic trade policy changes initiated in 1990 remain relatively intact, despite continued domestic pressures and growing trade deficits with Western Europe.

The Czech Republic: Betting on the Strong[24]

Economic policy in the Czech Republic can basically be regarded as a continuation of the transition strategy initiated while Czechoslovakia still existed. Unlike Poland and Hungary, there

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[24] The sources I have drawn on for this analysis include Jan Svejnar, ed., The Czech Republic and Economic Transition in Eastern Europe (San Diego: Academic Press, 1995): Ernst, Alekseev, and Marer, Transforming the Core, pp. 127-53; OECD, OECD Economic Surveys: The Czech Republic 1996 (Paris: OECD, 1996); Estrin, Brada, Gelb, and Singh Restructuring and Privatization: Case Studies, pp. 3-155; Mitchell Orenstein, "Out of the Red: Building Capitalism and Democracy in Post-Communist Europe," Ph. D. dissertation, Yale University, 1996; Marie Bohata, in cooperation with Michael Fischer, "Performance of the Manufacturing Industry in Transformation," Eastern European Economics 33 (January-February 1995): 74-96; Joe Cook, "Survey: Czech Republic," Business Central Europe 4 (No. 33, July/August 1996): 37-50; Jan Svejnar and Mroslav Singer, "Using Vouchers to Privatize an Economy: The Czech and Slovak Case," CERGE Working Paper Series, No. 36 (Prague: CERGE, April 1993); Lina Takla,"The relationship between privatization and the reform of the banking sector: the case of the Czech Republic and Slovakia," in Estrin,ed., Privatization in Central and Eastern Europe, pp. 154--76 ; Gerald A. McDermott, "Renegotiating the Ties that Bind: The Limits of Privatization in the Czech Republic," Berlin: Social Science Research Center, April 1994 (mimeo); Yudit Kiss, "Sink or Swim? Central European Defence Industry Enterprises in the Aftermath of the Cold War," Europe-Asia Studies 47 (July 1995): 787-812; Ed Clark and Anna Soulsby, "The Re-formation of the Managerial Elite in the Czech Republic," Europe-Asia Studies 48 (March 1996): 285-305. The personal communications of Andrew Schwartz have also been extremely helpful.

was no prior history of reform after the brief interlude of 1967-8. Enterprises were not only state-owned in a legal sense but state-controlled in a practical sense, lacking autonomy and with virtually all key decisions being made or approved by supervisory ministries. Nor was there a private sector to speak of in this most orthodox of Marxist-Leninist regimes. At the same time, the absence of reform also meant the absence of a monetary overhang,[25] while aversion to western trade prevented the accumulation of a large foreign debt. In short, the economy that presented itself to policymakers in 1990 was, in effect, the economy of a prudently managed CPE: highly centralized, concentrated and lacking dynamism, but nevertheless with a reasonable standard of living and without severe shortages, heavy foreign debt, or serious macroeconomic disequilibria.

Industry--especially producer goods--played an even larger role in the Czech socialist economy than in Hungary or Poland, accounting for 50 percent of GDP versus 30 and 40 per cent respectively. Agriculture was accordingly less important, although the country was basically self-sufficient in foodstuffs. Most industrial production had been geared to domestic and CMEA needs and secondarily to Third World markets. The socialist government's refusal to take on hard currency debt in the 1970s meant that the severe cutbacks in investment repayment necessitated in Poland and Hungary in the 1980s were not characteristic in Czechoslovakia. As a result, plant and equipment was less likely to correspond to western norms, but it was generally in better condition and of somewhat more recent vintage than in the other two states.

In part, the centrality of industry was a product of state socialist priorities. More profoundly, however, it also reflected long-standing traditions in Bohemia and Moravia, which had been the industrial powerhouse of the Hapsburg Empire in the nineteenth century and had achieved a standard of living slightly above Austria's between the two world wars.[26] Recapturing the status of an advanced industrial country by playing on these traditional strengths in manufacturing and engineering was one of the implicit goals of economic policy as the post-socialist era opened. The key to accomplishing this in the eyes of the team assembled around the then-Minister of Finance, Vaclav Klaus, was to move productive assets out of the state sector and into private hands as rapidly as possible. If the cornerstone of economic policy in Poland

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[25] For a perceptive analysis of why attempts to reform centrally planned economies lead to monetary overhangs, see Ronald I. MacKinnon, The Order of Economic Liberalization (Baltimore: Johns Hopkins Press, 1993), pp. 120-62.

[26] Note, however, that the Austrian economy virtually collapsed at the end of World War I as a result of the dissolution of the Empire. See Barbara Jelavich, Modern Austria (New York: Cambridge University Press, 1987).

was simultaneous liberalization/stabilization and the growth of small business, Czech economic strategy centered on privatizing SOEs through a mass voucher program, and other policy measures were geared to accommodate it.

While planning for the mass privatization began almost immediately--even prior to the 1990 election, when the Calfa caretaker government was still in power--liberalization measures did not take effect until January 1991, fully a year after Poland began its shock therapy. It began with a 64 per cent devaluation of the currency and making the crown internally convertible; most prices (with fuel and housing being the primary exceptions) were freed and subsidies to enterprises were decreased or discontinued entirely. Unlike Poland, where trade liberalization began with very low tariff rates, which then crept, upward in response to producer pressures, the Czech Republic opened its markets with a 20% import surcharge which was gradually lowered. Even so, neither exchange rate nor tariff protection were sufficient to compensate for the loss of CMEA markets and the deterioration of terms of trade that occurred: between German reunification, CMEA's collapse, and the contraction of domestic demand, industrial production fell by one third and GDP by over 20 per cent before a recovery began in 1994.

Maintaining the nominal exchange rate became an important anchor for other policy measures, including cutting government expenditures to keep the budget balanced and restrictions on wage increases in the state sector. Unlike the Polish situation, labor unions proved relatively cooperative (indeed, some might say docile), despite the drop in real incomes that followed the elimination of price controls. Part of the reason for this stance was economic, i.e., unemployment remained low. More profoundly, however, it was political: the Czech unions had been so compromised by their association with the socialist regime that they were willing trade militancy for even a weak but legally protected institutional position in the new order.

Monetary policy was also tight initially, and bank credits to enterprises dropped sharply in 1991, the first year of stabilization. Predictably, inter-enterprise debt tripled that year. Interest rates also rose substantially, but they nevertheless remained below the inflation rate, such that the interenterprise "queuing" worked implicitly as a means for creditor firms to subsidize debtors. Hence, while the decrease in state subventions relieved pressure on the budget, it did not have as big an effect on the allocation of resources within the (state) enterprise sector as might otherwise be expected.

In subsequent years, monetary policy eased somewhat, and insofar as the restrictive fiscal policy lowered the government's need to borrow, lending to enterprises began to resume. Undercapitalized banks were able to build up reserve by establishing a sizable spread between interest rates on loans and deposits and by selling non-performing loans to the government Konsolidacni (Consolidation) Banka, established in 1991. By 1993, $4 billion in non-performing loans--almost 20 per cent of total bank credits at the time--had been disposed of in this way.

The implicit rationale behind these and other measures seems to be that of granting SOEs a breathing space in which they could adapt to new conditions and prepare themselves for the centerpiece of the strategy: namely, the mass voucher privatization. Hence, the government sought to avoid liquidations or bankruptcies--and even major restructuring--until the new "private" owners were able to take control.

The voucher privatization program was preceded by a wave of break-ups and spin-offs: the number of state enterprises doubled or tripled in many branches of industry. While it would be tempting to attribute this to a liberal government's sponsorship of deconcentration, the evidence indicates that the splitting of firms was largely driven by management. Although the spin-offs allowed wages to rise in the parent enterprise, they did not produce improved performance in either the parent or the breakaway unit(s).[27] Hence, the main motivation behind the breakups was that of management positioning itself for voucher privatization--not surprising in light of the fact that the privatization "projects" (i.e., how much of the assets would be sold by voucher, how much to foreign partners, how much to employees and managers, etc.) submitted by management were far more likely to be approved than proposals from other sources.[28] The interest of older managers in rapid privatization was increased once the lustration law passed, since it barred individuals who had participated in various activities (e.g., the enterprise *milice*) from holding top posts in state agencies, including of course, state-owned enterprises. But if the same state-owned enterprise was privatized--be it by vouchers or any other method--lustration rules no longer applied.[29]

[27] See Lubomir Lizal, Miroslav Singer and Jan Svejnar, "Manager Interests, Breakups and Performance of State Enterprises in Transition," in Svejnar, ed., The Czech Republic , pp. 211-33.
[28] See Josef Kotrba, "Privatization Process in the Czech Republic: Players and Winners," in Svejnar, ed., ibid.
[29] Clark and Soulsby recount a wonderful tale of how a general director of an SOE discovered that three of the general managers had to be removed due to the Lustration Law. He arranged for them to be demoted to department heads (low enough not to be covered by the LL) and promoted members of their junior staff--all females--to their former positions. "The understanding of all parties was that this scheme would operate in name only, and that, when the enterprise was duly privatized, the demotees would be re-proposed for their former senior jobs, needing only the

Voucher privatization went on in several waves. While its economic effects are still debated, the program was a huge political success. Nevertheless, the program did not include many of the largest enterprises, and the National Property Fund often retained a share of ownership in many of the other firms which were privatized through the vouchers, although it is gradually selling its shares on the open market. As the recipient of the revenues received from privatization, the NPF is an important source of extrabudgetary funds, which have served a variety of purposes: transfers to the state budget to cover potential deficits, financing investment projects, even improving schools. In addition, it has been a key player in attempts to strengthen the banking system, both by floating bond issues for bank recapitalization and as a major owner of the three largest, voucher-privatized banks. For example, the recommendation of the government banking council in 1995 "to pay bank dividends below the amount proposed by the management was implemented in the banks where the NPF held a commanding stake, with the purposes of strengthening the reserves of the banks."[30]

A few major privatizations took the form of direct sales to foreign companies. These include the sale of the Skoda works to Volkswagen, the main tobacco enterprise to Phillip Morris, the oil refineries to a western consortium, and a large bloc of SPT Telecom shares to a Dutch-Swiss partnership. But outside the occasional spectacular privatization of a major company, FDI does not appear to play a major role in the Czech Republic, particularly when one contrasts it with Hungary. Interestingly enough, most of the Investment Privatization Funds have not sought to aggressively market their shares in privatized companies to foreign buyers. A possible reason for this is that insofar as each IPF is limited to a 20% ownership share, foreign firms are reluctant to buy into an enterprise in which they would be unable to control key decisions.[31] Alternatively, there is some evidence that the IPFs which are wholly-owned subsidiaries of the largest Czech banks have become a useful tool to generate business for the parent bank itself, even if the enterprise might well be better off taking its business elsewhere. Finally, most accounts see the Czech government itself as far more resistant than its counterparts in Poland or Hungary to granting the concessions major foreign investors have demanded.

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formal acquiescence of the new board of directors. And this is exactly what happened." In "Re-formation of management," p. 296.

[30] OECD, Czech Republic 1996, p. 48.

[31] By convertng themselves to holding companies, however, IPFs can get around these limits. 1995-6 did, in fact, see a wave of conversions and acquisitions by former IPFs.

Certainly, in the last year or so, there has been a major capital inflow into the country, but most of it appears to be the result of foreign borrowing by banks and enterprises. The latter have found that interest rates are often lower abroad, and the country's relatively strong credit rating and recent move to full convertibility facilitate taking advantage of it. The heavy borrowing activity, in turn, fueled an import boom in 1995, the cause of a major increase in the trade deficit.

The expansion of small, private businesses over the decade has been impressive; the tourist industry, highly underdeveloped under socialism but generating 4 to 5 per cent of GDP by 1995, has been a major source of earnings for this sector. The growth of small business was also given an impetus by a surprisingly problem-free restitution process and a rapid auctioning off of storefronts and retail premises by local governments at the start of the transition. Nevertheless, the core of the Czech economy is its industrial and manufacturing sector, and it is the activity of this sector--much of it voucher-privatized-- that seems to set the tone for all other undertakings. In contrast to Poland, it was large enterprises that led the way to growth in 1995, with output and labor productivity rising substantially in engineering, manufacturing, and transport equipment sectors. "Networks" seem to be operating largely within this sector and between it and the domestic small and medium sized firms that are often the products of earlier spin-offs. They do not appear to extend very much beyond the country's borders, with the possible exception of Slovakia. Meanwhile, government policies--from lax enforcement of bankruptcy laws to resistance to foreign buyouts--have contributed to the survival of these ties. One suspects that hardly coincidental to this approach is the fact that Czech firms, unlike their Polish counterparts, have not fallen behind on their payment of taxes--and that a large number of current managers were appointed on quasi-political criteria after 1990.[32]

Fiscal policy remains "conservative," and the Czech Republic has distinguished itself from Poland and Hungary by its ability to maintain a balanced budget. The surge in imports that occurred in the last two years saw the government react by cutting government expenditures in order to dampen demand. It moved rapidly to reduce planned wage increases for state employees and decreased planned investments. It is possible that a more flexible bargaining position toward potential foreign investors may also result as a means of countering the trade imbalance. Meanwhile, despite the government's neo-liberal pronouncements, the social safety net has been

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[32] The Czech tax authorities "have the power to collect unpaid taxes through direct appropriation of enterprise assets, through an internal purely administrative (as opposed to judicial) decision....[Hence,] tax compliance...is relatively high." OECD, Czech Republic 1996, p. 116.

maintained and attempts--not entirely successful--to simply modernize and reform it are the norm. Low unemployment has certainly been a factor enabling the government to avoid budget deficits without making major welfare cuts; the cessation of transfers to Slovakia, too, provided somewhat of a windfall gain in 1993. Unemployment has remained low, despite quite extensive "labor-shedding" by formerly state-owned firms (as well as those still in state hands). Such an accomplishment has been a great political aid to the governing coalition, and is due primarily to the creation of new jobs in previously undeveloped sectors like tourism and financial services, the small size of the labor force employed in agriculture, a decline in labor force participation, and a relatively effective job training program combined with penurious unemployment compensation.

Hungary: Selling to the Rich[33]

Post-socialist economic policy in Hungary differed from Poland in that a long series of carefully managed partial reforms allowed it to avoid a sudden and radical "shock" therapy. Liberalization thus occurred gradually, accelerating towards the ends of the 1980s so that prices and foreign trade had essentially been decontrolled even before the political transition took place. As for stabilization, here too the main program had been initiated under the outgoing Nemeth government in 1988-9, partly to satisfy IMF requirements. It was only when those measures were relaxed in 1992 that a growing internal deficit and rapidly deteriorating current account balance prompted a major new stabilization effort in 1995. Likewise, various reforms made in the 1980s had already seen the rise of a vibrant "second" economy, which grew rapidly with its full

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[33] The sources I have drawn on for this account include David L. Bartlett, The Political Economy of Dual Transformations: Market Reform and Democratization in Hungary (Ann Arbor: University of Michigan Press, 1997) ; David Stark and Laszlo Bruszt, Postsocialist Pathways: Transforming Politics and Property in East Central Europe (New York: Cambridge University Press, forthcoming); Eva Ehrlich, Gabor Revesz, and Peter Tamasi, Kelet-Kozep-Europa: honnon-hova? (Budapest: Akademiai Kiado, 1994), pp. 31-186; OECD, OECD Economic Surveys: Hungary 1995 (Paris; OECD, 1995); Ernst, Alekseev, and Marer, Transforming the Core, pp. 153-211; Estrin, Brada, Singh and Gelb, Restructuring and Privatization: Case Studies, pp. 155-267; Bela Papp, "A Survey of Hungary," Business Central Europe 3 (dec 1995/January 1996): 35-46; Economist Intelligence Unit, Country Reports: Hungary (London, EIU, 1991-6); Miklos Szanyi, "Adaptive Steps by Hungary's Industry During the Transition Crisis," Eastern European Economics 34 (Sept.-Oct., 1996): 59-77; Jan Adam, "The Transition to a Market Economy in Hungary," Europe-Asia Studies 47 (Sept. 1995): 989-1006. I have also relied heavily on the Working Papers series of the Institute for World Economy in Budapest (see above and below for specific citations) and many very helpful conversations with Ivan Major.

legalization at the end of the decade.[34] The tax burden also had begun to shift from the enterprise to the household sector thanks to the introduction of a personal income tax and VAT in 1989. Moreover, much (if far from all) of the legal infrastructure needed to accommodate a market economy and private ownership was already on the books when the first competitively elected government took office in May1990.

Similar to Poland, however, the down side of the many attempts to decentralize and reform the socialist economy was macroeconomic disequilibria; heavy foreign borrowing in the 1970s led in the 1980s to a series of on-and-off austerity measures, a decline in investment, as well as the highest per capita foreign debt in Eastern Europe. The precariousness of the Hungarian situation became only too clear in 1989, when the prime minister suddenly revealed that the real budget deficit and foreign debt were actually far higher than previously acknowledged. Moreover, the structure of Hungary's foreign debt differed from Poland's in that it was owed primarily to private creditors, making debt relief far less accessible. Combined with awareness of the country's need to continue borrowing abroad, it made debt relief an option successive governments all rejected. But the internal and external debt burden were important factors shaping privatization policy and "implicit" development strategies in Hungary, both of which were geared to attracting outside investment as a means of making at least the net debt manageable.

Such a strategy was not uncontroversial. In fact, bowing to pressures from its right, the moderate nationalist Antall government began to modify its privatization policy to better accommodate domestic investors after 1992.[35] Even these relatively minor deviations, however, were reversed by the center-left government that took office in 1994. Thus, the basic privatization strategy in Hungary has, on balance, been relatively consistent: assets should be sold to those who can purchase them on the most favorable terms offered rather than being given away. Given the level of domestic savings and the size of assets up for divestment, such a strategy necessarily advantaged foreign buyers. The contrast with the Czech Republic and even Poland, with its limited mass privatization program, is sharp. In sum, Hungary sought to

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[34] See Ivan Szelenyi, Socialist Entrepreneurs (Madison: University of Wisconsin Press, 1988); Istvan Gabor, "Modernity or a New Type of Duality? The Second Economy Today," in J. M. Kovacs, ed., Transtition to Capitalism? The Legacy of communism in Eastern Europe (New Brunswick: Transaction Book, 1994).

[35] Even then, the basic policy was not altered; rather, the government simply made a line of credit available on favorable terms to domestic entrepreneurs.

privatize SOEs on a cash basis in order to use the proceeds to relieve internal and especially external indebtedness.

Consequently, foreign direct investment was welcomed in Hungary to a much greater degree than in either the Czech Republic or Poland. The trend was apparent even before the landmark 1990 elections. Not only did Hungary pioneer the first sale of an SOE to a western buyer, when GE purchased a controlling share of Tungsram in 1988-9, but it was also the first state in the area to place a stock floatation on a western exchange (shares of IBUSZ, the state travel agency, were simultaneously offered in Vienna and Budapest in 1990). Indeed, FDI was perceived by both investment-starved enterprises and the heavily-indebted state as the only viable solution to the undercapitalization of industry resulting from the austerity measures of the 1980s and 90s. Symptomatic is that the decline of direct subsidies was accompanied by generous tax allowances for joint ventures and other forms of FDI.

Monetary policy contributed to the search for foreign partners. The National Bank's commitment to reining in inflation amidst continued state budget deficits soon led to a situation in which the commercial banks began to avoid lending to enterprises in favor of purchasing government securities. As in Poland and the Czech Republic, the curtailment of lending to the enterprise sector produced the predictable wave of forced inter-enterprise crediting. Even more important, however, it meant that enterprises without foreign partners lacked the financial means to modernize and restructure. The collapse of CMEA in 1991 aggravated the situation further; although Hungary had already made significant strides in reorienting exports westward in previous years, heavy industry, engineering, and agriculture were hit very hard by the loss of the eastern "market." At the same time, inflation rates--driven by the state budget deficit--remained high enough to produce a substantial real appreciation of the currency, making trade balances increasing problematic after 1992. In addition, unlike either Poland or the Czech Republic, price liberalization in Hungary included the price of labor; wage rates were decontrolled in the state firms as well as in the private sector. Consequently, both nominal and real wages increased for those who managed to find or keep their jobs, while growing unemployment levels reflected the situation of those who could not. A relatively generous unemployment compensation system, in turn, put additional pressure on the state budget. But on the positive side, labor productivity began rising substantially after 1992.

A second stabilization policy became imperative by 1995, entailing major budget cuts, tax increases, a significant devaluation of the forint and a shift to a crawling peg system with regular devaluations anticipated for the future, an import surtax, and an acceleration of privatization-for-cash. As a consequence, real wages dropped by about 10 per cent, putting at least a partial brake on import demand. The draconian measures came on the heels of a major bank recapitalization program in 1993, itself a consequence of a wave of bankruptcies that swept through the economy in the wake of a staff bankruptcy statute enacted in 1992. Recapitalizing the banks, assuming part of their bad loans and encouraging them to sell off the remainder at a discount made them immediate candidates for privatization, and most were sold off to strategic foreign investors together with energy and utility companies by the end of 1996. Meanwhile, it is estimated that close to 25 per cent of SOEs were liquidated in the bankruptcy proceedings, with many of their viable assets purchased by private and foreign investors.[36] Although the bankruptcy statute was subsequently altered to make it more lenient, it did have the impact of greatly diminishing inter-enterprise arrears.

Privatization, however, was only part of the FDI story. Hungary also attracted large greenfield investments, particularly in the automobile industry,[37] but also in other sectors. Frequently, a large investment by one multinational would then attract a network of subcontractors from western states.[38] Hence, although "foreign capital accounted for 34.85% of privatization in 1990-04, privatization probably contributed less that 15% of total imports of direct investment."[39] Joint ventures have been another important source of capital inflows. For example, in 1993, JVs accounted for 34 per cent of fixed investments and 34 per cent of net sales, greater than the combined totals for investment or sales of fully foreign- and/or still state-owned companies.[40] In addition, foreign-owned firms--greenfield and privatized--have become among the country’s largest exporters. Their use of imported parts and components has been facilitated by the government’s policy of granting them the status of a "duty free zone" wherever they are located; hence, components can enter without customs duties of VAT, provided they are

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[36] Estimate of Ernst, Alekseev, and Marer, Transforming the Core, p. .
[37] That Hungary has attracted no fewer than four greenfield assembly plants in the automobile industry is no small irony. For years, Hungarians had been congratulating themselves of having resisted the sirens of autarchy in CMEA by foregoing the opportunity to build a domestic automobile industry on the grounds that it had no comparative advantages in such a sector!
[38] This has also been the case with Skoda-Volkswagen in the Czech Republic
[39] Csaki, Sass, Szalavetz, "Foreign Direct Investment," p. 9.
[40] Papp, "A survey of Hungary," p. 42.

turned into exports. On the other hand, "firms embodying a foreign investment are more strongly represented in imports than in exports, so that they contribute to the trade deficit...In 1993 and 1994, when the country reported an extremely high trade deficit, foreign participation companies generated 40% and 56% of this deficit respectively." [41]

If the glamorous side of Hungary's transition strategy is the country's attractiveness to foreign investors, the situation in the domestic firms--both public and privately owned--has not been static. Despite what is usually regarded as a "gradual" transition, output declines in industry were on the same 30+% order as in Poland and Czechoslovakia. As for the state sector as a whole, its main accomplishment over the 1990-94 period appears to be that of diminishing the size of the losses many of its large firms have incurred. As noted earlier, high interest, high spreads, and risk-averse behavior by the banks have meant investment for restructuring has largely been unavailable unless a foreign partner supplies it. Thus, improvements in labor productivity have been due more to cuts in employment than to improving overall factor productivity. Interestingly enough, the OECD reports that "the bankruptcy law which came into operation in 1992 only marginally affected the largest loss-making firms."[42] Part of the reason, it would appear is that many such enterprises are located in regions lacking other employers, and subventions--at lower levels than in the past, of course--continue to be granted. As in Poland, the accumulation of tax arrears (especially in social security contributions) is one form such implicit subventions take.

The process of deconcentration within the state sector was actually begun in the 1980s. Escaping the supervisory authority of the State Property Agency after 1990 also led to significant de facto decentralization of enterprises, typically to the benefit of the management. By "commercializing" (i.e., transforming it into a joint stock company with all assets owned by the state) a large enterprise into the form of a holding company, central authorities had rights of control only over the "shell," whose subsidiaries were often partly and even primarily owned by the management--purchased, of course, at prices they negotiated with the holding company headquarters (namely, at prices they negotiated with themselves).

While the state sector's size and contribution to national income is steadily diminishing--be it through privatization, MBOs, or even occasionally closures--the number of domestically

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[41] Elteto, "Trade Balance," p. 21. See also Ivan Gizella, "A Privatizacios Kutatointest szerint a kulfoldi tarsasagok tul sokat importalnak," Magyar Hirlap, May 10, 1997.
[42] OECD, Hungary, p. 16.

owned small ventures has increased. As in Poland, the size of such ventures is small (less than 20 employees), partly because it facilitates tax evasion. The resulting picture is of an enterprise structure that can be compared to a vase: a large number of very small enterprises, a significant number of very large enterprises, and a relatively small proportion of medium size firms.[43] As expected, the service sector--especially retailing and personal services--is where many private firms are located, although 1993 data indicates the domestic private sector also accounted for 41% of exports, too. Generally, such firms have financed themselves from retained earnings and to the degree government actions have facilitated their growth, it has been essentially in the failure to effectively implement tax measures on this sector.

Nevertheless, it appears that the connection between domestic firms and those owned by foreign companies appears rather minimal, creating a curious sort of dual economy. The western firms tend to deal with each other, and the domestic firms tend to trade with each other. The relationship is perhaps symbolized by the resistance of the foreign firms to join the employer association that participates in pattern-setting collective bargaining arrangements or even in the domestic employers' lobbying group in favor of creating their own council to bargain with the government.

Hungary continues to provide an extensive network of social services, although they have become more targeted toward the poorer segments of the population as budgetary pressures have made it increasingly difficult to maintain universal coverage. Payroll taxes are thus quite high, although roughly comparable with those in Poland and the Czech Republic. Serious regional disparities between the eastern and western halves of the country have persisted and indeed grown quite substantially; not coincidental to this is the concentration of most western investment in the western border regions and the capital city. Agriculture went through a steep decline as input prices rose sharply, eastern markets collapsed, and imported food goods from Western Europe flooded in. While the Antall government (1990-94) waged what was close to a covert war against the cooperative farms, the center-left successor attempted to ameliorate the situation, raising farm subsidies to levels still far below those of EU or even the Czech Republic. But the result was that for the first year since the transition, farm output began to grow, with

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[43] See Eva Ehrlich, "Recent Conditions and Prospects in Central and Eastern Europe," Institute for World Economy Working Papers, no. 73 (Budapest: November 1996).

major gains being made by the cooperative farms, now somewhat reduced in acreage from earlier levels.

Overall, then, the implicit development strategy in Hungary has focused heavily on seeking integration with the west through ownership and foreign investment as much as through trade and commerce. While the country's macroeconomic indicators have often suffered from a tendency to bail out whatever cannot be sold, most observers seem to feel the microeconomic situation is on a much firmer footing thanks to FDI inflows. If the small enterprise sector is the most dynamic in Poland, the voucher-privatized enterprises the economic heart of the Czech Republic, it has been the ability to attract foreign investment that has been the distinguishing feature of the Hungarian transition.

Three strategies--but do any lead to "production networks"?

Despite three different approaches to the transformation problem, there are some broad similarities in overall economic developments in all three states since 1990. As already noted, all three countries underwent a massive trade reorientation; all three saw GDP decline by about 20 per cent between 1990-4, with policy measures affecting the timing more than the size of the drop. Similarly, there was about a 30 per cent decline in industrial output during the same period, although again, in all three countries, the decline in industrial employment, while sharp, was significantly less than the decrease in output. In each country, the expansion of the service sector from its depressed socialist levels helped to mitigate the losses in industry; as a result, all countries saw manufacturing account for a smaller portion of GDP than had been the case prior to 1989. In addition, it was performed by smaller enterprises than had been the case: all three economies saw a significant number of large state firms splitting into multiple units in the 1989-91 period, as managers positioned themselves for potential privatizations. Agriculture was invariably a calamity, although the relatively small size it played in the economy and as a source of employment in the Czech Republic somewhat mitigated the difficulties in that state. Finally, the private sector expanded rapidly in all cases, accounting for over fifty per cent of GDP by 1995 in each country.

Overall structural change thus seems to reflect broad macroeconomic strategies of liberalization and stabilization as well as the shift to hard-currency trade. One further similarity between the CEE trio should be noted as well, however, and that is the pressure put on the supply of social welfare by the social costs of the transition. Here, all states tried to at least put a floor on incomes and welfare, with the result that in aggregate terms, various forms of payments (pensions, family allowances, and health provision) increased. Even when efforts were inadequate to the size of the problem, consumption levels presumably dropped less than they would have without such aid, and one reflection of these efforts in the foreign trade pattern was consumer-demand fueled imports. As noted earlier, imports of consumer goods wound up were a significant factor in trade deficits in all three countries.

Be this as it may, let us turn to our central question, namely, what the relationship of the East and West European economies are to each other at the microeconomic level, and the degree to which East European productive capacities have been utilized by western firms as part of a broad-based network knit together by multilateral ties.

Here, the story is not a particularly encouraging one. At present, there seem to be four main forms that East-West economic interaction assumes at present: (a) Straightforward sales of commodities and/or services; (b) overseas processing contract work; (c) joint ventures; (d) foreign direct investment. There are isolated cases of production "networks" in each of these categories, but they tend to be the exception rather than the rule.

Direct sales of goods and services: Certainly, the opening of trade channels has seen a vast enlargement of straightforward exchanges of intermediate and final products as well as of services. For example, one of the main Czech steelmakers, Nova Huta, currently supplies aluminum wheels to BMW, while Hungary's RABA produces axles for International Harvester and Rockwell. On the import side, Poland's Optimus got its start by importing computers for the domestic market and rapidly switched to importing components from the Far East, assembling them itself, and marketing them under its own name. Optimus is currently the largest domestic producer of PCs in Poland, with a market share many times larger than IBM or Compaq. Moreover, realizing that a new law in 1996 requiring computerized sales receipts in all large retailers would create an instant market, the company purchased a license from Japan to manufacture cash registers, expanding its production assortment by relying on the same formula.

On the East European side, the centrality of this kind of relatively conventional trade is a sign of the ability of local firms to find ways of marketing and distributing their products abroad and demonstrating their competitive potential on home markets. In that sense, it marks an important form of adjustment and change at the enterprise level. As such, it indicates not so much the establishment of or entrance into new production networks abroad as an ability to maintain many of the pre-existing production networks at home and recast them in ways that products are delivered on time and are of a quality and price acceptable on a competitive market. Equally important, exports of either intermediate goods or final products are a means of establishing a reputation, acquiring references on a new market, and stabilizing finances.

Nevertheless, this trade consists simply of order and sales; little technology or know-how is transferred either way and one cannot really view it as the establishment of a production network involving multilateral forms of cooperation or partnership. While this type of arms-length relationship is quite traditional in older industries, the absence of networking--with domestic as well as foreign firms--appears to characterize much computer hardware production in Eastern Europe as well; as one observer notes, "Quite simply, computer firms import all their components from the Far East...and that is the end of the matter."[44] As we shall see, the situation is somewhat different when hardware producers seek to place their products on foreign markets (including markets in other East European countries), but for a (western or eastern) producer of a sophisticated final product able to market successfully to domestic buyers, the need to surrender some enterprise autonomy to take advantage of a cooperative arrangement appears to be quite limited to date.

In addition, the volume of this kind of conventional trade depends heavily on price competitiveness as well as marketing skills, an so the ability of the East European firms to exports depends heavily on low labor costs, favorable exchange rates, and their willingness to accept low margins. Furthermore, while enterprises are nowadays selling a larger proportion of their output on western markets, often this proportionate increase is simply a mask for the dramatic reductions they have had in the output they previously delivered to CMEA and domestic buyers.[45] Indeed, there are some indications that some SOEs may even be exporting at a loss, simply in order to keep their operations going. Not surprisingly, as domestic demand revived after 1994, this kind of export activity stagnated, a factor in the trade deficits that began to increase at about the same time. Last, but hardly, least, the products which seem to be most competitive in this type of trade have turned out to be those with relatively low value-added content. As one observer notes in the case of the Czech Republic, the enterprises which had the

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[44] David Dyker, "The Computer and Software Industries in the East European Economies--A bridgehead to the Global Economy?" Europe-Asia Studies 48 (No. 6, Sept. 1996):920.
[45] See Szanyi, "Adaptive Steps," pp. 68-70.

most initial success in shifting from CMEA to western markets were "typically...enterprises producing intermediate products, raw materials, and standard goods not dependent on R and D, high skills or complicated sales networks."[46]

OPT: If we look instead at the processing trade, here we find something approaching the notion of a production network. However, it carries mixed benefits for East European producers. The most obvious advantage is that it has enabled the enterprises engaged in it to survive--no mean accomplishment in the last few years. Occasionally, firms have also been able to upgrade their technology without making extensive new investments, as suppliers have leased equipment in order to better ensure the quality of the finished product. Precisely because of the low investment it involves, OPT has been a focal point for the small private sector as well, especially in Poland. In the state-owned and privatized sectors, too, OPT has allowed enterprises to put their excess capacities to use, allowing them a certain financial stability they would otherwise lack.

Nevertheless, these gains have also carried significant costs. As individual enterprises have been drawn into cross-national networks, often the domestic networks they previously supported have disintegrated. For example, the garment industry in all three countries has relied very heavily on the OPT trade, but the textile industry that once supplied it has collapsed, partly because its former buyers are committed to purchasing yarns and fabrics from western contractors. Engineering firms have also turned to OPT to keep their capacities operating; generally, however, the work has not been technologically challenging and has rarely led to the kind of product or process innovations they would ultimately need to stay economically viable. For example,

...Tesla Pardubice, the Czech communication equipment producer that developed the sophisticated Tamara surveillance system...received a considerable proportion of its income from assembling toasters and coffee-makers for a German firm, destined to sell on third markets. One of the steps they performed was to engrave on the back of the equipment: 'Made in Germany.'[47]

Indeed, in cases like these, rather than enhance capacities for innovation, the OPT work needed to keep a firm financially afloat makes its R and D work an expensive luxury it can no longer afford. In short, the OPT trade has certainly proven financially important for many

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[46] Bohata with Fischer, "Performance of the Naufacturing Industry," p. 80.
[47] Kiss, "Sink or Swim?" p. 800.

enterprises, whether privatized, private and even state-owned, but it tends to be part of the same deskilling phenomenon evident in much of the pure commodity trade.[48]

Joint ventures: Joint ventures are another important form East-West integration takes at the enterprise level. Hundreds of such ventures have been announced, although many of them are very small and one suspects the primary purpose they serve is tax evasion. But there are "real" JVs as well, in which the East European enterprise often supplies the production skills, while the foreign partner provides the marketing, distribution, and even some of the financing. For example, a 1992 study of Desta, a Czech manufacturer of forklift trucks, describes a JV about to begin with Linde, A. G., the strongest European manufacturer of such vehicles: "Desta would supply the high quality but lower-priced components, using its own production capacities, and Linde would reinforce its competitive position in the international marketplace."[49] Such a relationship is fairly typical of the genre, and does indeed indicate a kind of nascent "production network." As the Desta-Linde venture suggests, entering into some sort of JV can be critical for a local company's ability to move into new foreign markets, partly for the connections it affords and partly because it allows the relatively unknown East European producer to piggyback on the reputation of the partner. This is as true for hardware producers in electronics as in traditional manufacturing industries. As one observer recounts of the former, "We were particularly impressed by the statement of the general director [of a Latvian electronics firm] to the effect that you need a western partner even for the Eastern market."[50]

In some cases, JVs also involve a technology transfer, but this is fairly unusual, since normally foreign companies are unwilling to transfer proprietary technology unless they have far more control than the JV format permits. Nevertheless, JV's are often an important factor in an enterprise's ability to restructure and streamline its operations to improve performance: "A foreign joint venture partner presents the opportunity for an outside evaluation of the manager, thus raising the manager's incentive to perform well. Moreover, the foreign JV may reduce the uncertainty about the enterprise's prospects under restructuring (for example, by providing

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[48] See Marc Ellingstad, "The Maquiladora Syndrome: Central European Prospects," Europe-Asia Studies 49 (January 1997): 7-21; Peter Farkas, "Component Suppl, Contract Work and Technical Development: A Study of Hungarian Companies," Institute for World Economics Working Papers , No. 71 (Budapest: October 1996).
[49] Jaroslav Jiracek, "Engineering/Forklift Trucks: Desta," in Estrin, Brada, Singh, and Gelb, Restructuring and Privatization: Case Studies, p.13.
[50] Dyker, "Computer and Software Industries," p. 923.

access to finance for investment), thereby raising the manager's incentive to restructure."[51] At the same time, since some of the larger East European enterprises are simultaneously involved in several JVs with different foreign partners, it allows them to use the knowledge and experience gained in any one for their own objectives, enhancing the flexibility of the firm itself in multiple markets. But JVs are also often an introductory step in a buyout by the western partner; this has most often been the case in Hungary, which has attracted by far the largest amount of FDI in the region.

Foreign Direct Investment: It is with FDI where one would expect something like production networks to emerge, in which large MNCs build, modernize, and use East European facilities and labor to maximize comparative advantages among subsidiaries. In theory, such strategies would seem to make sense for the companies concerned, and it would entail spillover effects for local producers as well. Since most FDI has been in Hungary, our analysis centers primarily on that country's experience. Here, although there is indeed evidence that Hungarian subsidiaries of MNCs are being knit into the companies own regional networks, the spillover effects appear to have been extremely limited to date.

Overall, FDI in Hungary has certainly had positive effects. It is perhaps significant that the likelihood than an enterprise will have restructured its operations seems to be directly correlated with foreign involvement.[52] FDI has led to significant modernization of plant and machinery as well as streamlining the production process; in addition, it has provided quite significant employment opportunities for many, typically at wage rates above the national average.[53] Thus, in Hungary, it is estimated that foreign firms account for 20% of employment in the commercial sphere, at salary levels that are 40% higher than the average. Foreign owned firms have also been significant exporters, accounting for 60% of exports in 1995.[54]

However, foreign-owned firms also tend to follow what can only be called an enclave strategy, such that multiplier effects on local producers who are domestically owned and

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[51] Wendy Carlin, John van Reenen, and Toby Wolfe, " Enterprise Restructuring in Early Trnasition: the case study evidence from Central and Eastern Europe," Economics of Transition 3 (Dec. 1995):437.
[52] See ibid, pp. 427-59. Note that "foreign involvement" in this context also includes joint ventures.
[53] Nevertheless, much of the greenfield investment has been extremely capital intensive, and so the number of jobs created has been somewhat disappointing. See Bertalan Diczhasi, "Zoldmezon as iparba," Figyelo, May 9, 1997.
[54] Csaki, Sass, Szalavetz, "Role of Foreign Direct Investment in Hungary," pp. 9-10.

managed have been far less than originally expected.[55] For example, although Hungary has suddenly found itself with an automobile industry, neither GM, Ford, nor Audi use local suppliers very much. Rather, they tend to import components from their suppliers based in Western Europe or at best, attract their western partners to set up shop locally. VW's purchase of Skoda might appear to be somewhat different--but here, the "local" suppliers to Skoda kept up their business with the firm largely to the degree they were absorbed by companies who were VW's suppliers in Germany--at VW's rather explicit request to both.[56] The main exception to this pattern seems to be Magyar Suzuki, where EU local content requirement literally forced the firm to work through local suppliers whom Suzuki then aided to acquire the necessary licenses and technology.

The Hungarian automobile establishments are greenfield investments, but the experience in privatized firms has not been dissimilar. Unlike FDI in Asia, gaining market access seems to be the prime motive for establishing wholly-owned subsidiaries in Eastern Europe, and often the markets and connections of the SOEs acquired are as valuable as the assets themselves. For example, the Electrolux-Zanussi venture (or perhaps adventure might be more appropriate, as responsibility for the clean-up costs of the toxic waste dump on the plant site has yet to be determined) began with the purchase of Lehel, the sole manufacturer of refrigerators and other white goods in Hungary. The technology the new owners used was all imported as are the appliance components, and previous suppliers simply lost their business. R and D are centered in the home countries; final products are exported or sold in Hungary from imported components. Siemens' purchase of the sole Hungarian telephone manufacturer is a similar tale: the plant went from employing several thousand to a few hundred; the technology and equipment is all imported, and the workforce basically assembles it. Not coincidental to Siemens decision to take over the plant was the privatization of the Hungarian telecommunications company, MATAV, to a Deutsche Telecom/Ameritech alliance, since it guaranteed Siemens the ability to coordinate its production with that of a complementary firm with which it had longstanding business relations in Germany. A similar phenomenon appears to have taken place in the pharmaceuticals industry, where production facilities were modernized, but R and D was moved to the home headquarters.

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[55] See especially Farkas, "Component Supply;" also David Bartlett and Anna Seleny, "Foreign Direct investment in Eastern Europe: A Transaction Cost Analysis of Multinational Strategies in the Hungarian Automobile Industry," unpublished ms., 1996 (mimeo).
[56] See "Together Forever?" Business Central Europe 3 (No. 19, March 1995): 7-10.

The primary advantage for the foreign company on the Hungarian market--its ability to supply drugs already acceptable to the state health service--was, of course, retained.

The multiplier effect of FDI is thus mainly on smaller, western suppliers to larger companies, who often expand their operations to Hungary with the hope of gaining orders there as well. Because such companies already have a track record with an MNC, they do not have the problem of proving their reliability as suppliers the way a local firm would--nor do they often need the financing a Hungarian competitor would require. What one has here is less the creation of a cross-national production network than the transplantation of already existing ones.

In addition, the reliance of foreign firms on imports has often been problematic, at least as far as the management of trade balances is concerned. Much FDI has come in the form of imported capital goods, which presumably is only a short-term cost, able to pay itself back once capacities are erected and production begins. Moreover, by modernizing the country's technological base, it contributes to economic growth. But other kinds of importing are less salutary. In some cases, foreign firms will assemble products for export out of expensive imported components; when the goods leave the country, they appear to have been produced at a loss. But since the components are produced in another MNC subsidiary in Western Europe, the company itself has actually made a profit on the operation. Other examples concern foreign owned firms that have taken over distribution networks (e.g., retail chains); they often turn to traditional western suppliers even when local substitutes are available at lower cost. Many of the collective farms were extremely concerned over foreign purchases of food processing establishments, anticipating a switch to imported foodstuffs.[57] Certainly, local retailers are likely to sell imported goods as well, and in many ways, such practices offer an incentive to local producers to upgrade their assortments. But sustaining the constant trade deficit is becoming increasingly difficult.

Certainly, there are exceptions to these patterns. Eriksson, for example, has set up a software house in Hungary whose work is used for the entire Eriksson group. GE's purchase of Tungsram, too, has seen a modernization and maintenance of the former SOE's R and D work. GE not only took over Tungsram's already established western markets, but was able to expand them through its own distribution channels. GM had such success from its initial assembly plant

[57] Author's interviews, 1992.

at Szentgotthard--essentially a glorified OPT operation--that it is now building a plant in nearby Gyor to produce engines. But to date, such activities have been isolated exceptions.

Conclusion

All in all, then, regardless of distinctive development strategies, cross-national production networks have been the exception rather than the rule in all three of the CEE states. To the degree international production networks consist simply of a large MNC managing geographically scattered, wholly-owned subsidiaries, some of this appears to be developing in Hungary, largely because of the extraordinarily high degree of cooperation such companies have received from the government. But to the degree international production networks are defined as alliances between domestically-owned local firms and companies based in western Europe, in which both enterprises are independent and each sacrifices some autonomy in order to pursue a joint objective both benefit from, IPNs are few and far between--even in industries like electronics and computers, where one would most expect to find them.

Part of the reason is undoubtedly timing: it is simply too early for complex relationships to be established, particularly at a time when financing channels in Eastern Europe itself are so undeveloped. But the reasons may also reflect deeper barriers, from uncertainty about EU enlargement to the tendency of western firms to base their strategies in Eastern Europe on the exigencies of operation in their home countries. Ironically, precisely because of the CEE states' geographic proximity, it is relatively easy to leapfrog local companies and networks in host countries in favor of known suppliers across the border. Finally, the kind of "triangular trade" that was so important for Asia is to date missing in the CEE area. Conceivably, the former Soviet area could play the role of a large "third" market for which Eastern Europe could serve as a platform. In such a case, CEE producers might well offer a unique capability western firms would need to take advantage of and vice viersa. However, such a development would assume an economic recovery and an institutional infrastructure that could support further development in the CIS, and it is quite unclear how rapidly or fully either are likely to occur. And it is not at all clear how willing CEE governments would be to facilitate it, given their current foci and objectives. For these reasons, the local skepticism described at the outset of this paper is still far from ungrounded.

TABLE 1: **URBANIZATION (% of total population)**				
COUNTRY	**1980**	**1990**		
Indonesia	22.2	30. 6		
Malaysia	42.1	49.8		
Philippines	37.5	48.8		
Thailand	17	18.7		
Czech Republic	63.6	64.9		
Poland	58.2	62.5		
Hungary	56.9	62.1		
Sources: European Marketing and Statistics (London: Euromonitor Plc, 1997);				
International Marketing Data and Statistics (London: Euromonitor Plc. 1997)				

TABLE 2: **INFANT MORTALITY RATE (deaths per '000 live births)**				
COUNTRY	**1980**	**1990**		
Indonesia	114.8	65		
Malaysia	23.9	13.3		
Philippines	58.9	43		
Thailand	58.9	27		
Czech Republic	18.4	11.3		
Poland	21.3	16		
Hungary	23.2	14.8		
Sources: European Marketing and Statistics (London: Euromonitor Plc, 1997);				
International Marketing Data and Statistics (London: Euromonitor Plc. 1997)				

TABLE 3: LITERACY RATE (%)		
COUNTRY	**1980**	**1990**
Indonesia	65	82
Malaysia	70	NA
Philippines	89	94
Thailand	86	93
Czech Republic	99 (1981)	NA*
Poland	98 (1983)	NA*
Hungary	98 (1983)	NA*
* We have no reason to believe literacy has declined since 1980.		
Sources: European Marketing and Statistics (London: Euromonitor Plc, 1997);		
International Marketing Data and Statistics (London: Euromonitor Plc. 1997)		

TABLE 4: LIFE EXPECTANCY (years)		
COUNTRY	**1981**	**EARLY 1990'S**
		MALES/FEMALES
Indonesia	53	58.2/61.9 (1992)
Malaysia	64	69.1/73.8 (1993)
Philippines	61	63/66.8 (1992)
Thailand	63	65.7/70.4 (1992)
	MALES/FEMALES	MALES/FEMALES
Czech Republic	67/74.1	68.5/76.1 (1992)
Poland	66/74.4	67.4/76 (1993)
Hungary	66/73.4	64.5/73.8 (1993)
Sources: European Marketing and Statistics (London: Euromonitor Plc, 1997);		
1997); International Marketing Data and Statistics (London: Euromonitor, 1984, 1996)		

TABLE 5: <u>GNP PER CAPITA (in U.S. Dollars)</u>			
COUNTRY	1980	1990	
Indonesia	340	480	
Malaysia	1,740	2,260	
Philippines	660	630	
Thailand	740	1290	
Czech Republic	NA	NA*	
Poland	1490	1730	
Hungary	2110	2920	
* Most accounts would estimate GNP per capita in the Czech Republic as anywhere from 20-30% above Hungary's. In dollar terms, $3,200 would be about accurate.			
Source: <u>World Tables</u> (Baltimore: World Bank Books, 1995).			

TABLE 6: EMPLOYMENT BY ACTIVITY (% of total workforce)										
COUNTRY	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**	**I**	**J**
1982:										
Indonesia	59.4	0.2	7.3		1.5	14.6	2.4	0.1	12	2.5
Malaysia	34.4	1	17.1	1.5	4.9	13.6	4.2		17.6	5.7
Philippines	50.1	0.4	11	0.4	2.7	10.1	3.9	1.8	15.3	4.3
Thailand	70.1	0.2	7.9	0.3	1.9	8.4	2	8.3	…	0.9
Indonesia (92)	52.9	0.8	10.2	0.2	3	14.7	3.2	0.7	11.9	2.1
Malaysia (93)	21.1	0.5	23.4	0.8	7.3	17.1	4.7	4.5	20.6	
Philippines (94)	40.9	0.4	9.4	0.4	4.3	13	5.1	1.8	16.3	8.4
Thailand (94)	39.9	0.2	14.6	0.6	7.4	12.6	3	12.6	…	9.1
1982:										
Czechoslovakia	13.1	2.6	35.4	1.4	9.5	9.8	6.3	1.2	19.8	0.9
Poland	30.2	…	29.9	…	8.3	7.6	6.8	17.2	…	
Hungary	21	…	33.9	…	7.7	9.8	7.9	19.7	…	
Czech Rep. (91)	12.3	…	35.9	…	8.1	9.8	6.6	1.5	22.1	3.7
Poland (88)	27.8	2.8	24.6	1	7.9	8.1	6.7	1.7	19.3	
Hungary (90)	19.6	…	29.9	…	6.9	10.8	8.6	24.2	…	

A dashed entry in the table means that the information for that division has been incorporated in the preceeding column, or column between the two dashed entries. A Agriculture/Forestry/Fishing; B Mining/Quarrying; C Manufacturing; D Electricity/Gas/Water; E Construction; F Wholesale? Retail Trade; G Transport, Storage and Communications; H Finance,Insurance, Real Estate and Business Services; I Community, Social and Personal Services; J Not adequately defined

Sources: European Marketing Data and Statistics (London: Euromonitor Plc. 1984, 1997); International Marketing Data and Statistics (London: Euromonitor Plc. 1984, 1997

TABLE 7: ORIGIN OF GDP (percentage breakdown)										
COUNTRY	A	B	C	D	E	F	G	H	I	J
1981:										
Indonesia	24.5	24.1	11.7	0.5	5.5	15	4.1	NA	NA	14.6
Malaysia	23.5	4	18.1	2.3	4.7	13.6	6.9	NA	NA	26.9
Philippines	22.5	3.1	24.5	1.1	8.5	17.5	6.4	NA	NA	16.4
Thailand	23.9	1.7	20.1	1.4	5.3	22.7	7.3	NA	NA	17.6
1991:										
Indonesia	18.5	15.6	19.9	0.7	6	15.9	5.6	NA	NA	17.8
Malaysia	20.2	10.3	25.6	1.9	3.2	10.6	6.7	NA	NA	21.5
Philippines	21.2	1.4	25.4	2.5	5	15.3	5.9	NA	NA	23.4
Thailand	13.2	1.7	28.8	2.4	6.4	21.9	7.4	NA	NA	18.3
1982:										
Czechoslovakia	7.1	…	60.7	…	11	16.3	4.5	NA	NA	7
Poland	29.6	…	42.2	…	7	12.6	6.5	NA	NA	2.1
Hungary	14.1	…	49.4	…	9.7	19.9	5.7	NA	NA	1.2
1991:										
Czech. Rep.	5.6	…	43.9	…	6.3	10.5	4.1	9.6	4.9	15.1
Poland	6.9	…	40.2	…	10	13.2	5.6	4	21.9	-1.8
Hungary	10	3.1	21.5	3.3	5.3	14.3	8	NA	NA	34.5

A dashed entry in the table means that the information for that division has been incorporated in the preceeding column, or column between the two dashed entries. A Agriculture/ Forestry/ Fishing; B Mining/Quarrying; C Manufacturing; D Electricity/Gas/Water; E Construction; F Wholesale? Retail Trade; G Transport, Storage and Communications; H Finance,Insurance, Real Estate and Business Services; I Community, Social and Personal Services; J Not adequately defined

Sources: European Marketing Data and Statistics (London: Euromonitor Plc. 1984, 1995, 1996); International Marketing Data and Statistics (London: Euromonitor Plc. 1984, 1997

TABLE 8: TELEPHONES IN USE ('000)		
COUNTRY	**1980**	**1990**
Indonesia	487.3	1080.3
Malaysia	598	2,022.60
Philippines	702	1046.8
Thailand	497	NA
Czech Republic	3,150	4,278
Poland	3,387	5,232
Hungary	1,261	1,872
Sources: European Marketing Data and Statistics (London: Euromonitor Plc, 1997): International Marketing Data and Statistics (London: Euromonitor Plc, 1997).		

TABLE 9: ROAD NETWORK		
COUNTRY	**1980**	**1990**
	(length of rods, km)	**(density: km per km/2 of land)**
Indonesia	103,000	.13(1991)
Malaysia	24,700	.12(1993)
Philippines	154,400	.61 (1993)
Thailand	72,200	.10 (1994)
Czech Republic	73,788	NA
Poland	299,166	1.18 (1994)
Hungary	87,142	1.71 (1994)
Sources: European Marketing Data and Statistics (London: Euromonitor Plc, 1984, 1997); International Marketing Data and Statistics (London: Euromonitor Plc, 1984, 1997).		