Hungary After the Revolution: Privatization, Economic Ideology and the False Promise of the Free Market

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What's the worst thing about communism? What comes after.
- Hungarian saying

Introduction

The five year anniversary of revolution in Eastern Europe[1] is now past, yet throughout the former Soviet bloc there is widespread disappointment with the fruits of that sweeping change. The path to a market economy is creating poverty,[2] unemployment, and enor-

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1. I use the term Eastern Europe to refer to these European former state socialist countries: Albania, Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia, but not that part of Germany which was East Germany, due to its unique development situation. Other authors sometimes refer to "Central Europe" or "East-Central Europe" when discussing Hungary.

2. While a few fortunate entrepreneurs (including much of the old communist elite) are thriving in the new free market structures, unemployment, poverty, and a grave fear of the future are now persistent conditions for many Hungarians. In Hungary, as in the other countries of the region, it has become obvious that while a western-style economy can slowly be built in the aftermath of state socialism, it will not benefit most of the population. This fact has been documented extensively in the last two to three years. "The collapse of the Soviet-style command economy created a new class of brash capitalists brandishing cellular telephones as they cruise bumpy highways in sleek new cars. But it also instigated a downward economic spiral shoving millions . . . below the poverty line in a repetition of the inequalities that contributed to the rise of socialism and extreme nationalism here [Hungary] before World War II." John Pomfret, *Millions Below Poverty Line Ambivalent About Benefits of Capitalism*, WASH. POST., Oct. 25, 1994, at A13. "Amid the glitter of unbridled capitalism, however, one can also find a seamier side - huge pockets of poverty, unemployment, corruption, crime." Ron Chepesiuk, *The Bloom is Off the Rose*, ST. PETERSBURG TIMES, Jan. 2, 1994, at 1D. "The income of 66 percent of Hungarians has significantly fallen in the past few years . . . " *Wages Plummeting*, BUDAPEST WK., Dec. 15-21, 1994, at 4. "[C]ertain people [in Hungary] are accumulating a lot of

mous economic uncertainty on a scale unknown in this region until the birth of radical economic reform in 1989.[3]

In Hungary, the primary effect of post-1989 statutory changes introducing a market economy is the creation of massive inequality,[4] and the "collapse of civil order unlike anything the country has experienced in modern times."[5] This trend is unlikely to be reversed in the near future, and will ultimately become entrenched if current policies are not revised.[6] Andras Inotai, the head of the Institute for World Economics at the Hungarian Academy of Sciences, described the overall process:

> For the first time in history, these [Eastern European] economies became a laboratory for simple or simplified economic ideologies based on models that had previously existed only in university textbooks and which, fortunately, had never been applied in any full-fledged market economy . . . [T]he results of applying the Western patterns of transformation have become

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capital, while the majority of the population is not as well off as it was before." Carol Williams, *Tough Times; The Rapid Pace of Change in the Wake of Communism's Collapse has Fueled Fear, Anger and Disappointment*, L.A. TIMES, Apr. 14, 1992, World Report, at 2. "[T]he newborn capitalism brought unemployment, poverty and dramatic social and ethnic tensions to Eastern Europe - while it didn't change the weather." Miklos Vamos, *Kicking the Tires in Hungary*, NATION, Oct. 29, 1990, at 487.

3. *See infra* notes 150, 158, 165, 166, 176-180 and accompanying text.

4. After five years of reform, the situation is so extreme that ten percent of the population accounts for *one half* of consumer spending in the country. Frank Viviano, *Eastern Europe's Lost Generation: Historic Change Brings Alienation Instead of Hope*, S.F. CHRON., Sep. 19, 1994, at A1. "[W]ithin all six East European countries, a chasm has opened up between a tiny number of nouveau riche and a growing population of abysmally poor . . . " Kitty McKinsey, *East Europe's New Order; Western-style Economy Contrasts with the Third World Poverty*, OTTAWA CITIZEN, Nov. 5, 1994, at B7. " 'Some Hungarians became rich under the new system, but the homeless began appearing in the streets, as well. There's more concern for money than for people now,' complained a 19-year-old student who voted Socialist." Linnet Myers, *Economic Distress Boosts Hungary's Socialists to Election Victory*, CHI. TRIB., May 9, 1994, at 6, zone N. "Their societies [Poland, Czech Republic, and Hungary] have been divided into two classes: the envied few who, despite some rough going, have profited from the change and a resentful majority upset at not being able to make it." Jane Perlez, *Fast and Slow Lanes on the Capitalist Road*, N.Y. TIMES, Oct. 7, 1994, at A1. "Five percent of Hungarians are now extremely rich by any standards. However, fully a quarter of the population hovers around the poverty line of 9,000 forints ($129) a month, a third of the average wage." Kitty McKinsey, *Hungary: Gap Between the Rich and Poor Widens to Chasm in Policy Vacuum*, OTTAWA CITIZEN, Nov. 15, 1993, at D10. *See generally* Barbara Sierszula, *The New Capitalism's Capitalists: Rags to Riches in Hungary*, WORLD PRESS REV., Feb., 1994, at 14-17. Public opinion surveys show that a large majority of Hungarians believe that inequality has increased dramatically since the introduction of free market reforms. M.D.R. Evans, Jonathan Kelley, and Támas Kolosi, *Images of Class: Public Perceptions in Hungary and Australia*, 57 AM. SOC. REV. 461, 470. *See also infra* notes 180-183.

5. Frank Viviano, *Old Enemies Join Forces in Hungary; Communists Back in Power as Crime Soars, Economy Dives*, S.F.CHRON., Sept. 5, 1994, at A1 [hereinafter *Old Enemies*].

6. *See infra* part IV.

> increasingly ambiguous. Although curing some ills, at least temporarily and superficially, they have caused or aggravated crises in several other areas.[7]

The central elements of this overall process are privatization[8] and foreign investment, practices that are intimately connected.[9]

This article examines Hungary as a case study in the post-1989 revolutionary process in Eastern Europe. It explains how the transition to a market economy is taking place, how this transition has "caused or aggravated crises"[10] in Hungary, and why this transition will continue to fail into the long-term future. Part I outlines the laws important to the creation of a free market economy: first, the reforms of the socialist state, as they are often the backdrop and basis of recent reforms; and, second, the significant post-socialist laws. Part II argues that the post-1989 revolutionary project is a disaster that has almost entirely ignored the human costs of transition. The emerging capitalist relations of production,[11] created through privatization and foreign investment, are producing a small and wealthy entrepreneurial/technocratic upper class while impoverishing most of the population more thoroughly than did the preceding communist system. Part III examines why the failed strategies of the past five years have not been abandoned. This section will show that free market ideology, western aid policies, the

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7. Andras Inotai, *Transforming the East: Western Illusions and Strategies*, HUNGARIAN Q., (1992) at 24. These other areas are, *inter alia*, employment, real wage levels, health care, crime, and social welfare. *See also infra* part II.

8. "Privatization is the opposite of nationalization: privatization of state enterprises reflects the predominance of capitalist thinking, whereas nationalization is an obvious sign of socialist development. . . " Andrei A. Baev, *Civil Law and the Transformation of State Property in Post-Socialist Economies: Alternatives to Privatization*, 12 UCLA PAC. BASIN L.J. 131, 134 (1993). It is a "process of socio-economic transformation of the foundation of socialist centralized economies by means of transferring state assets and state enterprises to the private sector and thereby resulting in fundamental changes in ownership relationships in the spheres of production and distribution of material welfare." *Id.* at 150. *See also* Ira W. Lieberman, *Privatization: The Theme of the 1990s*, 28 COLUM. J. WORLD BUS. 8 (1992) (discussing the global importance and relevance of privatization).

9. Zsigmond Járai, *10 Per Cent Already Sold: Privatization in Hungary*, *in* HUNGARY: AN ECONOMY IN TRANSITION 77, 80 (István P. Székely and David M.G. Newbery, eds., 1993). I will suggest later in this article that these two processes can exist independently of each other, and that the privatization process ought to be reconceptualized and implemented in the absence of significant foreign capital.

10. Inotai, *supra* note 7.

11. Production relations, for purposes of this article, means the way society is organized for the production of goods and services. It includes the nature of ownership, control of productive resources and production decisions, and the distribution of decision-making power between workers, managers, owners, and the public at large. *See also* ROGER SCRUTON, A DICTIONARY OF POLITICAL THOUGHT 378 (1982) ("Marxian-influenced term for the relations between people in production, and between people and productive forces, which are enshrined in laws of property, and which define the base structure of society").

International Monetary Fund, and the agenda of Hungarian elites concertedly enforce the privatization and foreign investment regimes on the Hungarian population, although these policies are the demonstrable cause of enormous material inequality and poverty. Part IV argues that Hungary, in its attempt to catch up to the West, should reject its current development path. The growth of poverty and inequality in society will continue into the long-term future unless a different development model is adopted. Finally, Part V suggests that privatization through worker ownership is a realistic alternative to the traditional capitalist model of investor ownership emerging in Eastern Europe. This alternate organizing principle emphasizes the importance of economic democracy, not just political democracy. It is preferable for Hungary because it is more reflective of majoritarian desires for social justice in the transition process.

Why study Hungary? There are other East European countries in which the transition to a market economy has been more condensed temporally and more profound in its effects. Romania and the Czech Republic, for instance, are more illustrative of the radical nature of the recent transformations in the former Soviet bloc because prior to 1989 those countries had virtually no market elements in their economies.[12] For several reasons, however, Hungary was the natural candidate for successfully re-creating itself as a free market economy. It was the wealthiest country in Eastern Europe before the Berlin Wall came down. It was the only member of the Soviet bloc, except East Germany and arguably the Czech Republic, with substantial historical ties to the West. It had also been experimenting with marketization since 1968.[13] Hungary, in terms of its "progress" toward a market economy, was far ahead of its Soviet bloc neighbors when its socialist government fell in 1989.

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12. Roger W. Mastalir, *Regulation of Competition in the New Free Markets of Eastern Europe: A Comparative Study of Antitrust Laws in Poland, Hungary, Czech and Slovak Republics, and Their Models*, 19 N.C.J. INT'L L. & COMM. REG. 61, 80-81 (1993). "By late 1990, just before passage of the Czechoslovakian law on competition, Czechoslovakia had almost no private sector at all." *Id.*

13. This is the year the New Economic Mechanism was introduced. The time period of 1968 to 1989 is commonly referred to as "goulash communism" or "goulash capitalism," depending on the source. Either way, it means a series of reforms liberalizing the economy through decentralization of production decisions, and the limited introduction of private property, private enterprise, and foreign investment. The Hungarians began to connect themselves more and more with Western European and world economic institutions during this time. *See* Anthony R. Boote and János Somogyi, *Economic Reform in Hungary Since 1968*, INTERNATIONAL MONETARY FUND OCCASIONAL PAPER 83 (July 1991). The New Economic Mechanism continued centralized planning, but eliminated rigid production targets for state-owned enterprises. In place of production targets, incentives were created in the form of credits, prices and taxes in order to induce compliance with national goals. *Id.* at 1-2.

By that time, Hungary's economy had already taken substantial steps down the path to capitalism.[14] A study of the failure of market reform in Hungary, therefore, may best support the general proposition that the new market reforms (as currently applied) will fail throughout Eastern Europe and irreparably damage these societies. In other words, if the Hungarians can't do it, then the rest of Eastern Europe and the former Soviet Republics probably can't do it.[15]

I. Economic Laws

(a) *Background and Economic Laws under State Socialism*

Privatization and foreign investment are the essence of the project of transforming Hungary into a capitalist market economy.[16] The legal structures that promote radical privatization[17] and foreign investment are important components of this transformation.[18] These laws, therefore, will be described here in detail.

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14. *See infra* part I(a).

15. "As a leader in the restructuring, Hungary's experience can be expected to be a precursor of outcomes in other formerly centrally planned countries." Sarah J. Lane, *The Pattern of Foreign Direct Investment and Joint Ventures in Hungary*, 6 COMMUNIST ECON. & ECON. TRANSFORMATION 341, 362 (1994). The whole process of turning economically developed socialist countries into market economies is *sui generis*. This process had not happened anywhere before 1989. Later in this article, I will suggest that, in light of this fact, already doubtful textbook liberal economic theory ought to be scrutinized more closely before it is applied to reality as a prescription for Eastern European economic development. *See also* Csaba Varga, *Transformation to Rule of Law from No-Law: Societal Contexture of the Democratic Transition in Central and Eastern Europe*, 8 CONN. J. INT'L L. 487, 488 (1993) (discussing this transformation in the context of constitutional and legal reform).

16. *See* JAN KREGEL ET AL., THE MARKET SHOCK, 15 (1992) (describing the importance of these two events).

17. The economic transformation, was, in fact, quite radical in Hungary. "The transition in Hungary was not gradual because earlier reforms failed to resolve basic problems. Therefore it was in fact a hidden shock therapy." Gabor Bakos, *Hungarian Transition After Three Years*, 46 EUROPE-ASIA STUDIES 1189, 1193 (1994). Only if viewed in relation to its state socialist neighbors, however, can it be said that privatization has been a gradual process in Hungary.

18. The legal system plays a vital role in creating capitalist societies. Eastern Europe is no exception, and these societies are using the law as an instrument of economic reform.

> Capitalist property and contractual relations thrived in countries where the process of law-making, as well as the interpretation and application of law, became more predictable, reliable and responsive to capitalist interests. The essence of capitalist investment is the ability of individuals and companies to plan ahead, assume and rely upon contractually formulated commitments in a legal, fiscal, institutional and regulatory environment that is as predictable and stable as possible. Without ownership created, recognised and protected by law, no trade increasing the utility of seller and buyer can take place. Ownership

The legal system in Hungary, as everywhere, exists primarily to legitimize and articulate the economic and political policies of the state.[19] This is not to say that a system of laws will never take on a life of its own. Neither does it deny that there are sometimes symbiotic relationships between the legal system and the economic and political structure of society. However, only five years into the creation of a new government and legal regime, it is hard to see what the lasting effects of the law *per se* will be. Instead, it is easier to analyze the effects of economic policies because they are more explicit and immediately observable.

The legal environment in the final years of state socialism must be understood to make sense of recent legal reforms. The defining legal concepts of property and contract in Hungary were codified in the Civil Code of 1959, which identified three types of property: private property, personal property, and social property. Private property was the least favored in the law, although it was recognized and protected to some extent.[20] The civil code limited the holding and use of private property, and a law that forbade the employment of more than five persons in a private business severely limited private economic activity. This, of course, was re-

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> defines the relation of persons - natural or juridical - to goods, tangible or intangible. The third fundamental building block is company law . . .

Thomas W. Waelde and James L. Gunderson, *Legislative Reform in Transition Economies. Western Transplants - A Short-Cut to Social Market Economy Status?*, 43 INT'L. & COMP. L.Q. 347, 351-53 (1994). Production relations characterized by the private ownership and control of productive forces, along with opportunities for investment of capital, are the *sine qua non* of capitalism. *Id.* This section will therefore concentrate on laws regulating the privatization process and foreign direct investment.

19. I posit as a general rule that economic decisions *per se* do not exist. All economic decisions are political decisions, as well, because they necessarily involve power and the distribution of scarce resources in society. I say "economic and political policies" only to separate analytically those which are almost purely political, for example, obscenity laws or freedom of religion laws, and I follow John Elliott's view of the character of economic decision-making:

> [I]ssues of equity and social justice are built into the very fabric of economic life; they do not arise merely as ethical judgments added exogenously so to speak purely to economic analyses. Second, the economy itself, not only the state and public policy, is inherently political. Therefore, determination of wise decisions in relation to such matters as unemployment, depression, equality, and poverty are properly rooted in political philosophy as well as technical economic analysis . . . The economy itself is a political system because power and wealth are inextricably connected.

John E. Elliott, *Challenges Facing Social Economics in the Twenty-First Century: A Radical Democratic Perspective*, REV. SOC. ECON., Dec. 22, 1993, at 504.

20. Cheryl W. Gray et al., *Hungarian Legal Reform for the Private Sector*, 26 GEO. WASH. J. INT'L L. & ECON. 294, 303-04 (1992). Three types of property were recognized in the socialist state: social or cooperative property (owned or controlled by the state), personal property (homes, furniture, clothing, etc.), and private property (individually-owned means of production). *Id.*

lated to the goal of state socialism, which used central government planning as the primary redistributive mechanism in society.[21]

The origin of economic liberalization was János Kadar's[22] "New Economic Mechanism," a policy introduced in 1968 as Hungary's first major turn away from central planning.[23] There were further moves—halting, uncertain, and often contradictory—toward a market economy in the two decades that followed.[24] Inheritance and gift taxes were reduced by twenty to forty percent in 1986, and bonds and savings accounts were completely exempted from taxation.[25] The tax exemptions favored those wealthy enough to have savings, and were designed to speed the capital formation process. The foreign investment law was liberalized. It cut joint venture profit taxes from forty percent to twenty percent, created tax holidays for new companies in certain fields, allowed western majority participation and guaranteed profit repatriation to foreign companies.[26] This law also simplified licensing, registration and accounting procedures to attract foreign capital.[27]

The following year parliament adopted laws that allowed private ownership of farmland[28] and instituted bank reform.[29] In January 1988, another tax reform law was passed. Parliament

21. The defining feature of actually existing socialism in Eastern Europe from 1947-1989 was state control of the means of production in order to create material equality among citizens. *See also* SCRUTON, *supra* note 11, at 4, 435, and 447 for definitions of the terms "actually existing socialism," "socialism," and "state socialism."

22. Kadar was the HSWP Prime Minister of Hungary from 1956 to 1988. He was installed by the Soviet Union immediately following the destruction of the 1956 rebellion, and ruled until he was quietly removed by his own party in 1988. He died one year later. Kadar cautiously implemented economic reforms throughout the 1970s and 1980s. *See Obituary of János Kadar*, DAILY TELEGRAPH, July 7, 1989, at 21 (briefly discussing his life and policies as Prime Minister).

23. *See supra* note 13.

24. The reforms were contradictory in many ways, however, because they often allowed some types of private enterprise without making structural changes necessary to give the liberalizations any real meaning. For example, joint ventures with foreign companies were allowed since 1972, but almost never occurred due to exorbitant profit taxes and excessive regulations. *Hungary: Reform of the Foreign Investment Laws Leads to Increase in the Number of Joint Ventures - Problems and Opportunities, Part 1*, GAS DAILY RISK MONITOR, Mar. 26, 1987, *available in* NEXIS, NEWS Library, ARCNWS File. Thus, part of the early revolutionary effort in 1989 was to pass all-encompassing statutory changes to remove any lingering barriers to the market economy.

25. *Hungary; Inheritance and Gift Taxes Reduced under New Law*, BBC Summary of World Broadcasts, July 10, 1986, *available in* NEXIS, NEWS Library, ARCNWS File.

26. GAS DAILY RISK MONITOR, *supra* note 24.

27. *Id.*

28. *Hungary Legalizes the Private Sale and Purchase of Farmland*, Xinhua General Overseas News Service, Mar. 20, 1987, *available in* NEXIS, NEWS Library, ARCNEWS File. The law allowed a maximum of six thousand square meters to be

passed the basic privatization law in 1988,[30] known as the Companies Act.[31] This allowed state enterprises to transform themselves into limited liability corporations or stock corporations. The Companies Act reintroduced capitalist production relations to the Hungarian economy, and was thereafter used as the basis for privatization.[32] Although the original text of this Act was couched in the language of state socialism—referring, for example, to the "people's economy" and to the "more efficient utilization of social property"— its primary purpose was completely at odds with socialist orthodoxy.[33] The Companies Act also created a legal framework for developing employer business organizations similar to those of the western market economies.[34]

In October parliament approved the most liberal foreign investment law in the region. It is known as the Foreign Investment Act of 1988.[35] The law opened Hungary to enormous investment by Western corporations, gave foreigners the rights to create or join Hungarian companies,[36] and guaranteed to them the full protection and security of their investments.[37] All of these changes were advanced by the Hungarian Socialist Worker's Party (HSWP).[38] The seeds of a market economy, therefore, were already apparent in the late socialist legal system.

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owned by an individual. Until this law was passed, almost all farmland belonged to the state.

In 1988, Istvan Degen, the head of a sub-department of the HSWP Central Committee stated, "We reject theses [*sic*] that the state form of property is the supreme one." *Is Private Investment in Hungary Consistent with Socialism?*, BBC Summary of World Broadcasts, June 17, 1988, *available in* NEXIS, NEWS Library, ARCNWS File. A public statement like this, which contradicts the essence of state socialist theory, would have been impossible in any other Soviet bloc country (except the Soviet Union itself) at this time, and demonstrates just how far the HSWP had pushed reform by 1988.

29. Jason McDonald, *Transition to Utopia: A Reinterpretation of Economics, Ideas, and Politics in Hungary, 1984 to 1990*, 7 E. Eur. Pol. & Societies 203, 219 (1993).

30. Act VI on Economic Associations of 1988 (Companies Act), *translated in* U.S. Dept. of Commerce, Central & E. Eur. Legal Texts, Oct. 10, 1988.

31. *Id.*

32. Nigel Swain, Hungary: The Rise and Fall of Feasible Socialism 10 (1992).

33. *Id.*

34. Int'l Labour Office, United Nations, World Labor Report, 51 (1994).

35. The original law was Act XXIV of 1988 regarding investments by non-residents in Hungary. *Translated in* U.S. Dept. of Commerce, Central & E. Eur. Legal Texts, Oct. 10, 1988. *See also Two Cheers for Hungarians, Three for Balts, None for Czechs*, Economist, Oct. 15, 1988, at 59 (U.K. edition at 61). *See also* Gray et al., *supra* note 20, at 307.

36. Companies Act, *supra* note 30, at Part One, Chapter I, § (4)(1).

37. *Id.* at § (1)(1).

38. The HSWP ruled Hungary from 1948 until 1989. During this time, the HSWP was, for all practical purposes, the Hungarian government.

The socialist constitution of 1949 has never been repealed, but was extensively rewritten in 1989.[39] This is known as the "new" constitution. The HSWP itself was responsible for this radical reinvention of the constitution, which was passed through the HSWP-dominated parliament.[40] This revision occurred in October, only a month before the total collapse of the HSWP government.[41]

The new constitution created a western-style parliamentary democracy, an independent constitutional court, and an independent judiciary. Unlike most western constitutions, it defines the basic economic doctrine of the country and certain economic rights of individuals. The constitution declares that "Hungary has a market economy in which public and private property are to receive equal consideration and protection under the law,"[42] and that the state "recognizes and supports the right to enterprise and the freedom of economic competition."[43] The rights to property and inheritance are also guaranteed.[44] On the other hand, the constitution makes numerous guarantees regarding the social welfare of its citizens.[45] The government has largely ignored these constitutionally-guaran-

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39. About 80% of the constitution was replaced. "[A]s legislators like to say, the only sentence that remains unchanged is the identification of Budapest as the capital city." E. EUR. CONST. REV., Summer 1992, at 4 (untitled note). Even the name of the country was changed, from the "People's Republic of Hungary" to just the "Republic of Hungary."

40. E. EUR. CONST. REV., Spring 1992, at 3 (untitled note) (describing briefly what has happened to constitutional reform from 1989 to 1991). After the 1989 revisions, there has been much talk but little action regarding further changes to the constitution. *Id.*

41. At least half a year before this event, the HSWP Justice Minister had spoken openly of creating a western-style constitution, even praising the achievements and longevity of the bourgeois constitutions. *See* David Lewis, *Law Professor Spearheads Quiet Revolution in Hungary*, The Reuter Library Report, Dec. 29, 1988, *available in* NEXIS, NEWS Library, ARCNWS File.

42. A MAGYAR KOZTARSASAG ALKETMANYA [Constitution of the Republic of Hungary], Ch. I, Art. 9, § (1), *translated in* U.S. DEPT. OF COMMERCE, CENTRAL & E. EUR. LEGAL TEXTS, Dec. 31, 1990.

43. A MAGYAR KOZTARSASAG ALKETMANYA [Constitution of the Republic of Hungary], Ch. I, Art. 9, § (2).

44. *Id.*, Ch. I, Art. 13, § (1), and Ch. I, Art. 14.

45. The articulation of these rights is not surprising, considering that this constitution (still in force today) was written by the HSWP. Several positive economic rights are thus defined. The state will see "to the wants of the needy through a long line of social measures." *Id.*, Ch. I, Art. 17. The state "guarantees the equality of men and women in regard to all . . . economic . . . rights." *Id.*, Ch. XII, Art. 66, § (1). The two subsequent sections in this article guarantee economic rights specific to women. Section (2) states that "mothers receive special support and protection before and after the birth of their children, in compliance with separate provisions of the law." Section (3) says that "[S]pecial rules ensure protection for women and young people in the performance of their jobs." "Every child has the right to enjoy the care and protection on the part of their families, *and by the State and society*, that is necessary for satisfactory physical, mental and moral development." *Id.*, Ch. XII, Art. 67(emphasis added).

teed social welfare rights during the post-1989 rush to capitalism. These constitutional guarantees may be the rights to which present and future calls for social justice in economic reform can appeal.

This much reform was accomplished under the leadership of the HSWP before the 1989 revolution because the party understood its weakening position and the way history was moving in the late 1980s. State economies throughout Eastern Europe had proven incapable of producing sustained economic growth relative to the West and consequently were incapable of meeting growing consumer demands.[46] Hungarian elites (HSWP deputies and state en-

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The right to work and "to the free choice of employment and occupation" is guaranteed. *Id.*, Ch. XII, Art. 70/B, § (1). All citizens have the "right to equal pay for equal work," *Id.*, § (2), and everyone who works has "the right to emolument that corresponds to the amount and quality of the work performed." *Id.*, § (3). The following section provides "the right to rest and free time for recreation, and regular paid holidays." *Id.*, § (4). The right to form organizations "for the protection of economic and social rights together with others, or to adhere to such an organization" is protected, *id.*, Ch. XII, Art. 70/C, § (1), and the right to strike is listed but can be exercised only as far as the law allows. *Id.*, § (2).

Another Article in this chapter guarantees the right to social security to all citizens, *Id.*, Art. 70/E, § (1), but the next sentence describes the particular disadvantaged groups which are entitled to "the provisions necessary for subsistence." These are the elderly, the ill, the disabled, widows or orphans, and those unemployed through "no fault of their own." The apparent meaning of this section is that all citizens, who happen to become a member of one these protected categories have a right to state-provided support, not all citizens *per se*, as the first sentence standing alone would seem to indicate. The next section in this article "upholds the right of people to being provided for through the social security system and its institutions." *Id.*, § (2). Again, it is unclear whether this means a general right or whether it only extends to those individuals falling within one of the groups listed in the immediately preceding section.

There is one other Article in this chapter which protects the rights of the poor explicitly, *Id.*, Art. 70/A, § (1), and any discrimination under this section "is strictly punishable by law." *Id.*, § (2). In the same Article, "Hungary promotes the realization of equality before the law with measures aiming to eliminate inequalities of opportunity." *Id.*, § (3).

The movement for constitutional reform and the creation of a permanent constitution is gathering momentum again, and economic rights may not fare as well in any new document, even though the parliament is again dominated by the socialists. (Parliament enacts the constitution.) *Id.*, Ch. II, Art. 19, § (3)(a). While the socialist party in power is the successor to the HSWP (which wrote the current constitution), it has nonetheless promised to push privatization and the elaboration of the market economy. *See infra* note 189. As I will document later, the goal of maintaining broad constitutionally-guaranteed protections for social welfare rights is mutually exclusive of the current privatization process. Thus, it will be interesting to see whether the socialist party will pursue privatization or social welfare guarantees if forced to choose when re-drafting the constitution.

46. There was a growing disparity in standards of living existing in Hungary and Western Europe in the 1980s. Hungarians were especially conscious of this disparity because of their relative freedom to travel to Western Europe (unlike their neighbors in the other Soviet bloc countries). At this time, there was widespread awareness, among both the general public and elites in the HSWP, of the failure of state socialist planning in Eastern Europe to maintain an economy which could keep

terprise managers), who were better off than the rest of society under state socialism, discovered in the 1980s that they could successfully reposition themselves to benefit personally from the coming free market system.[47] The HSWP gradually surrendered socialist orthodoxy, therefore, and moved cautiously into the free market paradigm in that decade.[48] HSWP elites profited from the revenue brought in by privatization and foreign investment,[49] and are presently among the main winners in the emerging market economy.[50] Consequently, class divisions in Hungarian society, which existed in a more muted form until 1989, were aggravated by the free market revolution, rather than erased.[51]

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pace with post-war economic development in the West. *See generally* SLAVENKA DRAKULIC, HOW WE SURVIVED COMMUNISM AND EVEN LAUGHED (1993).

This is not to say that the socialist government could claim no achievements—there were many. The pre-1989 regime created a relatively effective and widely available (if not technologically advanced) health care system, guaranteed pension and real financial security in old age, housing for practically everyone, a stable economy in which almost everyone had some guarantee of employment. As post-1989 revolutionary changes proceed, the old system looks increasingly better by comparison.

47. "[The reformed communist] is the most urbane of ghosts. No gibbering, no rotting shroud. It wears a smart suit; it laughs infectiously and runs up and down the steps of parliaments carrying a laptop and a copy of the Financial Times. It asks international bankers to lunch, and talks gravely about the need to restrain wage-push inflation. Only the sharpest ears can detect a faint clank of chains." Neal Ascherson, *An Urbane Spectre with a Suit and a Laptop is Haunting Europe*, INDEPENDENT, May 15, 1994, at 20.

48. The example of the Soviet Union under Mikhail Gorbachev was an enormous boost to reform-leaning deputies in the HSWP. Obviously, the relatively bold moves toward a market economy that went into place after 1986 could not have happened without at least tacit approval from the Soviet Union. The surprising part of all the reform within the Soviet bloc was the extent to which the Soviet Union itself outpaced the Hungarians in terms of implementing privatization. In October, 1989, for example, Gorbachev warned East German leader Erich Honecker that "history punishes those who are late." *See Europe: Five Years Later; The Decades of Division*, L.A. TIMES, Nov. 1, 1994, World Report, at 10. This factor is important in terms of explaining HSWP attitudes toward economic restructuring.

49. "In a report examining the privatisations under way, the [International Metalworkers' Federation] says that jobs and workers' living standards are being sacrificed, while ex-Communist officials in collusion with foreign banks and financial advisors are profiting handsomely." *IMF: East European Privatisation Benefiting Former Communist Nomenklatura?*, EUR. INFO. SERVICE, MULTINATIONAL SERVICE, SECTION II: THE TRADE UNION CHALLENGE, No. 337, Nov. 20, 1993.

50. *Id. See also* Ákos Róna-Tas, *The First Shall be Last? Entrepreneurship and Communist Cadres in the Transition from Socialism*, 100 AM. J. SOC., No. 1, July 1994, at 40. In Hungary ex-HSWP cadres are more successful than other people in the new free market economy. They tend to maintain and expand their elite positions relative to the rest of society. *Id.*

51. *See infra* notes 180-83 and accompanying text. Even though political democracy has developed to some extent in Hungary, a major issue in the 1994 elections was "the increasing distance between the government and the citizens. The government began to inhabit a place worlds apart from the populace. It seemed more intrigued by what could be freely pillaged, and showed little interest in the day-to-day

Hungarians became increasingly critical of their economic system in the late 1980s, and demands for liberalization grew.[52] The dissatisfaction with the state economy was substantially misplaced, however, as Hungarians compared the *reality* of socialism with the *ideal* of capitalism.[53] Hungarians tended to concentrate on the successes of capitalism and ignored its failures in the 1980s and through the early revolutionary years of 1989 and 1990.[54] There was, therefore, little comprehension before 1989 of the enormous human suffering that would result from a radical transformation to a market economy.[55] Also, many reformers misjudged Hungary's chances of thriving in a market economy, and initially believed that free market economic success would come fast and with immediate benefits.[56]

These misperceptions about the ease with which a market economy could be created were common, but were not fully understood until it was too late—when unemployment, poverty and infla-

problems of the average person." Peter Nadori, *The Return of the Pink Pussycats*, 7 UNCAPTIVE MINDS, No. 2(26), Summer 1994, at 52.

52. After the Soviet military crushed the 1956 uprising, Kadar struck an implicit deal with the Hungarian people, promising them economic prosperity in return for their acquiescence in the oppressive political system. Kadar largely fulfilled this promise for the three decades following 1956. In the late 1980s, however, the Hungarian economy began to falter, and the rate of material progress and income growth began to slow. Hungary was increasingly burdened by foreign debt in the 1980s, as well.

53. For a presentation of this argument in detail, *see* McDonald, *supra* note 29, at 206-07. He describes how "economic utopianism" colored Hungarian's perceptions of radical privatization and restructuring. "The point is that the *institutions* of the [capitalist] model exist in one country and constitute a utopia for another." *Id.* at 206-07. *See also* Linnet Myers, *'New Left' Rises from Communists' Ashes*, CHI. TRIB., June 5, 1994, at C1. "Many East Europeans seemed stunned by the factory closings and poverty that accompanied free market competition. They looked forward [in 1989] to the opportunity to become rich under capitalism, but hadn't considered the chances of becoming poor." *Id.* Similarly, Hungarians generally equated political freedoms with the existence of a capitalist system. *Id.* *See also* Walter C. Neale, *Society, State, and Market: A Polanyian View of Current Change and Turmoil In Eastern Europe*, 25 J. OF ECON. ISSUES, No. 2, June, 1991, at 467.

54. The dominant belief in 1989 and shortly thereafter was that the free market would make everyone in Hungary as prosperous as Western Europeans. *See generally* McDonald, *supra* note 29. This belief blinded many people to the reality of economic transition. *Id.*

55. There were many causes for this misperception, not least of which was the fact that the transformation from state socialism to market capitalism had never before been made anywhere in the world. *See supra* note 15. "Expectations were inflated both domestically and internationally over the required timeframe to complete the economic transition. Many experts failed to factor in the wide economic and social ramifications of mass privatization." Katalin Barazda, *Hungary-Privatization*, MARKET REPORTS, 1994 National Trade Data Bank, Mar. 17, 1994, *available in* NEXIS, NEWS Library, CURNWS File.

56. *Id.*

tion caused by the massive post-1989 restructuring had already begun to affect society.

(b) Post-Revolutionary Privatization and Foreign Investment Laws

A unique combination of events in 1989 persuaded the ruling HSWP to remove itself from power.[57] This happened swiftly and without bloodshed,[58] ending more than four decades of one-party, socialist, and foreign-imposed rule. Hungarians met the end of one-party socialist rule with a demand for the apparent utopia of western-style capitalism.[59] Repealing or modifying the laws of the socialist state became an important part of the process of creating a market economy.

Two distinct objectives have driven the reform of the legal system since 1989. First, Hungary sought to create a western-style multi-party democracy subject to a constitutionally-defined separation of powers and checks and balances.[60] This project has been largely accomplished. It is mostly beyond the scope of this article and has been written about extensively elsewhere.[61] Second, in

57. This event was the "assisted suicide of actually existing socialism." Norman Rush, *What was Socialism. . .and Why We Will Miss It So Much*, 258 NATION, No. 3, Jan. 24, 1994, at 91. At the same time as it officially disbanded, the HSWP reformed itself as the Hungarian Socialist Party, and now sometimes (albeit reluctantly) refers to itself as the "successor party." It promised in 1989 that it would henceforth only participate as just another political party in a multi-party democracy. In the summer elections of 1994, it regained control of the government. *See infra* notes 188-89 and accompanying text.

58. "The Hungarian political transition was the quietest revolution of the 20th century; it happened so quietly that, as it is said, 'not even a window pane was broken.'" János Simon, *Post-Paternalist Political Culture in Hungary: Relationship Between Citizens and Politics During and After the "Melancholic Revolution" (1989-1991)*, 26 COMMUNIST AND POST-COMMUNIST STUDIES, No.2, June 1993, at 238.

59. *See generally* McDonald, *supra* note 29.

60. Hungarians want a political system that is procedurally fair and which discourages extremist parties, either left or right, from gaining power. *See* E. EUR. CONST. REV., Spring, 1994, at 69 (untitled note) (describing Hungary's progress in post-1989 political reform).

61. Some political (and non-economic) factors enter into the equation explaining the desire for reform both before and after 1989. Perhaps the largest of these is the issue of national sovereignty. While many elites in the HSWP were committed to the socialist system, they were *not* committed to the Soviet Union's definition of and enforcement of that system, and resented external interference in Hungary. Further, the history of the 1956 rebellion points to the influence of the sovereignty factor. More than two thousand Hungarians died as a result of the failed revolution of 1956, and the effect of that event, although difficult to interpret and measure, should not be ignored.

However, many seemingly political factors are more "economic" than they appear at first glance. Most evidence shows that the 1956 uprising was a call for participatory socialism more than a reactionary counter-revolution demanding a return to the fascist years under Horthy and Gombos. The uprising was led by workers'

1989 a paramount concern in legal reform was the creation of a virtually unregulated market economy. The general plan seeks to privatize the economy to catch up with Western Europe, secure membership in the European Community, and participate in and benefit from the world capitalist economy.[62] The second objective, creating a market economy, is presently a more interesting question since economic dissatisfaction is far more widespread than political dissatisfaction.[63] Therefore, this section will focus on changes in the laws associated with the economic transformation.

Statutory changes created after 1989 currently chart the course for privatization in Hungary. These legal reforms reflect elite attitudes toward economic reform, the desires of western gov-

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councils. Laszlo Abod, a veteran dissident of 1956 and then a member of the Budapest Central Workers' Council, says that:

> the councils, which had appeared throughout the country, stood for 'the defense of socialism, for workers' power and workers' ownership, and for the struggle against reaction.' He is still of the same opinion today. 'Nobody wanted to give the factories back to the capitalists,' he recalls. 'They wanted workers' ownership, so that workers could have a genuine say in management.' This type of thinking doesn't go down too well today in Hungary, where privatization is one of the lynchpins of government policy. And yet the views of Abod were arguably the views of the majority at the time. Writer Istvan Eorsi was active in intellectual circles in 1956. He, too, spent four years in prison. Today he is a supporter of the opposition Free Democrats, a party that strongly advocates free-market developments. Yet he agrees that in 1956 the main political thrust was to create a different, democratic form of socialism. 'Nobody wanted to go back to the old, pre-war system,' he admits. The documents and newspaper cuttings of 1956 all confirm this.

Bob Dent, *Letter from Budapest; Influence of 1956 Uprisings in Hungary*, NEW STATESMAN & SOC'Y., Oct. 29, 1993, at 11. "Although [1956] was a rising against the so-called socialist state, it was not a rising against socialism. Far from it. The revolution recreated socialism anew as the most radical form of democracy." Bill Lomax, *The Rise and Fall of the Hungarian Working Class*, *in* C.M. HANN, MARKET ECONOMY AND CIVIL SOCIETY IN HUNGARY 57 (1990). For other good accounts of the 1956 revolution, *see* Timothy Foote, *'But if Enough of Us Get Killed Something May Happen. . . ' Hungarian Revolution of 1956*, SMITHSONIAN, Nov. 1986, at 52, and *The Blood of Budapest; Anniversary of Soviet Invasion*, NEW REPUBLIC, Nov. 17, 1986, at 7.

62. *See* David Firestone, *What's Left for the Left? Now that Eastern Europe Seems to Want Capitalism - and Lots of it - the Left has an Uncertain Role*, NEWSDAY, Jan. 9, 1990, at 3. *See also No Halfway House*, ECONOMIST, Mar. 24, 1990, at 21 (U.K. edition at 19). At the dawn of Eastern European revolution, there was little support for social democrats or reform communists. Most people wanted free market capitalism, and rejected a "Third Way" between state socialism and laissez-faire. *Id.* In 1989, the overwhelming majority of Hungarians supported radical privatization of the economy. At this time, more than two-thirds of the population felt that widespread privatization would be desirable, and almost three-fourths felt that the market economy had more advantages than drawbacks. GYORGY CSEPELI & ANTAL ÖRKÉNY, IDEOLOGY & POLITICAL BELIEFS IN HUNGARY: THE TWILIGHT OF STATE SOCIALISM 124 (1992). In recent years, poverty caused about by rapid privatization has almost completely destroyed support for "Wild West Capitalism." *See infra* notes 176-79 and accompanying text.

63. *See infra* notes 176-79 and accompanying text.

ernments and financial institutions, and occasionally public attitudes toward reform. "The legal framework is now being geared toward encouraging, protecting, and rewarding entrepreneurs in the private sector."[64] The old legal system is being replaced by laws "appropriate to the requirements of a state based on the rule of law and those of a market economy."[65]

Although these reforms began under the HSWP government, during that time (from 1968 until the fall of the HSWP government) there was always an ideological commitment to some sort of "socialism." Now there is not.[66] This is the crucial difference in post-1989 rhetoric and legal reform. No longer is there any requirement to fashion change within the framework of socialist ideology. The constraints of that day, both external (the Soviet military) and internal (Kadar's power and his personal commitment to socialism,[67] for example) have been swept away.

The creation of a market economy dominated by private enterprise has been accomplished through statutory, rather than constitutional, change.[68] The passage of laws that smooth the way for selling state enterprises to foreign investors has been the govern-

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64. Gray et al., *supra* note 20, at 295.

65. *Lawyers Recommend Comprehensive Review of the Current Legal System*, BBC Summary of World Broadcasts, Apr. 29, 1992, *available in* NEXIS, NEWS Library, ARCNWS File.

66. Since 1989, the whole socialist past, including its forms of property, institutional arrangements, and welfare politics, has been completely delegitimized. Zsuzsa Ferge, *Marginalization, Poverty and Social Institutions*, *in* 16 LABOR & SOC'Y 417, 421 (1991). But the political constraints of demands for equality and social welfare are still powerful factors in Hungarian politics, just not in the highly ideological form which they previously took. Related to this is the profound backlash against rapid privatization of the economy. *See* Myers, *supra* note 4. Many Hungarians are demanding a return to some elements of the old socialist system. The important point is that the *ideological* elements of the socialist system and its language have disappeared as a political force.

67. Despite his complicity in the suppression of the 1956 rebellion by Soviet soldiers, Kadar was later tolerated by the Hungarian people. From humble beginnings, he was genuinely dedicated to socialist ideals and lived modestly throughout his rule. On account of his beliefs, he suffered both in a fascist prison during World War II, and in a Stalinist prison during the Rakosi years. *See supra* note 22.

68. What has happened to the Constitution of the Republic of Hungary since 1989? As noted earlier, the socialist constitution was 80% revised in that year. The preamble to the 1989 version states that "the National Assembly, *until the adoption of the new Constitution of the country*, establishes the text of the Constitution of Hungary as follows." A MAGYAR KOZTARSASAG ALKOTMANYA, Preamble, *quoted in* Peter Paczolay, *Constitutional Transition and Legal Continuity*, 8 CONN J. INT'L L. 559, 564 (1993) (emphasis added). Thus, the assumption was that the 1989 document was to be only an interim solution. A new constitution, however, has yet to be written. In September, 1994, new talks regarding the creation of this constitution were on parliament's agenda. *See New Constitution Talks to Begin in September*, BBC Summary of World Broadcasts, Aug. 23, 1994, *available in* NEXIS, NEWS Library, CURNWS File. *See also supra* note 40.

ment's top priority. Parliament has also enacted laws that further liberalize the banking system, regulate bankruptcies, define contract and, to some extent, property.

Amendments to the 1988 Companies Act and the 1988 Foreign Investment Act reaffirmed those laws' original commitment to a market economy, and opened Hungary even further to foreign direct investment.[69] In 1991, these amendments eliminated the requirement of government approval on foreign investment, eliminated a rule prohibiting foreign-owned companies from holding majority stakes in other Hungarian companies, and expanded profit repatriation guarantees.[70] These amendments deepened the previous Foreign Investment Act's obvious bias in favor of foreign capital. The most generous provisions apply to companies with foreign investment that operate hotels or engage in manufacturing.[71] The initial capital requirement for a new company was doubled (from HF twenty-five million to HF fifty million).[72] Hungarian companies rarely possess capital in this amount. Therefore, the benefits of the Companies Act amendments, tax and otherwise, accrue mainly to foreign-owned companies or companies with substantial foreign investment.[73] Some tax reductions are even statutorily limited to companies with at least thirty percent foreign participation.[74]

Privatization accelerated greatly after 1989. The "spontaneous privatization" of state enterprises, which led to the underselling of those firms, caused parliament to enact laws centralizing control over the privatization process.[75] A 1990 law allowed small state owned businesses in the service sector to privatize by auction.[76] By

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69. Act XXIV: Amendments to the 1988 Act on Economic Associations, *translated in* U.S. DEPT. OF COMMERCE, CENTRAL & E. EUR. LEGAL TEXTS.

70. *Hungary: Foreign Investors Still Welcome in Hungary*, EUROMONEY INT'L FIN. L., Mar. 2, 1991.

71. *Id.*

72. At exchange rates as of January 1, 1995, this amount increased from 236,000 U.S. dollars to 471,000 U.S. dollars.

73. *See Budapest Tries to Sell Hungarians on Capitalism*, N.Y. TIMES, May 6, 1993, at A13.

74. *See* EUROMONEY INT'L FIN. L., *supra* note 70. At the end of 1991, parliament passed a law limiting the tax breaks and tax holidays given to companies with foreign investment. These companies retained substantial benefits even after this action. *Id.*

75. Act XIII of 1989, Act VII of 1990 (establishing the State Property Agency). *See* Barazda, *supra* note 55.

76. Act LXXIV of 1990. This law focused on small service sector businesses. Foreign investors were not allowed to participate in these privatizations. But foreign capital is generally not interested in small-scale investments in the first place. *See also* András Sajó, *Has State Ownership Truly Abandoned Socialism? The Survival of Socialist Economy and Law in Postcommunist Hungary*, *in* GREGORY ALEXANDER & GRAZYNA SKAPSKA, A FOURTH WAY? 202 (1994).

early 1992, about half of these small firms had privatized.[77] In early 1991, the government eliminated parliamentary supervision and judicial review of privatization, thereby acquiring direct control over the process.[78] Between 1991 and 1994, the number of firms in which the state maintained a majority stake dropped from 1,848 to 553 as a result of privatizations or liquidations.[79] At the beginning of 1995, a parliamentary panel decided to continue privatization at an accelerated pace.[80] This panel announced that the state will no longer maintain majority holdings in banks, utilities, or large industries. All other state enterprises will eventually be fully privatizated.[81]

II. The Effects of the Post-Revolutionary Economic Laws

Foreign investment and privatization are symbiotically related under the present course of economic reforms. These practices,[82] intensely ideological and integral parts of a theory of economic reform often forced onto developing countries, guarantee that the better part of 400 million people in Eastern Europe will be cast into a lifetime of poverty.

The results in the last five years have been enormous. Hungary now has the most business-friendly laws in Eastern Europe.[83] Since parliament liberalized its foreign investment laws and began the privatization of state-owned enterprises, western capital has flooded the country. In the rush to capitalism, virtually everything of value has been privatized and sold to foreign investors. The state enterprises which remain in state hands, therefore, are overwhelmingly those that do not make profits.[84] Almost every state enterprise capable of producing profits has been, or is about to be, sold to western companies. Foreign investment in Hungary amounted to 1.45 billion dollars in 1991,[85] by 1993 it was 2.3 billion dollars,[86] and at the beginning of 1994, total foreign investment was over six

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77. *Id.*

78. *Id.*

79. Blaise Szolgemy, *Hungarian Parliament Panel Approves Privatization Law*, REUTER EUR. BUS. REP., January 24, 1995.

80. *Id.*

81. *Id.*

82. *See infra* notes 240-45 and accompanying text.

83. Blaise Szolgyemy, *Hungary Still Seen as Foreign Capital's Darling in East*, REUTER EUR. BUS. REPORT, Jan. 10, 1995, *available in* NEXIS, NEWS Library, CURNWS File [hereinafter *Darling in East*].

84. Some of these have been sold to Hungarian investors.

85. UNITED NATIONS, ECONOMIC COMMISSION FOR EUROPE, ECONOMIC SURVEY OF EUROPE IN 1993-1994 136 (1994).

86. *Id.*

billion dollars, in over 21,000 joint ventures.[87] More than half of all foreign investment in Eastern Europe goes to Hungary;[88] and Hungary is by far the highest per capita recipient of foreign direct investment.[89] Gas and electrical power, the railroad industry, shipbuilding, steel production, public transportation systems, and telecommunications are already in the hands of western corporations or on the auction block at bargain prices. At this rate, Hungarians will soon own nothing but their postal service.

Hungary receives a disproportionate share of this investment because it has passed laws granting generous terms to foreign investors. Western investors in Hungary have successfully influenced the content of these foreign investment laws through well-organized lobbying efforts,[90] and "Hungary's political elite has consistently encouraged foreign investment."[91] Hungary also has a history of laws that encourage joint ventures, a well-developed physical infrastructure, cheap labor[92] from a highly educated workforce,[93] low workplace health and safety standards, and even lower environmental standards.[94] Unfortunately, foreign investment does not benefit most of the population.

> Since the Cold War ended, Hungary has netted $7 billion in foreign investment, more than all its eastern neighbors combined. But when Hungarians reckon the impact, it is not the glittering

87. Sam Loewenberg, *Hungary Socialists' Stringent Economic Plan*, S.F. CHRON., Aug. 1, 1994, at A10. Total foreign investment in Hungary in the first nine months of 1994 was 926 million dollars. *Darling in East*, *supra* note 83. By contrast, in 1988 there were only about one thousand joint ventures in Hungary. Róna-Tas, *supra* note 50, at 50.

88. Williams, *supra* note 2, at 2.

89. ECONOMIC COMMISSION FOR EUROPE, *supra* note 85, at 136. Between 1989 and 1993, Hungary received 280 dollars per capita of foreign assistance including foreign investment, Romania was a distant second with 185 dollars, and Poland third with 113 dollars. Russia received less than 13 dollars per capita during this period, and Ukraine only received 70 cents. *Where Aid Really Went*, E. EUR. MARKETS, May 13, 1994, *available in* NEXIS, WORLD Library, ALLWLD File.

90. Anne Henderson, *The Politics of Economic Transformation: Foreign Investment and the Transition to Open Market Economies in Eastern Europe, A Case Study of Poland and Hungary*, THE NATIONAL COUNCIL FOR SOVIET AND EAST EUROPEAN RESEARCH, May 5, 1993, at iii.

91. *Id.* at ii. Henderson also states that the Hungarian working class has been "quiescent" in response to foreign investment. *Id.* at iii. This assertion is misleading. Whatever silence there is among the working class as to foreign investment is primarily a result of their exclusion from policymaking, because a broad plurality of the working class is clearly opposed to foreign investment. *See infra* note 121.

92. *See* Craig Whitney, *West European Companies Head East for Labor*, N.Y. TIMES, Feb. 9, 1995, at D3.

93. Hungarian students score third in the world in math and science. Eszter Cukor & Gyorgy Kavori, *Wage Trends in Hungary*, 130 INT'L LABOUR REV., No. 2, 1991, at 177-89.

94. Marlise Simons, *East Europe Still Choking on Air of the Past*, N.Y. TIMES, Nov. 3, 1994, at A1.

> new boutiques and restaurants in central Budapest they think of. Those are largely for tourists and Hungary's monied 10 percent.[95]

Foreign investment generally increases inequality[96] and harms the host economy as a whole.[97] Even a strong supporter of foreign investment in Hungary admits that foreign capital undermines domestic enterprises, and is "driving the majority of the Hungarian state sector into bankruptcy."[98] In some cases, state enterprises were practically given away to foreign investors.[99] This practice typically rewards both the foreign investor (who gets a bargain) and the managers of the enterprise (who get lucrative employment con-

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95. *Old Enemies*, *supra* note 5, at A1. "The downtowns of the major cities dazzle, but as you move away from the sparkling splendor of recently opened Western shops to the outskirts of Budapest Prague or Warsaw, you come upon shabbiness and often enough downright poverty." *Eastern Europe: Approaching the West*, SWISS REV. OF WORLD AFFAIRS, January 3, 1995. *See also infra* note 163.

96. Volker Bornschier, *Dependent Reproduction in the World System: A Study on the Incidence of Dependency Reversal*, *in* CHARLES F. DORAN, NORTH/SOUTH RELATIONS: STUDIES OF DEPENDENCY REVERSAL 103-110 (1983).

97. "Foreign investment entails the depressing possibility that Eastern European nations would simply exchange external military domination by the Soviet Union for external economic domination by western capitalism." Henderson, *supra* note 90, at 2. This is a real threat because western companies which invest abroad extract more wealth from the host country than they put into it. This occurs because profits are mostly repatriated, not re-invested into the host economy. Foreign investment increases unemployment because it is generally capital intensive. It aggravates unequal income distribution because high-income groups are disproportionately employed by, and otherwise connected to, the foreign company. Economic growth is adversely affected because the foreign company draws local capital and "brain power" away from indigenous industries. Ndiva Kofele-Kale, *The Political Economy of Foreign Direct Investment: A Framework for Analyzing Investment Laws and Regulations in Developing Countries*, 3 LAW & POL'Y INT'L BUS., No. 2-3, Mar. 22, 1992, at n. 3 (summarizing the conclusions of C. FRED BERGSTEN ET AL., AMERICAN MULTINATIONALS AND AMERICAN INTERESTS 354 (1978)). When western companies invest abroad, their concern is to "make profits out of a given distribution of income rather than to eliminate the poverty and hardship that exists in developed as well as undeveloped societies." TERESA HAYTER, THE CREATION OF WORLD POVERTY 80 (1981). *See also* Volker Bornschier et al., *Cross-National Evidence of the Effects of Foreign Investment and Aid on Economic Growth and Inequality: A Survey of Findings and a Reanalysis*, 84 AM. J. OF SOCIOLOGY, No. 3, at 651 (1978) (arguing that foreign investment hinders economic growth and increases income inequality). *See generally* LAWRENCE ALSCHULER, MULTINATIONALS AND MALDEVELOPMENT (1988).

98. Henderson, *supra* note 90, at iv.

99. In 1989, one of the Hungarian government's largest companies, the lighting and electronics manufacturer Tungsram, was sold to General Electric for $150 million. Its annual production was estimated to be worth approximately $200 million. Also in that year, Britain's Telfos company paid $4 million for a majority interest in Hungary's state-owned Ganz Railway Engineering (valued at about $100 million). *Foreign Investment in Hungary: Testing the Water*, ECONOMIST, Oct. 21, 1989; Yuri Fehér, *Versions of Economic Reform: A Complex Debate in Hungary*, DISSENT, Summer 1990, at 348, 349. The underselling of state enterprises has probably decreased as a result of laws passed in 1989 and 1990. *See supra* note 75 and accompanying text.

tracts with the new foreign owner).[100] The Hungarian people as a whole suffer, however, because valuable national assets are thereby sold to foreign corporations at fire sale prices.[101] The new foreign owners also typically institute mass lay-offs once they control the firm.

The type of foreign investment projects usually supported by western governments are those that benefit the "monied 10 percent."[102] Typical of foreign investment in Hungary are the following projects in Budapest which are subsidized by the United States government: Dunkin' Donuts franchises, Pizza Hut home delivery, a private western-style dry-cleaning service, a private clothing store for professional women, a fast food packaging company, a company that produces armored vans and personal cars, and so on.[103]

Another example of how foreign investment is disproportionately targeted to the interests of the rich is in the Hungarian hotel industry. Foreign investment here is extensive, and most four and five-star hotels in Budapest are now owned by American or Western European companies.[104] These hotels cater to wealthy western tourists and business travelers. Few Hungarians can afford to patronize them because the average cost of a night's stay amounts to about a quarter of the average monthly salary in Hungary.[105] Thus the rate of domestic occupancy in the best Hungarian hotels was 7.3

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100. Christopher G.A. Bryant, *Economic Utopianism and Sociological Realism: Strategies for Transformation in East-Central Europe, in* THE NEW GREAT TRANSFORMATION? CHANGE AND CONTINUITY IN EAST-CENTRAL EUROPE 59 (Christopher G.A. Bryant & Edmund Mokrzycki, eds., 1994).

101. This practice of "spontaneous-privatization" has been largely brought under control now that the privatization of remaining state enterprises is regulated by the State Property Agency. There are still examples of state enterprises being undersold, however.

102. *See Hungarian-American Enterprise Fund (Magyar-Amerikai Vállalkozási Alap)*, 4TH ANN. REP. for a description of these investments. The enterprise fund is a quasi-private branch of the United States government, and is described *infra* in notes 209-12 and accompanying text.

103. *Id.* at 13-21.

104. Andreas F. Lorenz & Thomas P. Cullen, *Hotel Investment Opportunities in Hungary*, CORNELL HOTEL & RESTAURANT ASS'N Q., Dec., 1994, at 18. Before one of Hungary's three largest hotel companies (Pannonia) was privatized and sold, one-third of its employees were laid off in order to make the property more attractive to foreign investors. *Id.* at 25. In January, 1994, the sale of the state's largest hotel company (HungarHotels) to American General Hospitality was approved but then cancelled by the government when the price became public and was considered to be too low. In 1993, however, the gem of this chain, the enormous Duna Intercontinental in downtown Budapest, was sold to the Mariott corporation. *Id.*

105. Average wage figure from *Eastern Europe: USA is Biggest Investor*, HETI VILAGGAZDASAG, May 21, 1994, *available in* NEXIS, NEWS Library, CURNWS File. Hotel Figure from MTI Hungarian News Agency, *Hungarian Hotel Industry Survey Results*, Nov. 30, 1994, *available in* NEXIS, NEWS Library, CURNWS File.

percent in 1993 as compared to 39.9 percent in western Europe in the same year.[106]

Foreign developers putting up hotels and business space in central Budapest "appear to regard Hungary as a theme park for outlandish schemes that would not be permitted in western Europe."[107] The designs of western developers ignore historic character preservation in Budapest, and Hungarian architects have not only aesthetic complaints, but argue that foreign investment has reduced them to a state of "intellectual and artistic serfdom" as wage slaves for these developers.[108]

As foreign capital rolls through Hungary, commodifying or suppressing local culture, it often extinguishes domestic products, replacing them with a "better" western variant. (These western substitute products are often much more expensive than the product they replaced and are therefore not available to as many people.)[109] For example, the more than ten McDonald's locations in Budapest have effectively destroyed the business of small Hungarian street-side food vendors,[110] and the new western fast food chains "do not intend to offer Hungarian dishes."[111]

Foreign investors exert considerable political influence in Hungarian politics and lobby for cuts in social welfare spending, claiming that Hungary "cannot afford" to offer its workforce sick leave, maternity leave, or paid holidays.[112] Today, wholly or partly

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106. MTI Hungarian News Agency, *supra* note 105.

107. Adam Lebor, *Welcome to the West, Budapest*, INDEPENDENT, Jan. 6, 1993, at 12.

108. *Id. See also* Ference Andai, *Blue Danube: Hungarians Begin to Feel Disillusioned with Way of the West*, OTTAWA CITIZEN, July 7, 1993, at A11. "The impact of aggressive foreign capitalists is evident everywhere, particularly in the capital of Budapest." *Id.*

109. Blaise Szolgyemy, *Hungary's Traditional Takeaway Dish Loses Out to 'McFood'*, REUTERS, Jan. 3, 1995, *available in* NEXIS, NEWS Library, CURNWS File. The langosh (fried, flat dough with garlic and sour cream) vendors sold their snacks for about 20 cents each. Hamburgers from Western fast-food chains cost from 60 cents to two dollars, and "are hardly bargains in a country where the average after-tax wage barely exceeds $300 a month." *Id.*

110. *Id. See also Hungary: Goliaths Kill David - City Grill Closes*, EUROMARKETING, Nov. 8, 1994, *available in* NEXIS, NEWS Library, CURNWS File (describing how foreign fast food restaurants put the Hungarian "City Grill" fast-food chain out of business).

111. *Id.*

112. Miklós Szanyi, *Experiences with Foreign Direct Investment in Hungary*, INSTITUTE FOR WORLD ECONOMICS, HUNGARIAN ACADEMY OF SCIENCES, Apr. 1994, at 18. Foreign investors lobby against these employment benefits and social welfare protections because they must contribute to the cost of programs through payroll taxes. *Id.* In some areas of the economy, however, foreign investors are not exempt from contributing to social insurance.

foreign-owned companies do not have to contribute to Hungarian social insurance.[113]

Foreign investment in Hungary also aggravates an increasingly unequal global distribution of resources. As ownership of the means of production is gradually transferred to Western European and American companies,[114] wealth is extracted from Hungary to be repatriated to the West.[115] The profits earned by foreign-owned enterprises will not stay in Hungary, but will eventually go home with their western owners, a process that will gradually decapitalize Hungary and make real economic growth in the future virtually impossible.[116] Western companies apparently intend to repatriate most of their profits rather than reinvest them in Hungary because none of these companies would invest in Hungary before the law explicitly guaranteed them repatriation rights and currency exchange.[117] Of the thousands of western companies that now operate in Hungary, only a few have promised not to repatriate their profits.[118] Hungary is taking on the role of an economic colony

113. The significance of exemption from social insurance contributions is that foreign companies reap the benefits of tax holidays but are not required to help the Hungarian government pay for the social costs of the transition to the market economy, a transition which these foreign corporations are intimately involved in creating. This is evidence of how highly Hungarian elites value foreign investment as a part of the reform process. *See generally* Zoltan Mihaly, *Tax Reforms Roll Out the Red Carpet for Investors Looking at Central Europe*, 4 J. INT'L TAXATION, No. 4 (Apr. 1993).

114. "Around 10 percent of the joint ventures (JVs), mainly the filials of large trans-national corporations like General Electric, General Motors, Ford, Suzuki, Nestle, and Unilever, absorb 80 percent of all invested foreign capital. The bulk of car-making, printing, publishing, glass and construction materials, food-processing, breweries, tobacco, alcohol, sugar, and candy production is dominated by foreigners." Judit Kiss, *Privatization Paradoxes in East Central Europe*, 8 E. EUR. POLITICS & SOCIETIES 122, 130 (1994).

115. Hungary's generous repatriation laws allow foreign owners of businesses to take their profits back to Western Europe and the United States. *See supra* note 70 and accompanying text.

116. The repatriation of profits is growing. Foreign companies repatriated only about 10 million dollars in the first half of 1992. *Profit Repatriation Negligible in Hungary*, MTI Hungarian News Agency, Aug. 18, 1992, *available in* NEXIS, NEWS Library, ARCNWS File. Only a year later, however, repatriation had grown to approximately 66 million dollars. Also, these figures are probably substantially underestimated because foreign investors can take their profits out of Hungary in other forms, such as export under-invoicing, import over-invoicing or through trademark fees. *Editorial Report*, HUNGARIAN TELEGRAPH NEWS AGENCY, July 8, 1994. In 1994, foreign investors made approximately 600 million dollars in profits, but re-invested only approximately 70 million dollars. *Id.*

117. *See supra* notes 70 and 85-89 and accompanying text.

118. McDonald's has agreed to reinvest its Hungarian profits, as has Henkel Hungary Kft., an Austrian cosmetics and washing detergents company. *Henkel Hungary Kft. to Expand*, MTI Hungarian News Agency, Nov. 17, 1994, *available in* NEXIS, NEWS Library, CURNWS File.

where profits and resources flow out of the region and into American and EC bank accounts.[119]

Therefore, it is not at all surprising that Hungarians are increasingly ambivalent about the desirability of further foreign ownership.[120] A large plurality of the Hungarian working class is decidedly opposed to any foreign investment at all.[121] "Foreign investment has generated some 85 percent of revenue from privatization. There is a dangerous mood that it is 'them [foreigners], not us' who are the beneficiaries of capitalism in Hungary."[122] It has become obvious to most people that foreign corporations, even when denominated "joint ventures,"[123] are completely unconcerned with helping the Hungarian people or their economy. In reality, foreign capital comes to Hungary for one of two reasons—cheap labor or new markets. The behavior of some foreign companies doing busi-

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119. "The fabled free market may result in Eastern Europe taking on characteristics of Latin America. Eastern European governments may soon face similar conditions as their countries become Latin Americanized, except that Western Europe, not the United States will act as the major colonizer." Saul Landau, *A New World to Exploit: The East Joins the South*, Vol. 42, No. 5, MONTHLY REV., at 29, Oct. 1990.

This inequality is not only noticeable because Eastern Europe is as a whole losing ground *vis-a-vis* the West. Eastern Europe itself is separating more and more into haves and have-nots. The wealthiest three countries - the Czech Republic, Hungary, and Poland - are relative success stories in comparison with their poorer neighbors Romania, Bulgaria, Slovakia, and the former Soviet Republics. In the latter group, poverty, disparity of wealth, and general misery exist on a scale even larger than among the former. In Bucharest, Romania, for example, "beggars roam the subways, more than 100 homeless children live in the main railway station and thousands of babies are abandoned each year to orphanages because their mothers can't feed them." McKinsey, *supra* note 4, at B7. And in Bulgaria, 64% of children lived below the poverty line in 1993, as compared to 18% in 1990. *After the Wall*, GUARDIAN, Nov. 3, 1994, at T2. *See also* Perlez, *supra* note 4.

120. Only a third of Hungarians actually approve of continued foreign investment, according to a recent poll. Twenty-eight percent view it as a necessary evil, and 35% disapprove of foreign investment entirely. *Hungarian Public Opinion on Foreign Capital*, MTI Hungarian News Agency, Feb. 10, 1995, *available in* NEXIS, NEWS Library, CURNWS File (reporting telephone survey by TeleMedia First Hungarian Telemarketing Service for the newspaper MAGYAR HIRLAP).

121. Forty percent of workers surveyed saw nothing positive in foreign capital, while only seven percent unconditionally supported it. Jane Perlez, *Hungarians Cooling to Foreign Investment*, N.Y. TIMES, May 3, 1994, at A12.

122. Ian Traynor, *The Worst May Well be Over for the Former Communist States in Transition*, GUARDIAN, Jan. 9, 1993, at 13. *See also Hungary: Joint Ventures Boom on Lax Tax Law*, EUROMONEY TRADE FIN. & BANKER INT'L, Apr. 23, 1990. "Criticisms that the Hungarian authorities are pawning the family silver have gained momentum since the sale of a stake in Tungsram to General Electric." *Id.*

123. This term is misleading in the Hungarian context. Most "joint ventures" are in reality entirely controlled by the Western (American, Austrian, British, or German) partner in the venture. Many "joint ventures" have no Hungarian participation, whatsoever. Lane, *supra* note 15, at 342. In joint ventures with minority foreign ownership, there is a trend for the foreign partner to become the majority owner, either through buying out the Hungarian partner or through "share capital increases not matched by the Hungarian partner." *Id.* at 352.

ness in Hungary also reveals that the interests of Hungarians are not considered when these companies make decisions.[124]

The results of the privatization process are also substantial. In 1989, there were approximately 5000 private firms in Hungary. At the end of 1993, there were more than 69,000.[125] The number of privatized state enterprises expanded by more than 2800 percent (from 27 to 760) from 1990 to 1993.[126] These 760 state enterprises were on average sold for only twenty to twenty-five percent of the book value of their assets, "and even less in the case of assets sold to foreign investors."[127] Even if the assets' book value estimates were somewhat inflated, it is clear from this data that privatization of state enterprises brought in much less revenue than desired. It merely redistributed wealth into private hands. Most agricultural cooperatives and state farms have been privatized, so that now ninety percent of all farmland is privately owned.[128] Most of Hungary's housing remained in private hands throughout the state socialist period. Privatization of the twenty percent of housing owned by the state increased rapidly after 1989.[129]

The process and effects of the Hungarian privatization project are important because this is "the stage on which will be decided which social groups will have access to the means of production."[130]

124. For example "[w]estern tobacco companies are openly defying cigarette advertising laws in Hungary," and trying to coerce Hungarian officials into lifting the bans. Ken Kasriel, *Western Tobacco Firms Spurn Hungary's Ad Ban*, ADVERTISING AGE, Sept. 14, 1992. In another instance, Korf AG of Baden-Baden and Metallgesellschaft AG of Frankfurt bought a steel works in Ozd, Hungary, laid off 85% of the employees, and then, less than a year later, changed their minds about the investment and pulled out completely, leaving the town economically devastated. The World Bank, to its credit, subsequently created a job re-training center in Ozd, but its graduates are placed at cheap labor textile plants owned by Italian and Belgian producers. Perlez, *supra* note 121. Since foreign investments began pouring into Hungary after 1989, Hungarians have "discovered that business decisions by foreign owners were dictated by corporate headquarters in the West, not by the needs of the local economy." *Id.*

125. Bakos, *supra* note 17, at 1200. According to Bakos, however, this extreme figure may be misleading because many of the newly incorporated private companies are "hibernating." *Id.*

126. *Id.* at 1199.

127. *Id.* at 1200-03. Data from *Eves jelentés az állami vagyon privatizációjáról*, (Yearly Report on the Privatization of State Property), Állami Vagyonügynökség (State Property Agency), 1992.

128. Anna Canning & Paul Hare, *The Privatization Process - Economic and Political Aspects of the Hungarian Approach*, *in* PRIVATIZATION IN CENTRAL & EASTERN EUROPE 198-200 (Saul Estrin, ed., 1994).

129. *Id.* at 200-01.

130. Járai, *supra* note 9, at 77. "The distribution of wealth in the emerging capitalist society is largely determined by the privatization policy applied." Gábor Hunya, *Frictions in the Economic Transformation of Czechoslovakia, Hungary & Poland*, *in* ECONOMIC TRANSFORMATION IN EAST-CENTRAL EUROPE & IN THE NEWLY INDEPEDENT STATES 61 (Gábor Hunya, ed., 1994). "This transition requires a profound

In other words, privatization will determine society's economic winners and losers. This, to a large degree, has already been done. The primary result has been the redistribution of wealth to the rich.[131] To ordinary Hungarians, however, privatization "is synonymous with corruption or unemployment."[132]

The cumulative result of Hungary's free market transformation, the salient characteristics of which are the privatization and foreign investment regimes, has been the creation of human suffering and inequality on a massive scale.[133] The specific events creating this situation are unemployment (caused mostly by the rapid privatization of state enterprises), inflation (caused both by price deregulation[134] and scheduled price increases),[135] and the public health crisis (caused by the privatization of health care). The combined effects of these and other events have made the "costs of the transformation. . . increasingly hard to bear. In most [Eastern European] countries, the prospects range from the gloomy to the cata-

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change in property relations. . . these changes create a new economic elite and redistribute property and material well-being. In this process, some people gain wealth, others lose it; some see their incomes grow, while others see a marked deterioration in their earning power." Róna-Tas, *supra* note 50, at 40 (describing the change from socialist to capitalist economies in Eastern Europe).

131. Kiss, *supra* note 114, at 151. From 1990-1994, the Hungarian government "privatized state property in an artificial, unjust, and half-witted way designed only to build up its own clientele." Nadori, *supra* note 51. "Two years ago, foreigners acquired 70 percent of privatized property in Hungary. While that figure has decreased by now to about 50 or 60 percent, Hungarians still feel largely shut out of the privatization." Perlez, *supra* note 121. The Eastern European, including Hungarian, experience thus far is that privatization is incompatible with social justice. Privatization "leads to injustice, gaping economic inequalities, and social tensions, and creates more losers than winners, at least for the time being." Kiss, *supra* note 114, at 144. *See also* Christine Rider, *Privatization in the Transition Economies: A Critique*, J. POST KEYNESIAN ECON., June 22, 1994; Peter Murrell, *Privatization's Harms: Economics in Eastern Europe*, CURRENT, Jan., 1993, at 34.

132. Lucy Hooker, *Hungary Finds that Oranges are not Capitalism's Only Fruit*, GUARDIAN, Feb. 16, 1995, at 11.

133. Economic reform as widespread as that which has taken place in Hungary since 1989 is a very complex process. It is difficult to isolate the specific effects of each statutory change. It would be inaccurate and misleading, therefore, to suggest that privatization and foreign investment are the sole measures of capitalist development or the sole causes of the poverty and despair resulting from the reform process over the course of the past five years. I focus on privatization and foreign investment because they are at the core of current economic reforms in Hungary and throughout Eastern Europe. Also, the complex relationship of internal and external economic factors makes determining cause and effect problematic, especially when economic reform of this kind has never happened before. *See supra* note 15. Also, many relevant economic events (global economic conditions, for example) occur without reference to the Hungarian legal system and are therefore outside of its influence.

134. Silviu Brucan, *Shock Therapy Mauls Those Who Unleashed it in Eastern Europe*, WORLDPAPER, June 1994, at 3.

135. *See infra* notes 153-54 and accompanying text.

strophic, and instability and unpredictability are largely present."[136] Most observers have found in Eastern Europe a great likelihood that the gap between rich and poor will widen.[137]

Unemployment was almost unknown before 1989,[138] and most people valued the high level of job security that existed under state socialism.[139] Most unemployment then was transitional in nature, and not the result of a structural imperative necessary to keep wages from rising above a certain level (as it is historically in capitalism).[140] Most unemployment now is the result of the closing or privatization of large state enterprises, because the private sector is not capable of absorbing these laid-off workers back into the workforce. Thus, unemployment has almost doubled in the last two years, climbing from 6.6 percent to thirteen percent between 1992 and 1994.[141] This is only official unemployment. Actual unemployment is much higher because there are many more people who

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136. INTERNATIONAL LABOR OFFICE, UNITED NATIONS, WORLD LABOR REPORT (1992).

137. *Id. passim.*

138. There was no significant unemployment until 1986, and unemployment was only about one percent until 1990. UNICEF, UNITED NATIONS, CENTRAL AND EASTERN EUROPE IN TRANSITION: PUBLIC POLICY AND SOCIAL CONDITIONS 4 (1993). Use of the term "unemployment" was ideologically unacceptable under state socialism and did not enter the public discourse until 1987. It is clear, however, that many Hungarians began to worry about "employment difficulties" in the mid- to late- 1980s. R. Angelusz, et al., *Unemployment as Reflected in Hungarian Public Opinion*, 41 ACTA OECONOMICA 214 (1989). Whether these difficulties were a product primarily of the failure of the state economy or of the growing marketization of the economy is arguable, especially insofar as marketization was a response to shortcomings of the planned economy. In 1987, a study showed that attitudes toward unemployment in Hungary were extremely differentiated on the basis of the respondent's economic class. Only ten percent of unskilled manual workers agreed that there were certain advantages to having unemployment in the economy, while 62% of managers and intellectuals agreed with this statement. *Id.* at 217.

139. In 1987, 69% of the population thought unemployment was entirely disadvantageous for society. Angelusz et al., *supra* note 138, at 217.

140. Capitalism cannot function without unemployment. In a situation of full-employment, workers can successfully demand higher and higher wages (thus destabilizing the system through uncontrolled wage-push inflation) and the employer cannot replace workers demanding higher wages, because there are no people looking for work. *See* Karl Marx, *Economic and Philosophical Manuscripts*, *in* KARL MARX: EARLY WRITINGS 279-309 (Random House ed., 1975).

141. Williams, *supra* note 2; Loewenberg, *supra* note 87. While these figures may not seem outrageous by Western European standards, one must consider that under the socialist government in Hungary, unemployment was at the highest around one percent. (There was *underemployment* in state socialism, but that is a somewhat different question.) Therefore, the relative increase in unemployment in the last five years is enormous.

The unemployment benefits/wage ratio (unemployment benefits divided by the average nominal wage) has declined continuously since 1991, as has the share of the unemployed who receive benefits. In 1991, 78% of the unemployed received benefits; in 1992, 72% did; and by 1993, only 52% did. Thus the hardships imposed by unemployment are growing not only in terms of the numbers of people unemployed, but would like jobs but have given up looking for work, and are thus not reported in the statistics.[142] Unemployment in Hungary disproportionately harms already disadvantaged groups such as Gypsies, the unskilled, women, the elderly, and the sick, thereby increasing inequality by marginalizing broad segments of the population.[143] People who become unemployed increasingly tend to remain unemployed, a phenomenon that also stratifies the population and punishes disadvantaged groups.[144]

Inflation has also grown enormously since the introduction of rapid economic reforms. In the first year of the revolution, consumer inflation was about 17.5 percent,[145] it peaked at approximately thirty-five percent in 1991,[146] and since then has been stable at around twenty percent.[147] High inflation in any country has a disproportionately harmful effect on the poor, because people with limited incomes spend most of their money on food, housing, and public transportation and are thus harmed more by price increases.[148] High inflation in Eastern European societies tends to increase material inequality which in turn magnifies antagonisms between social groups.[149] One report asserts that the "prices of ba-

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also in terms of the declining availability of benefits for those persons unemployed. ECONOMIC COMMISSION FOR EUROPE, *supra* note 85, at 90.

142. M. Godfrey et al., *Report on a Survey of Unemployment and Active Labour Market Programmes in Hungary*, ILO/JAPAN PROJECT ON EMPLOYMENT POLICIES FOR TRANSITION IN HUNGARY, Oct. 1993. Actual unemployment in Hungary is about 1.3 times greater than official unemployment. *Id.*

143. Ferge, *supra* note 66, at 428. Traditionally, Gypsies are the last hired and first fired, and in 1992 suffered unemployment of around 40%, compared to the nationwide rate of almost 14%. Henry Kamm, *Gypsies Suffering in Hungary's Shift*, N.Y. TIMES, Nov. 7, 1993, at A9.

144. As of the last quarter in 1992, the average duration of unemployment was 38 weeks, up from 28 weeks in the first quarter of the year. As of March, 1993, more than half of the officially unemployed had been jobless for more than six months. Ruth A. Bandzak, *The Role of Labor in Post-Socialist Hungary*, 28 J. ECON. ISSUES 524, (citing data from the *Statisztikai Havi Kozlemenyek* (Hungarian Central Statistical Office), *Kozponti Statisztikai Hivatel* (Monthly Bulletin of Statistics), May 1993).

145. Williams, *supra* note 2.

146. *Crossing the East-West Chasm*, ECONOMIST, May 16, 1992 at 57 (U.K. edition at 43).

147. Loewenberg, *supra* note 87.

148. Expenditures for food, housing, and public transportation are relatively fixed and necessary costs. Therefore, the lower a family's income, the greater these fixed costs are as a percentage of the household's total income. Conversely, the rich spend only a small fraction of their incomes on food, housing, and public transportation, and thus inflation does not hurt them as much.

149. Grzegorz W. Kolodko, *Social and Political Aspects of Inflation*, E. EUR. ECON., Spring 1989, at 50, 51. Data concerning the negative social consequences of differentiation in material status is from Yugoslavia, Poland, and Hungary. *Id.* Hungarians attitudes toward inflation vary according to the economic class of the respondent, which clearly demonstrates how inflation disproportionately punishes the lower classes. In June, 1992, 49% of the lower income respondents (those with

sic goods have hit pensioners and wage earners so hard that insecurity dominates all perceptions of new opportunities, and the dominant emotion is fear."[150] The plight of many fixed-income pensioners (who under socialism were reasonably secure in their retirement) can be observed in Budapest's subway stations, where a common sight is elderly men and women standing from dawn to dusk by the exits trying to sell produce or flowers from their gardens.[151] Inflation has forced some pensioners to shoplift or find food in garbage bins to survive.[152]

The Hungarian government intentionally creates much inflation (oftentimes at the urging of western advisors and the IMF) in order to make state-owned enterprises more attractive to potential foreign investors. For example, beginning in 1995, energy prices will increase an average of twenty-six percent.[153] This should bring more cash to utilities companies. Theoretically, then, the utilities' companies rising profits will lure western investment into these companies.[154] This approach to foreign investment ignores the fact that these higher energy prices, together with other scheduled price increases, will severely and disproportionately harm those people living in poverty and those with limited incomes.[155]

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incomes less than $66 per month) in a survey stated that current price increase were intolerable, while only 22% of high income respondents (those with incomes greater than $176 per month) thought the same. This survey also revealed that the poor were far more fearful than the rich of future price increases. Charles L. Choguill & Robert Manchin, *A Further Consideration of the Human Aspects of Economic Readjustment in Hungary*, 32 SOCIAL INDICATORS RESEARCH (1994), at 80-81.

150. Susan Woodward, *The Tyranny of Time: Eastern Europe's Race to the Market*, BROOKINGS REVIEW, Jan. 1992, at 6. *See also* McKinsey, *supra* note 4. " 'If you are an elderly person on a pension living alone with an old spouse, you have to choose between eating and heating and buying medicine,' said Zsuzsa Ferge, Hungary's leading researcher on poverty." *Id.*

151. The author's personal observation.

152. Andai, *supra* note 108. "Unidentified Man #1: (Through Translator) Just look down any of these [Budapest] streets. There isn't one, but three people rummaging in every dustbin. Don't talk to me about capitalism. It stinks." *Hungarian Capitalism Mixed Blessing*, National Public Radio, Morning Edition (radio broadcast, Feb. 24, 1992).

153. Krisztina Fenyő, *Anger Rises as High as the Prices*, BUDAPEST WK., Jan. 5-11, 1995, at 5 (describing how new price increases will hurt the poor). "Amelia Horvath (Social Worker): (Through Translator) In 1989 I knew of some families who had their electricity cut off because they couldn't pay their bills. But today the number of people in that situation is growing faster than we can count. It's dark in a lot of apartments now." National Public Radio, *supra* note 152.

154. The Hungarian government has announced its intention to sell to foreign corporations the country's nine electric power companies and five distribution companies. *Hungary to Speed Up Energy Sector Privatization*, REUTER EUR. BUS. REPORT, January 24, 1995.

155. Fenyő, *supra* note 153. One third of Hungarian families are now below the poverty line. These are the people who bear most of the costs of reform. *Id.* Other scheduled price increases in 1995 are as follows: public transportation by 20%, tele-

Health care will be less available to most Hungarians if government privatization plans are put into place. Post-1989 reform of the health care system was driven by free market ideology,[156] exemplified by the fact that "in 1991 the main slogan of the government's health policy was the following: 'Health care will no longer be a citizen's right'."[157] The consequence of moving toward health care privatization will be to leave some people out of universal coverage.[158] Support for public health care has already weakened, and a recent UNICEF report documents "a deterioration of unparalleled proportions in human welfare throughout most of the region," characterized by the growth of infectious diseases, stress, malnutrition and alcoholism.[159] The World Health Organization reports that health care systems in Eastern Europe have begun to collapse since 1989, and tuberculosis is climbing to epidemic levels in Hungary and neighboring countries.[160] Life expectancy fell during the period 1990-1995 throughout most of Eastern Europe, and especially

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phone by 6%, postal services by 15%, and meat and milk by 20%. *Id.* All of these increases affect items or services which are necessary for everyday work and life. This scheduled inflation, therefore, disproportionately punishes the poor and those living on fixed incomes (pensioners and other people on public assistance). *See supra* note 148.

156. Eva Orosz, *Handicapped by Old and New Traps: Hungary's Health Care Reform*, 44 INT'L SOC. SECURITY REV. 25 (1991).

157. *Id.* The new socialist government of Gyula Horn, however, has at least professed that every person should have access to basic health care services. The nuts and bolts health care policy of the Horn government remains to be seen. *See MZSP's Csehak Views Health Care*, MAGYAR HIRLAP, *translated in* E. EUR. INTELLIGENCE REP., June 1, 1994.

158. "As a consequence, some of the most disadvantaged groups are likely to be left out of such insurance. For example, those who receive unemployment benefits are entitled to health insurance, but when their unemployment benefit expires they may become uninsured. Under the present turbulent socio-economic circumstances, many miserable situations can not be foreseen; hence, elimination of universal eligibility may have tragic consequences. Creation of such a "bottomless" system - taking into consideration the distressing increase in poverty and unemployment - shows the insensitiveness [*sic*] of the government to the real social problems." Orosz, *supra* note 156, at 25.

159. Barbara Crossette, *For Region's Poor, Economic Changes Bring a High Cost*, INT'L HERALD TRIB., Oct. 8, 1994, available in NEXIS, NEWS Library, CURNWS File. *See also Eastern European Demography; Of Death and Dying*, ECONOMIST, Jan. 7, 1995 at 41. "Communism could seriously damage your health; but post-communism is proving even worse." *Id.* at 41. *See also Eastern Europeans Discover Capitalism Kills, UN Claims*, HERALD (Glasgow), Oct. 7, 1994, at 8.

160. *See* Edward Luce, *TB Rises in Eastern Europe*, GUARDIAN, June 21, 1994, at 10. "The WHO was careful to avoid overt political criticism of the switch to laissez-faire economics in eastern Europe, but privately officials expressed anger at the way the former communist countries had been encouraged by Western aid donors to dismantle free health care services." *Id. See also* WORLD HEALTH ORGANIZATION, UNITED NATIONS, TB DEATHS INCREASING IN EASTERN EUROPE, June 20, 1994 (press release).

in Hungary.[161] This deterioration of national health is the direct product of radical privatization in Eastern Europe.[162] The biggest western investment in Hungarian health care, thus far, is the opening of a private hospital in Szentendre designed to serve the wealthiest two percent of the country's population.[163]

The rapid pace of economic reform has magnified another problem previously almost unknown—homelessness.[164] As of late 1993, there were an estimated twenty to thirty thousand persons in Budapest without any housing.[165]

Women suffer disproportionately from the ill effects of capitalism in Hungary and in the rest of Eastern Europe.[166] Privatization

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161. *See Drive to Market Reform Endangers Democracy: Report,* Agence France Presse, Feb. 3, 1995, *available in* NEXIS, NEWS Library, CURNWS File.

162. The state of national health in Eastern Europe is clearly related to privatization. The only two countries in the region which increased public health expenditures after 1989 - the Czech Republic and Slovakia - are also the only two countries with decreasing post-1989 mortality rates. ECONOMIST, *supra* note 159. UNICEF Director General James Grant, in discussing the deterioration of children's health and welfare throughout Eastern Europe, and including Hungary, explicitly blamed privatization for the emerging health disaster:

> Mr. Grant criticised Western institutions such as the International Monetary Fund (IMF) and the World Bank for advising political leaders to undertake economic reforms without giving due consideration to the social consequences. He acknowledged that the West has provided a number of economic advisors, but very little in the way of social welfare counselling.

UNICEF Assesses Social Costs of Reforms in Eastern Europe, EURO-EAST, Feb. 22, 1994.

163. *Hungary: Soviet Barracks to Become American Private Hospital*, FIGYELO, *translated in* Reuter Textline, Feb. 17, 1994, *available in* NEXIS, NEWS Library, CURNWS File. This is an excellent example of how foreign investment usually ignores issues of distributional justice in host countries like Hungary. Western investors are primarily concerned with profits, and not with the effects of their business activities on the distribution of income or resources in the countries in which they invest. *See also supra* note 124.

164. *See* JANOS KORNAI, THE SOCIALIST SYSTEM: THE POLITICAL ECONOMY OF COMMUNISM, 312 (1992). Under state socialism, housing was a right, and the state ensured that everyone had some place to live. This is not to say that in practice state socialist governments provided adequate housing, for they rarely did. Housing shortages and overcrowding were endemic in Eastern Europe under state socialism. There were, however, very few people with no housing at all. *Id.*

165. *Glum Christmas for East Europeans*, Agence France Presse, International News, Dec. 25, 1993, *available in* NEXIS, NEWS Library, CURNWS File. *See also Cold Winter Tortures Hungarian Homeless*, Xinhua General Overseas News Service, Jan. 7, 1993, *available in* NEXIS, NEWS Library, ARCNWS File. ("It is estimated that 10,000 are long-time homeless people and another 25,000 to 30,000 spend the night in the [subway] tunnels.") "Unidentified Man #4: (Through Translator) They took away my flat and my furniture. My wife and I sleep under a staircase now. the government goes on about how Hungary must catch up with Western Europe, but is this the price we have to pay? It's killing us." NPR, *supra* note 152.

166. *See* Alan Boyle, *In Eastern Europe, Life Getting Harder for Women*, STAR TRIB. (Minneapolis), Sept. 5, 1993, at E11 (contrasting how Czech women are losing access to child care, which was subsidized by the former communist government,

and market reforms have brought the sex industry to Hungary. Privatization is "convert[ing] love and sex into commodities."[167] Prostitution, for example, has reached epidemic proportions over the course of the last five years.[168] Even the Hungarian women's movement has been commodified and manipulated by a western agenda, so that "almost all scholarly research on women in Hungary has so far been inspired, financed, and published by foreign institutions or agencies."[169] The newly emerging capitalist system disproportionately punishes other historically disadvantaged groups as well.[170]

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with the concurrent explosion of pornography and prostitution across Eastern Europe).

> At first, the collapse of Communist governments gave women and men alike hope for a better life. But life has instead gotten tougher for women in particular, feminists say. Rather than improving their lot, women are losing many of the things they once took for granted - such as equity in education and the workplace, reproductive rights, free health care and child care.

Id. On the other hand, gender equality in Eastern Europe under state socialism was realized in mostly superficial ways. The literature is substantially divided on the question of which system, pre- or post-1989, did more for the realization of gender equality. What seems clear is that the situation for women was relatively bad under state socialism, and is also bad in the emerging market economies.

> Instead of being thankful for the privilege of the Communist "equality" with men, which forced women to climb scaffolding, to get black lung disease in coal mines, to drive tractors and harvestors and hand-milk cows for pennies at the collective farms, we dreamed of the promised inequality of capitalism, which peeped occasionally from the glossy pages of six-month-old issues of *Vogue* or *Burda*, and sometimes its bright colors flashed in our eyes through the cracks in the Berlin wall, together with a package of perfumed Tampax or a pair of blue jeans. (As Slavenka Drakulic put it in *How We Survived Communism and Even Laughed*, Communism failed, if for no other reason, because for more than seventy years of existence it could not invent and provide tampons and sanitary napkins.)

Mariana Katzarova, *Gender Politics and Post-Communism: Reflections from Eastern Europe and the Former Soviet Union*, NATION, July 26, 1993, at 4 (Book Review). *See also infra* notes 167-69.

167. Judit Kiss, *The Second 'No': Women in Hungary*, 39 FEMINIST REV. 49, 55 (1991). *See also* Maria Adamik, *Hungary: A Loss of Rights?*, 39 FEMINIST REV. 166 (1991). On the issue of the commodification of human emotions, *see A Division of Hallmark Cards Inc. is Making Progress Toward Establishing a Licensing Agreement in Hungary*, KANSAS CITY BUS. J., Nov. 4, 1994.

168. Edith Oltay, *Prostitution Thriving in Hungary*, 2 RFE/RL RESEARCH REPORT, No. 22, May 28, 1993. Increased prostitution is linked to economic hardship, which in turn is linked to privatization. Many prostitutes are under the age of 18. The sex industry has grown exponentially since 1989. *Id.*

169. Elzbieta Matynia, *Women After Communism: A Bitter Freedom*, 61 SOC. RES. 351, 366-67. Among Eastern European women, there is some disdain for western feminists doing research projects in the East and offering their "expertise" to women's groups in the east. *Id. See also* DRAKULIC, *supra* note 46, at Ch. 13.

170. " 'The change of system was very bad for Gypsies. Now whenever someone has to be sacked it's always the Gypsy but that was impossible then [under state socialism]. The economic situation is getting worse and worse and we cannot pay the

Almost every other social indicator in Hungary points to a worsened and worsening situation in the post-revolutionary period. In Budapest the crime rate has doubled in the last five years.[171] This is also a direct effect of post-1989 economic reforms.[172] Especially disturbing is the recent explosion of racially-motivated crimes.[173] Environmental pollution is one of the worst legacies of state socialism. Recent reports, however, suggest that pollution is at least as bad and perhaps actually worse due to the new free market system.[174] Ironically, only Hungary's traditionally high suicide

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rent,' said Jozsef Bader, the Gypsy Duke of Eger." Adam Lebor, *Hungary Hones Creed of Hate*, TIMES, Aug. 14, 1993. Gypsies are disproportionately hurt by poverty. By 1993, 81% of Gypsy households lived below the poverty line. Rudolf Andorka, *Hungary: Disenchantment After Transition*, WORLD TODAY, Dec., 1994, at 233. In Hungary, Gypsies and Jews are the only numerically significant ethnic minorities. This is primarily because approximately 50,000 Hungarian Gypsies and 565,000 Hungarian Jews were murdered by the fascist Arrow Cross government and the German military during the Second World War. *See* George Jahn, *Fearful Memories Still Haunt Budapest Square*, L.A. TIMES, July 10, 1994, at A16. Today about one percent of the population is Jewish, and about five percent is Gypsy. The other Eastern European countries, notably the former Yugoslavia and some of the Central Asian Republics, provide obvious examples of resurgent persecution of ethnic minorities. Homosexuality is not accepted in Hungarian society, regardless of the regime in power or the nature of the economic system. *See* Miles Graham & Christian Heppinstall, *Hungary: Gays Still Ostracized in Post-Communist Era*, INTER PRESS SERVICE, June 9, 1992.

171. *Crime Doubled in Budapest Since the Fall of Communism*, BBC Summary of World Broadcasts, Oct. 8, 1994 (from Duna Satellite Service, Budapest), *available in* NEXIS, NEWS Library, CURNWS File. "In 1993 alone the number of crimes in Budapest reached 133,000. There were 665 crimes committed for every 10,000 residents of the capital and this was 1.5 times the national average." *Id. See also* David Rocks, *Democracy Fuels Crime; E. Europe Becoming as Unsafe as Other Places*, CHI. TRIB., Nov. 26, 1993, at 9. The title of this article is misleading, and exemplifies how the western press often confuse the terms "democracy" and "free markets." A more accurate headline would instead read "*Economic Reform Fuels Crime*." "White-collar crime, tax fraud and organized crime - none of which was widespread before 1989 - are all increasing rapidly. In Hungary, for example, experts estimate that financial crimes have grown sixfold in the last four years." *Id.*

172. According to police in Budapest, rising crime is a result of hard economic times. Caren Chesler & Bruce Holmes, *Murder Rate Surges as Year Comes to End*, BUDAPEST SUN, Jan. 5-11, 1995, at 2.

173. The most common victims of hate crimes in Hungary are Gypsies, Jews, and Africans. *See* Lebor, *supra* note 170, for a discussion of anti-Gypsy violence. The upsurge in this type of crime is directly related to economic hardships caused by the post-1989 liberalization of the economy. One other recent and recurring hate crime is the continuing desecration of the Jewish cemetery in Budapest. Almost all of the mausoleums have been robbed, and swastikas are spray-painted onto them. (Research and observations of the author and Dave Holtan.)

174. An environmental crisis was created by the socialist governments' obsession with heavy industry. The focal point of the harm is at the intersection of the Czech, Polish, and German borders. Unfortunately, capitalism has done little or nothing to improve environmental conditions:

> The onset of capitalism has not cleaned the region's foul air, soil, or water. But its instruments are now measuring it. The stark message of the sensors is that almost five years after the collapse of Commu-

rate (the highest in the world) has remained unaffected by the economic upheaval.[175] Public opinion surveys show that eighty-seven percent of Hungarians now believe they are worse off or about as well off as they were five years ago.[176] Seventy-three percent of the population expects the country's economic situation to either stay the same or continue to deteriorate.[177] Another survey found that Hungarians clearly preferred the old socialist economy over the current economy. They even ranked the old socialist economy as being slightly better than the economy that they expect will exist five years from now.[178] The dominant opinion now, after five years of reform, is that capitalism is a "fast track to easy riches for a privileged and corrupt few."[179]

> nism, the region's environment continues to decay. Chemical works, smelters, coal mines and power plants are still infusing air and water with waste far surpassing international standards and causing severe health problems. Toxic dumps go on poisoning ground water and cities keep on spewing their raw sewage into rivers. What's more, capitalism is bringing its own problems - more traffic pollution, less public transportation, more plastic foam, more clashes between environmentalists and the peddlers of consumerism.

Simons, *supra* note 94. *See also* Sam Loewenberg, *Pollution Slows Down Privatization*, BUDAPEST WK., July 21-27, 1994, at 6. "But environmental problems are a low priority for privatization agencies under a mandate to privatize state-owned land and industries as fast as possible to generate income for their cash-strapped countries." *Id.* *See also* Debora MacKenzie, *Experts Clean Up as Eastern Europe Stays Dirty*, NEW SCIENTIST, Apr. 9, 1994, at 8 (describing the failure of western environmental assistance).

175. Ian Traynor, *Other Lives: A Countryside Full of Grim Reapers*, GUARDIAN, June 4, 1994, at 27. According to the World Health Organization, the incidence of suicide in Hungary is 40 per 100,000 population, the world's highest. *Id.*

176. Craig R. Whitney, *East Europe's Hard Path to a New Day*, N.Y. TIMES, Sept. 30, 1994, at A1 (reporting Gallup Hungary Ltd. survey conducted from July 8 to 12, 1994, with 1,000 adults in Hungary. The poll had a margin of error of plus or minus three percentage points). *See also* McKinsey, supra note 4. "Average Hungarians feel acutely that they are paying a harsh price for the centre-right government's mismanagement of the transition to capitalism." *Id.*

177. Whitney, *supra* note 176.

178. Richard Rose & Christian Haerpfer, *Mass Response to Transformation in Post-Communist Societies*, 46 EUROPE-ASIA STUD. 15 (1994). Not only did Hungarians indicate a preference for the socialist economy, they also ranked the old state socialist government higher than the current government. They did, however, believe that the government in five years time would be superior to the old socialist government. *Id.* at 23. An overwhelming majority of Hungarians (86%) "said that a secure job was far more important to them now than the freedom to travel or the richness of consumer choice that they have enjoyed since communism collapsed." Whitney, *supra* note 176.

179. *Don't Lose Faith in Freedom*, BUDAPEST WK., Sept. 22-28, 1994, at 8 (editorial). *See also* McKinsey, *supra* note 4.

> "Everybody should pay a price, but it looks like only we are paying the price for this transition," said Karoly, one of the 500 desparately poor people who eat lunch in the Red Cross's soup kitchen in the Seventh District [of Budapest] every day. "Just look around at who is building new houses for themselves. These are all the people in power now,"

The free market reforms introduced since 1989 have strongly magnified income inequality in Hungary. There was income inequality under state socialism, but the disparity was never as profound as now.[180] Most empirical studies have shown that the distribution of income in Eastern European countries, including Hungary, under state socialism was more equal than in Western countries during the same time period.[181] Before the free market revolution, the average income of the poorest segment of the population was approximately sixty-two percent of median income, and the income ratio between the top and bottom deciles was only 2.6 (in contrast to the United States, where a decile ratio of 8.9 reflects enormous income inequality).[182] By 1993, Hungary's decile ratio

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> said Karoly, a 47-year-old disabled man who must get by on a pension of 6,200 forints ($89) a month.

Id. "Western business tycoons and cell-phone carrying opportunists have not won much affection in the hearts of ordinary Hungarians, for whom the only tangible effects of the free market are rising prices and dwindling welfare payments." Hooker, *supra* note 132.

180. "[T]he distribution of income is worsening.... Today the vast majority of the population in [Eastern European] countries are living in economic conditions which are demonstrably worse than those under the inefficiencies of central planning." KREGAL ET AL., *supra* note 16, at 12. *See* Robin Knight & Victoria Pope, *Back to the Future*, U.S. NEWS & WORLD REP., May 23, 1994, at 40. "Today, the gap [in Hungary] between rich and poor is 50 percent wider than it was in 1989." *Id. See also supra* notes 2 and 4.

181. *See generally* A.N.D. MCAULEY, ECONOMIC WELFARE IN THE SOVIET UNION (1979); F.L. PRYOR, PROPERTY & INDUSTRIAL ORGANIZATION IN COMMUNIST & CAPITALIST NATIONS (1973); A.B. ATKINSON & J. MICKLEWRIGHT, ECONOMIC TRANSFORMATION IN EASTERN EUROPE & THE DISTRIBUTION OF INCOME (1992). Some studies have claimed that inequality under state socialism was actually comparable to that of the West, once non-income benefits were considered. Certain perks, like access to higher education, travel, access to foreign currency, better housing, and so on, were more readily available to communist party officials. These studies don't seem to recognize that other types of social income in kind, such as basic education, vacations, and health care were more evenly distributed than in the West. These studies also fail to recognize that much of the income inequality in Hungary from the period 1968-1989 was induced by market reforms, especially the growth of private enterprise in the 1980s. *See* ALEC NOVE, THE ECONOMICS OF FEASIBLE SOCIALISM REVISTED, 137 (1991) (suggesting this possibility). *See also* UNICEF, *supra* note 138, at 4. "In the years immediately preceding the introduction of economic reforms, the countries of Eastern Europe undeniably boasted substantially lower levels of income inequality and poverty rates than those prevailing in the majority of the middle income and developed countries. [This observation] remains true even if account is taken of the privileges of the nomenklatura." *Id.*

182. Hungarian figures are from Anthony B. Atkinson & John Micklewright, *The Distribution of Income in Eastern Europe*, EUI WORKING PAPER ECO NO. 92/87, EUROPEAN UNIVERSITY INSTITUTE'S WORKING PAPERS IN ECONOMICS, 1992, at 10. The decile ratio measures the individual distribution of household per capita income. The income of the top decile is divided by that of the bottom decile. The decile ratio of 2.6 is from 1982. Between the years 1970-1986, the Hungarian decile ratio never varied from the range 2.4 to 2.6. *Id.* Figures for the United States decile ratio are from UNITED NATIONS DEVELOPMENT PROGRAMME, HUMAN DEVELOPMENT REPORT, 197 (1992). The United States income ratio is between the top 20% and bottom 20%

had more than doubled, to 5.8, reflecting a huge growth in income inequality over a very short time.[183] This growing inequality will have profoundly negative consequences in Hungary. First, as income inequality grows, the stability of a democracy decreases.[184] This is especially true in countries like Hungary where democracy has only recently been established.[185] Notably, the increase in social tensions related to rising inequality could cause the collapse of the reform process entirely. Further, the benefits of expanded political freedom that may or may not coexist with the new market economy will be substantially meaningless to most people, because of the enormous new disparities. Also, as income inequality rises, more people will become alienated and either withdraw from the economy or reduce their efforts in it, causing economic performance to decline.[186]

In the rush to set up capitalism through privatization and foreign investment, however, protecting those people hurt by the reform process has been an afterthought in parliament.[187] By the summer of 1994, social conditions had become so intolerable that Hungarians voted the Socialist Party back into power with a large majority of the seats in parliament.[188] Hungarians thought they

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of households over the years 1980-1988. *Id.* This suggests that the real decile ratio in the United States is higher.

183. Andorka, *supra* note 170, at 233.

184. *See generally* Edward N. Muller, *Democracy, Economic Development, and Income Inequality*, 53 AM. SOCIOLOGICAL REV., at 50 (1988) (arguing that strong income inequality destabilizes democracies).

185. *See* Agence France Presse, *supra* note 161 (describing a Council of Europe report warning that market reforms are destroying new democratic institutions in Eastern Europe). "The drive to market reforms in eastern Europe must be restrained if the massive growth in poverty is not to pose a serious threat to democracy in the region." *Id.*

186. Amos Witztum, *Privatization, Distribution and Economic Justice: Efficiency in Transition*, *in* PRIVATIZATION IN CENTRAL & EASTERN EUROPE 92 (Saul Estrin, ed. 1994).

187. *See* Nadori, *supra* note 51.

188. The reconstituted Socialist Party found enormous electoral success in the summer of 1994. The socialist party now commands an absolute majority in parliament (209 of 386 seats) and is the dominant partner in a coalition with the Free Democrats. The party has publicly committed to a course of privatization and market reforms quite similar to those introduced by the center-right Democratic Forum, which it replaced. *See* Myers, supra note 4. (The Democratic Forum governed through a center-right coalition from 1990-94.) The following is explanatory of why the socialists were brought back to power in the summer 1994 elections:

> Last week, a 71-year-old Hungarian woman recounted an incident at a drug store to explain why she voted for the former Communists. She had seen an old man who was shaking violently but asked for only a fraction of the medicine he needed because that was all the money he had. The woman took the pharmacist aside and secretly paid for the medicine herself. She hadn't seen such a thing in decades, she said, her face filled with anger, and she has no desire to see it now.

were voting in this election for an alternative to the disastrous market policies of 1990-1994, and expected the resurrected Socialist Party to put the brakes on free market reforms in order to protect jobs and social welfare. They were in for an ugly surprise, however, when the newly elected socialist government revealed that it had no intention of slowing privatization or foreign investment.[189] This proved that the new "successor" to the HSWP is as uninterested in popular opinion now as it was when it ruled Hungary from 1948-1989.[190] Hungarians are now governed by what is arguably the most right-wing socialist party in human history.[191]

III. The Persistence of a Failed Model of Reform

If the social cost of free market reforms is so devastating, why has not Hungary's new socialist government abandoned these policies? Obviously, Hungarian elites benefit from privatization through foreign investment, and therefore have a built-in bias toward maintaining this project.[192] There are three additional phenomena that bind Hungary and Eastern Europe to the failed project of radical privatization: the unhelpful nature of coercive western aid programs; the policies of the International Monetary Fund; and free market ideology. These factors are substantially interwoven.

(a) Western Aid Programs

There are many manifestations of western aid to the region, but most assistance is ideological,[193] promotes or is contingent

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Myers, *supra* note 4, at C1. "There is no denying that . . .the pro-market political parties [in Poland and Hungary] associated with the International Monetary Fund - World Bank 'shock therapy' approach, have accomplished something unimaginable in 1989: making large numbers of people nostalgic for the old Communist economic order." Robert McIntyre, *A Look at the Communist Comeback*, WASH. POST, June 12, 1994, at C3.

189. "Despite their roots in the old communist party the Socialist technocrats promise an almost Thatcherite economic programme designed to speed up privatization, cut spending and encourage foreign investment." Lucy Hooker, *European Business: Little Yellow Chick Fails to Fly as Hungary Cancels Expo 96*, GUARDIAN, July 30, 1994, at 7.

190. *See generally* András Körösényi, *Intellectuals and Democracy in Eastern Europe*, 65 POL. Q. 415 (1994) (arguing that Hungarian intellectuals, including socialist party elites, either dislike democracy or are ambivalent to it).

191. *Id. See also supra* note 47.

192. *See supra* notes 47, 49, 50 and 91 and accompanying text.

193. Mark Neufeld, *West's Bankers Could Send Russia to the Brink*, TORONTO STAR, Aug. 12, 1992, at A19. "The human costs of restructuring East European economies in accordance with free-market principles appears irrelevant to neo-conservative ideologues in the West." *Id.*

upon economic liberalization,[194] and does virtually nothing to improve the lives of most Hungarians and other Eastern Europeans.[195] Fast-paced legal and economic reform to allow foreign direct investment and privatization is encouraged and in some contexts demanded by the West.[196] What are these aid programs and how exactly have they failed?

The United States inititated a large aid program immediately after the HSWP gave up power in late 1989. The Support for East European Democracy Act of 1989[197] (SEED Act) was created to support economic reform in Hungary and Poland. The SEED Act has virtually nothing to do with supporting democracy in either country.[198] Its true objectives are, *inter alia*, "to promote the devel-

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194. John Goshko, *Detours on Painful Journey to Democracy, Free Markets Raise Disenchantment in West*, The WASH. POST, May 23, 1992, at A27. "By now, almost all of the U.S. aid money for Eastern Europe is directed at activities that foster privatization or that support [foreign] investment and trade. About 40 percent goes to 'enterprise funds' that are private boards set up by recipient countries to make loans and offer technical assistance to small and medium-sized private businesses." *Id.* Foreign aid generally is designed more to help the western countries giving the aid than to help the developing countries receiving it. Hayter, *supra* note 97, at 83. The "big bang" or "shock therapy" approach to economic reform was pushed on Eastern European countries by the International Monetary Fund, the World Bank, the OECD, and other western institutions after 1989. Chakravarthi Raghavan, *Central/Eastern Europe: Disarray and Discontent Dog Reform*, Inter Press Service, Apr. 7, 1995, *available in* NEXIS, NEWS Library, CURNWS File. *See also infra* note 227 and accompanying text.

195. In particular, western aid programs are not concerned with the distribution of existing wealth or any new wealth that is created in Eastern Europe. "Western experts do not devote appropriate attention to the distribution issues of the East European transition, to the shocks that are expected in view of inequalities and poverty." *No Market Economy Without Social Justice, CDPP Chairman Says*, MTI Hungarian News Agency, Sept. 25, 1994, *available in* NEXIS, NEWS Library, CURNWS File. (The CDPP is the Christian Democratic People's Party, currently in opposition in the parliament). "The claim of massive (in fact virtually non-existent) Western aid to the transforming economies is pure public relations. . . . Much of the support has actually been rechannelled to the donor countries, being used to cover the sometimes astronomically high costs of Western experts and advisors. In Hungary 90 per cent of the PHARE programme has been in the form of so-called technical assistance, covering the $1,000-per-day consultancy fees of 'foreigners temporarily stationed in Hungary.'" Inotai, *supra* note 7, at 31.

196. *See U.S. Assistance to Central and Eastern Europe, Hearing before the Subcommittee on Europe and the Middle East of the Committee on Foreign Affairs*, 102nd Cong., 2nd Sess., June 3, 1992 (dialogue between Robert Barry and Rep. Tom Lantos about privatization and foreign aid strategy). *See also supra* note 194.

197. Support for East European Democracy (SEED) Act of 1989, Pub. L. No. 101-179, 103 Stat. 1298.

198. The U.S. government claims that about seven percent of SEED Act disbursements to Hungary have gone to "strengthening democratic initiatives." *U.S. assistance to Central & Eastern Europe, supra* note 196, at 116 (figure as of Mar. 31, 1992). This figure is misleading, however, because even some of the projects which allegedly support "democratic initiatives" are actually subsidies for the creation of a free market economy. All of the following are examples of these projects: Free Trade Union Institute, Center for International Private Enterprise, paying SUNY to estab-

opment of a free market economic system characterized by. . . dismantlement of all wage and price controls. . . [and] liberalization of investment and capital, including the *repatriation of profits by foreign investors*. . . "[199] Twenty-five of twenty-seven sections in substantive titles of the SEED Act provide for economic reform or economic assistance, while only one section has anything to do with "democracy," and one is about "cultural" exchanges.[200] The United States government views the SEED Act primarily as a vehicle for promoting American corporate interests in Hungary.[201]

Even viewed for what it really is, a program of economic reform, the SEED Act is a failure. The United States Agency for International Development (USAID) disburses to American companies and law firms the millions of dollars that Congress has authorized under the SEED Act through fiscal year 1995.[202] Most of the SEED money, however, is used to develop these companies' business connections in Hungary, rather than helping Hungarians.[203] "The real winners in AID's foray into the region [Eastern Europe] have been the [American] companies, law firms, and accounting firms that have quickly gotten a piece of the new post-communist pork."[204] USAID has paid contractors to find overseas

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lish chambers of commerce in two cities, and English language instruction. *Id.* at 109.

199. SEED Act, *supra* note 197, at § 2(b) (emphasis added).

200. *Id.* at § 1.

201. The following is testimony from a congressional hearing about American aid to Eastern Europe. Robert Barry was the State Department's special advisor to the Deputy Secretary for Eastern European Assistance at the time:

> MR. BARRY: . . . Again, there are domestic political problems in many countries about resentment of foreign capital coming in. Somehow these attitudinal problems, I think, have to be dealt with, and we are trying to do this through a form of using our media, using USIA, using joint cooperative television shows, for example, to show that foreign investment in Southeast Asia or foreign investment in other parts of the world can be very beneficial for the recipient countries. So that's the kind of attitudinal problem I think we have to attack.

U.S. Assistance to Central and Eastern Europe, *supra* note 196, at 52.

202. Julie Kim, *Poland, Czech Republic, Slovakia, and Hungary: Recent Developments*, Congressional Research Service Issue Brief, Oct. 4, 1994, at 16. As of October 1993, Hungary had received over 152 million dollars of SEED Act money. P.L. 103-306, H.R. 4426 was signed into law on August 23, 1994, and provided for 359 million dollars in SEED Act funds to Eastern Europe and the Baltic states, plus 69.2 million dollars for the European Bank for Reconstuction and Development. *Id.*

203. Sheila Kaplan, *Contracting Problems, Management Woes Plague Aid in the Ex-Communist Block; Many Agency Projects Seem More Like Aid to U.S. Law Firms and Other Companies Than to the Emerging Democracies*, Legal Times, May 31, 1993, at 1. Douglas Hellinger, of the Development Gap: "These AID contracts raise the very real question of whether our assistance programs in Eastern Europe and Russia are designed to help these countries move forward on a more self-reliant path or if, in fact, our goal is to push forth U.S. investment." *Id.*

204. *Id.* at 1. *See also* Georgie Anne Geyer, *Big Help; U.S. Consultants Eat Up Foreign Aid*, Phoenix Gazette, Mar. 19, 1994.

investment opportunities for an American company, overlooked potential conflicts of interest by firms representing clients that do business with the same governments that USAID is paying them to advise,[205] illegally failed to use competitive bidding in the contracting process, and wasted hundreds of thousands of dollars of SEED Act money paying American law firms to provide services that other organizations are performing free.[206] American businesses and consulting firms are tripping over each other to get a piece of the SEED Act pie and these firms are on the lookout for overseas business.[207] The conflicts of interest danger is especially pronounced in USAID's contracts with American law firms. SEED Act money has already underwritten more than a dozen American law firms who advise the governments of Eastern Europe and the former Soviet Union. Typically, these firms also represent western businesses interested in investing in the region. The resulting danger is, of course, that state-owned enterprises on the auction block will be undersold to the detriment of the selling country. In Hungary, "the selling of Hungarian companies to foreign firms at unfairly cheap prices has generated so much adverse publicity that the government established a new privatization agency to supervise the privatization process."[208]

Of the SEED Act's initial disbursements in 1989, one of the largest was a sixty million dollar grant to support the Hungarian-American Enterprise Fund (HAEF). This is a quasi-private organization created by the SEED Act, designed to help private firms in Hungary get off the ground.[209] The head of the Hungarian govern-

205. Janine R. Wedel, *Polish Officials Sour on US AID Approach*, CHRISTIAN SCIENCE MONITOR, Mar. 2, 1992, at 18. "A potential conflict of interest lies in the fact that Western consulting firms doing asset valuations are often the same firms helping other clients to buy at the prices these Western firms help set. This undercuts the full value of East European properties." *Id.*

206. *Id.*

207. Ian Traynor, *When the East's Dreams Evaporate*, GUARDIAN, Nov. 19, 1994. "The same criticisms are levelled at the western aid programmes, which have functioned as work and wealth creation schemes for western companies setting up operations in the east. Washington's USAID [SEED Act] programmes, which disburses hundreds of millions of dollars in assistance and advisory work, doles out funds almost exclusively to US companies in the region." *Id.* at 16.

208. Jack Kaikati, *Privatization in Eastern Europe: Lessons from the Hungarian Experience*, MID-ATLANTIC J. BUS., Dec., 1992, at 213. The extent to which American law firms are complicit in underselling state enterprises in Hungary in still unclear, because USAID does not require its SEED Act contractors to disclose their clients. Senator David Pryor said that "the truth is that the taxpayers are paying for contractors who are working both sides of the street." Kaplan, *supra* note 203.

209. Typical of the Fund's deals was a three million dollar investment of taxpayer's SEED Act money into an equity stake in the Hungarian franchiser of Dunkin' Donuts, Kentucky Fried Chicken, and Pizza Hut. The former Managing Director of the Fund, Charles Huebner, defended this decision by claiming that not

ment's State Holding Company (one of the agencies responsible for privatizing state enterprises) was forced to resign in 1993 after it was discovered that the United States government, through the HAEF, was "supplementing" his salary at the rate of 130,000 dollars per year.[210]

In 1993 the U.S. House of Representatives Appropriations Committee issued a scathing review that "accused the fund of mismanagement and of violating a slew of guidelines by investing four million dollars in a small banking firm [EurAmerica] that pays its managers annual salaries of almost 400,000 dollars."[211] The HAEF created EurAmerica to avoid USAID oversight in setting up SEED Act programs.[212]

The European Union's version of the SEED Act is called PHARE, and has been, by most accounts, moderately more beneficial than American assistance. Even PHARE aid, however, focuses too much on bankrolling western experts,[213] to the detriment of the actual needs of the recipient countries.[214] The Hungarian Ministry of Agriculture has complained that "one-third of all PHARE aid for Hungarian agriculture went to foreign consultancy companies whose studies were virtually useless. . . ."[215] The aid is "not sufficiently directed towards improving the population's standard of liv-

only will it create thousands of jobs in Budapest, it will also generate "people who will now know how to wash, how not to smell, how to smile, how to be fast." Henry Copeland, *Finance: Uncle Sam's Helping Hand Pockets the Change*, Inter Press Service, Apr. 26, 1993, *available in* NEXIS, NEWS Library, ARCNWS File. Creating the new capitalist man (or woman) will apparently be the crowning achievement of American aid efforts in this part of the world.

210. *Head of State Holding Company Resigns*, MTI Hungarian News Agency, June 18, 1993, *available in* NEXIS, NEWS Library, CURNWS File.

211. Peter Maass, *Congressman Charges Aid Effort Goes Awry; Hungary Enterprise Fund Pays Fat Salaries*, WASH. POST, July 29, 1993, at A15.

212. Copeland, *supra* note 209. *See also* Henry Copeland, *A Bit Too Enterprising? U.S. Funds for East Europe Stir Criticism*, INT. HERALD TRIB., Apr. 17, 1993, available in NEXIS, NEWS Library, ARCNWS File. Congressman David Obey (D-WI), Chairman of the House Appropriations subcommittee on foreign assistance, claims that the enterprise funds "have been treated with kid gloves because of the political connections of their board chairman and I think that needs to come to a screeching halt.'" *Id.* A US-AID officer says that the funds are "run as fiefdoms with no accountability to the American people." *Id.*

213. Stephen Nisbet, *EU Prepares for Expanded Links with East Europe*, REUTER EUR. BUS. REP., Mar. 16, 1994, *available in* NEXIS, NEWS Library, CURNWS File. "The EU's notoriously inefficient PHARE assistance programme funds EU firms almost exclusively." Traynor, *supra* note 207.

214. *EC: Eastern European Criticism of Functioning of PHARE and TACIS Programmes*, Reuter Textline, Agence Europe, June 11, 1993, *available in* NEXIS, NEWS Library, CURNWS file.

215. *PHARE-Funded Studies Criticized*, MTI Hungarian News Agency, Feb. 1, 1994, *available in* NEXIS, NEWS Library, CURNWS File. Gyorgy Rasko, State Secretary at the Agriculture Ministry noted, on the other hand, that some other PHARE programs in Hungary were helpful. *Id.*

ing."[216] PHARE programs throughout Eastern Europe are also widely regarded as environmentally damaging.[217] (One notorious example of PHARE "assistance" to Eastern Europe was the shipment of extremely poisonous pesticides, banned in the West, to Polish farmers. The PHARE program made no attempt to explain or structure their possible uses.)[218] Even PHARE assistance explicitly directed to environmental renewal projects has usually been squandered on over-paid western consultants or else used in a way that "solve[s] one environmental problem while creating another."[219]

The European Bank for Reconstruction and Development (EBRD), modeled on the World Bank, was created in 1990 to help speed economic reform by loaning money to private and public projects in the East. Unfortunately, as of 1993, the bank "had spent more on internal costs—in particular, its glamorous marble-and-mirrored headquarters in London—than it had disbursed in Eastern Europe."[220] A glaring example of this waste was the construction of the "now infamous $1.1 million Carrara marble elevator bank."[221] Lawyers from the EBRD's large legal department are helping to build the foundations for capitalism by suggesting new business-friendly laws. They once wrote a draft that became the basis for proposed legislation in Hungary.[222] There is an obvious

216. *Id. See also PHARE Slammed by Auditors*, E. EUR. MARKETS, Nov. 26, 1993.

217. Rob McLean, *Deputies Criticize PHARE Program*, UPI, Apr. 22, 1994, *available in* NEXIS, NEWS Library, CURNWS File. *See also supra* note 174.

218. *Id.* Du Pont de Nemours International, perhaps along with Monsanto and other American agro-chemical companies, played a large role in this fiasco. This is another typical example of the impact of western capital in Eastern Europe. *Poland: Du Pont in Poland*, GAZETA BANKOWA, Dec. 9, 1990, *available in* NEXIS, NEWS Library, ARCNWS File. Greenpeace has recently accused the PHARE program, the World Bank, and various multinationals including Monsanto, of collaborating to force poisonous pesticides on the Albanian government. *Greenpeace Urges Recall of Pesticides Sent to Albania, Blasts EU Agricultural Aid*, BNA INT'L ENVIRON. DAILY, Oct. 27, 1994, available in NEXIS, WORLD Library, ALLWLD File.

219. MacKenzie, *supra* note 174.

220. Emily Barker, *Starting from Scratch*, AM. LAWYER, June 1994, at 42. The EBRD is now derisively referred to by many as the "European Bank for Redecorating and Designing." It has been calculated, as well, that the cost of the new marble-coated bank headquarters would feed a queue of eighty Russian women for approximately 232 years. *Id. See also* Paolo Miurin & Andrea Sommariva, *Financial and Technical Assistance to Central and Eastern Europe: A Critical Appraisal of the Role of International Institutions*, WASH. Q., Summer, 1994, at 91.

221. Barker, *supra* note 220, at 42. As of 1993, the EBRD had probably done more to subsidize Italian marble cutters than help Eastern Europeans. More recent reports suggest the EBRD's "governors. . . have not yet lost their penchant for high living. . . " John Roberts, *Finance - Eastern Europe: EBRD Role to be Discussed at London Meet*, Inter Press Service, Apr. 8, 1995, *available in* NEXIS, NEWS Library, CURNWS File.

222. Barker, *supra* note 220, at 42.

potential for conflicts-of-interest inherent in this practice. EBRD lawyers have written the business laws for East European governments and are simultaneously advising clients about investments in these same countries.

The record of the SEED Act and other foreign aid to Hungary is clear. These are projects calculated to advance western foreign investment in Hungary, clothed as foreign aid programs. Western aid to Hungary thus far has also been characterized by high levels of mismanagement and the self-promotion and profiteering of western firms. Given these facts, one must wonder if there is any value at all in Western aid? Perhaps, aid from the United States and Western Europe is not designed to benefit Hungary at all. "Truly effective aid for Eastern Europe can threaten the West's own manufacturing base and adversely affect living standards."[223] It is at least conceivable that western governments foresaw this in 1989 and structured aid accordingly.[224]

(b) The International Monetary Fund

The International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank) are heavily involved in the Hungarian reform process.[225] Western governments dominate both institutions,[226] and the IMF to a large de-

223. Rune Bech, *Great Pain in Place of a Plan*, GUARDIAN, January, 10, 1992, at 23. *See also infra* note 292 and accompanying text.

224. The most likely explanation for Western involvement is related to foreign policy concerns. Early American aid (the SEED Act, for example) was granted at a time when the Soviet Union still existed and the Bush Administration wanted to invite Hungary and Poland into binding Western economic structures as quickly as possible in order to prevent them from ever going back to the CMEA and the Warsaw Pact. This promised to hasten the destruction of the Soviet bloc in Eastern Europe as well. Bush went to Hungary and Poland in 1989, and made a big deal of announcing massive aid for those countries in order to send a signal to Czechoslovakia, East Germany, and the rest, encouraging them to join the revolution and implicitly signaling that they would be rewarded if they did. When the Soviet Union disintegrated, and thus the Warsaw Pact along with it, initial Western generosity diminished.

225. Hungary joined the IMF in 1982. See *Hungary Earns IMF Support*, FIN. TIMES, May 10, 1982, at 14. Hungary joined the World Bank in 1983-84. (Not to be outdone by the EBRD, the construction of the new World Bank headquarters in Washington, D.C. recently ran 83 million dollars over budget, hardly a practice in keeping with the strict austerity measures the Bank insists upon for Third World economies.) George Graham, *Red Faces at World Bank as HQ Costs Break Budget*, FIN. TIMES, July 16, 1993, at 4.

226. The World Bank and IMF were created at the Bretton Woods conference in 1944 in order to maintain and elaborate western hegemony in the world economy. Hayter, *supra* note 97, at 88. They were ostensibly created to assist developing countries with loans and monetary policy. The World Bank and IMF are related institutions (membership in the IMF is required for membership in the World Bank). Traditionally, the head of the World Bank is nominated by the President of the

gree determines the Hungarian government's economic policies.[227] International financial institutions, the EBRD and IMF included, demanded privatization as a condition for financial assistance.[228]

Western financial institutions (IMF and EBRD) and governments have promised a total of about twenty-seven billion dollars of assistance to Hungary, Czechoslovakia, and Poland. Only fourteen percent of this is grants, the rest is mainly loans and credit guarantees.[229] To get these loans and credits, however, Hungary must maintain a good credit rating in the international lending community and world bond markets. This credit rating depends on whether the IMF has given its blessing to the Hungarian budget. In 1992, the World Bank threatened to refuse to disburse any more loans until Hungary came to an agreement with the IMF on its next budget.[230] Hungary, therefore, cannot afford to ignore IMF demands for budget cuts if it wants to integrate into the West. Unfortunately for Hungary's poor and unemployed, the IMF consistently demands sharp cuts in social spending as a precondition for a favorable credit rating.

> Although free-market devotees like the IMF and World Bank have generally praised Hungary's moves to slash subsidies and liberalize prices, average Hungarians are paying the price in the form of double-digit inflation, 12 percent unemployment and a sharp polarization between haves and have-nots.[231]

United States and is an American citizen. Traditionally, the head of the IMF is a Western European. The United States, Japan, Germany, France and Britain are the largest contributors and therefore account for about 40% of the voting power in both institutions. *See* Waldon Bello & Shea Cunningham, *Reign of Error: The World Bank's Wrongs*, DOLLARS AND SENSE, Sept./Oct. 1994, at 12.

227. "The IMF is the central nervous system of the international monetary market. . . [and] Hungary's standing. . . depends largely on how the IMF views the Hungarian economy." Christopher Condon, *Economic Tune-Ups May No Longer Be Enough*, BUDAPEST WK., Nov. 3-9, 1994, at 10. In fairness to the free market reformers, it must be noted that Hungary is now beholden to western financial institutions in large part because the former state socialist government ran up a twenty billion dollar foreign debt. MICHAEL BURAWOY & JANOS LUKACS, THE RADIANT PAST: IDEOLOGY & REALITY IN HUNGARY'S ROAD TO CAPITALISM 170 (1992). *See also* Angus MacKinnon, *Commission Warns Hungary to Stick to Reform Programme*, Agence France Presse, Feb. 9, 1995, *available in* NEXIS, NEWS Library, CURNWS File (reporting that the European Commission requires privatization and other reforms as a precondition for Hungarian membership in the European Union).

228. Judy Batt, *Political Dimensions of Privatization in Eastern Europe, in* PRIVATIZATION IN CENTRAL & EASTERN EUROPE 89 (Saul Estrin, ed. 1994).

229. ECONOMIST, *supra* note 146.

230. *World Bank Loan Depends on IMF Approval of Hungary's Budget*, MTI Hungarian News Agency, Sept. 15, 1992, *available in* NEXIS, NEWS Library, ARCNWS File.

231. *Hungarian Finance Minister Jumps to Avoid Being Pushed*, GUARDIAN, Feb. 12, 1993, at 9.

In this way, the IMF's actions in Hungary ignore the social costs of transition and contribute to growing inequalities in Hungary.[232]

In late 1994, the IMF director personally instructed the Hungarian government to cut back on social welfare expenditures.[233] This advice may seem odd, coming at a time when so many people face poverty and unemployment (due in part to the very policies that the IMF and other western financial institutions advocate) and thus rely on public assistance to meet basic needs, but this demand is typical of IMF austerity measures forced upon Hungary and other countries as a precondition for World Bank loans.[234]

In early 1995, the IMF again demanded that Hungary reduce its budget.[235] The Finance Ministry complied by announcing large cuts in social spending[236] only a day before the beginning of sched-

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232. KREGEL ET AL., *supra* note 16, at 114. The IMF is generally concerned with purely numerical or scientific calculations of the health of a society and is generally unconcerned with distributional issues:

> The main mistake is that IMF-type programmes give more weight to three single measures: (1) The stabilization of the currency, (2) price deregulation as well as elimination of State intervention, and (3) privatization. Their immediate and radical implementation has not halted the fall in production and employment. It is a serious mistake to believe that a set of three measures alone can create a socio-economic context in which the single agents, by the pursuit of their private interest, add to their own benefit and to that of society. On the contrary, 'shock therapy' adds more damage to the socio-economic context that already exists.

Id. See also UNICEF, *supra* note 138.

233. Jane Perlez, *Living too High in Hungary; Leadership Shies From Belt-Tightening Despite Warnings of Severe Problems*, INT'L HERALD TRIB., Oct. 27, 1994. "The Hungarian government is under pressure from the International Monetary Fund and the World Bank to curb its generous social spending, especially family benefits." *Id.* Kitty McKinsey, *Hungary Pressed to Trim Social Welfare; Mothers Afraid They'll Lose an Important Part of their Family Incomes*, GAZETTE (Montreal), Dec. 19, 1994, at B5. "Among the benefits the [IMF] says must be reviewed are the three kinds of child support payments families receive on the birth of a child; pensions starting at 55 years of age for women and 62 for men; unemployment benefits that begin immediately upon leaving school and last for one year of joblessness; and generous payments for medicine." Perlez, *supra*, Oct. 27, 1994.

234. IMF policies in Eastern Europe are substantially the same as those the IMF has forced upon the rest of the developing world.

> Typically, they include the following elements: a) reductions in government expenditures on social programs such as health and education; b) restrictive labor policies, involving wage reductions and layoffs; c) ending of subsidies/price controls for basic foodstuff; and d) reform of other tax structure to redistribute wealth from lower-income to higher income groups (in accordance with the dictum that "the poor don't work because they have too much, while the rich don't work because they have too little").

Neufeld, *supra* note 193.

235. *IMF Wants Further Cuts in Hungary Deficits*, REUTER BUS. REP., Feb. 24, 1995, *available in* NEXIS, NEWS Library, CURNWS File.

236. These budget cuts of at least 100 million dollars will decrease the family allowance and child benefits, lay-off university staff, and introduce tuition fees at

uled talks with the IMF regarding a new loan-agreement for Hungary.[237] The Minister of Welfare resigned in protest over these budget cuts, noting their effects on the poor in a country already suffering from massive unemployment and growing poverty.[238] Hungarian trade unions and the national Gypsy organization threatened strikes if social spending was decreased as planned. IMF demands are pushing Hungary to the brink of social unrest and disorder. What is surprising, really, is how long people have tolerated these yearly spending cuts and price increases.

(c) Ideology[239]

Market ideology[240] dominates concepts of economic development in Eastern Europe and has a negative impact on successful development.[241] Market ideology is particularly powerful in the context of the privatization process,[242] and colors all perceptions of economic development strategies.

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state-owned universities for the first time. Child benefits will cease to be a civic right. Blaise Szolgyemy, *Hungary Devalues Forint, will cut Social Spending*, REUTER EUR. BUS. REP., Mar. 12, 1995, *available in* NEXIS, NEWS Library, CURNWS File.

237. *IMF Talks Begin on Monday*, MTI Hungarian News Agency, Mar. 13, 1995, *available in* NEXIS, NEWS Library, CURNWS File.

238. *Government Austerity Measures*, BBC Summary of World Broadcasts, Mar. 16, 1995, *available in* NEXIS, NEWS Library, CURNWS File.

239. Ideology means "any set of ideas and values which has the social function of consolidating a particular economic order." SCRUTON, *supra* note 11, at 213. A similar formulation is a form of consciousness which "supports or justifies reprehensible social institutions, unjust social practices, relations of exploitation, hegemony, or domination." Raymond Geuss, *Ideology*, *in* TERRY EAGLETON, IDEOLOGY 269 (1994). *See also* Tibor Szabo, *The End and Renewal of Ideology in Central Europe and in Hungary*, 17 HISTORY OF EUR. IDEAS 747 (1993) (generally discussing the ideology of state socialism and more recent ideologies replacing it). *See also* DERRICK K. GONDWE, POLITICAL ECONOMY, IDEOLOGY, AND THE IMPACT OF ECONOMICS ON THE THIRD WORLD 31-55 (1992) (discussing ideology in economics).

240. "The most significant ideology [in Hungary], and one that was already noticeable during the elections of 1990, is that of the market economy, synonymous with support for capitalism." Szabo, *supra* note 239, at 751.

241. Robert Chote, *Economics: One World, Different Solutions*, INDEPENDENT, Sept. 26, 1993. "Applying Western-style free market solutions in blanket fashion throws up all sorts of problems. Bribing Eastern Europe into breakneck liberalisation may threaten the sustainability of capitalism in these countries by fostering inequality on an unsustainable scale." *Id.* at 12.

242. Privatization is "an intensely political process and involves significant social engineering, particularly in Eastern Europe." Lieberman, *supra* note 8, at 8. "The push for privatization in East Europe arose largely from the infectious ideological fervor of emissaries from Western organization, such as the World Bank and the U.S. Agency for International Development." Phineas Baxandall, *The Privatization Myth*, DOLLARS & SENSE, Jan./Feb. 1995, at 23. A recent letter to the editor in a Budapest newspaper raised the ideology issue in the following way: "Or is the privatization of everything just an ideology, which in the USA and Britain - and the IMF and World Bank! - is accepted as not so efficient after all, having been exposed as a

> The early champions of reprivatization seemed to know and care little about the actual distributive results of their programs. Regardless of their outcomes, these programs epitomize their advocates' ideologies and, to the extent they are enacted, the ideologies of the region's new governments. These new governments assure the ideological intensity for their projects when they claim to be polar opposites of the deposed socialist regimes. . . .[243]

Part of the power of this ideology derives from its advocates' success in portraying privatization as a neutral and natural process.[244] Ideology also causes the means (privatization) of economic reform to be mistakenly seen as the end itself.[245] There is little evidence, however, in the history of twentieth century economic development that radical privatization and destruction of the state sector can create economies that are more satisfactory than ones with a large state sector.[246] In fact, there is nothing inherently better about pri-

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fraud that depresses economies, makes an elite stupidly rich and the poor ever poorer?" Martin Baker, *Why Privatize Everything?*, BUDAPEST WK., Jan. 5-11, 1995, at 7 (letter to the editor).

243. Anna Gelpern, *The Laws and Politics of Reprivatization in East-Central Europe: A Comparison*, 14 U. PA. J. INT'L BUS. L. 315 (1993). Privatization was embraced by the new post-communist government of Eastern Europe in order to "demonstrate both to their electorate and the international community how radically different they [were] from their predecessors." Kiss, *supra* note 114, at 142.

244. A good example of this refusal to acknowledge the ideological content of privatization and free market reforms is János Kornai's book THE SOCIALIST SYSTEM (*see supra* note 164). Throughout the almost 600 pages of text, the respected Hungarian economist and free market apologist Kornai describes in great detail and attacks the ideological nature of state socialism, while never admitting the vital role which ideology plays in capitalism and in capitalist development. *Id.* at 49-54 and 414-18. Furthermore, the legal literature on foreign investment overwhelmingly ignores any discussion of the social welfare effects of foreign investment. A search of the Infotrac/Legaltrac database found 1668 articles under the topic "foreign investment." Of those, only six were in the subtopic of "social aspects." Search of Infotrac/Legaltrac CD ROM on Mar. 1, 1995 (database covering English language legal periodicals from 1980 to Feb., 1995).

245. Rider, *supra* note 131, at 589. "Privatisation is a fetish of the era, as well as a strange euphemism for an ideological crusade. It offers both negative and positive potential. The danger is that it will merely create the conditions for massive increases in inequality of income, wealth and power, and in the case of eastern and central Europe enable foreign capital to obtain and/or cement control over national economic and social policies, as well as create more fertile conditions for the 'mafiosation' of the State." Guy Standing, *Restructuring for Distributive Justice in Eastern Europe*, INTERNATIONAL LABOUR OFFICE, CENTRAL AND EASTERN EUROPEAN TEAM, BUDAPEST, Jan., 1993, at 16.

246. Postwar Japan and Germany did not rely on privatized economies to achieve their economic successes. Both countries used strong state direction and state sector employment to re-build after 1945. The history of economic development in the South shows that relying on privatization is a mistake. In many cases, the World Bank and IMF forced privatization on the governments of African, Asian, and Latin American countries, where the state sector was often the engine of the development process. Generally, the private sector failed to develop as promised and these countries faced even more economic deterioration after structural adjustment was im-

vate ownership of the means of production as opposed to social ownership thereof.[247]

Western governments self-interestedly advocate for Eastern Europe a level of privatization that they would never accept in their own countries. (The state sector accounts for forty-two percent of the Gross Domestic Product of the OECD[248] countries.)[249] These are hardly free market, laissez faire economies. The OECD countries do not admit the necessity of massive government intervention in their own economies because if they were to do so they could not enforce their privatization agenda throughout the developing world. Privatization allows direct foreign investment and enormous profit-taking by western companies, develops markets for western goods, and entrenches a pattern of massive resource flows back to western countries.[250]

Western advisors and the bulk of the literature on post-1989 reform describe capitalism as a naturally occurring condition,[251] as opposed to socialism, which they portray as an artificial imposition.[252] Nothing could be less true. Both systems have at different times and places been formulated in intensely ideological ways, and both capitalism and socialism have existed as pragmatic economic systems. The problem in Eastern Europe today is that a highly ide-

posed. *See generally* WALDEN BELLO & SHEA CUNNINGHAM, DARK VICTORY: THE U.S., STRUCTURAL ADJUSTMENT, AND GLOBAL POVERTY (1994).

247. *See* BURAWOY & LUKACS, *supra* note 227, at 59-66 for a synopsis of this argument. The authors compare efficiency of production in two firms, one in America, and the other in Hungary under state socialism. "Effective operations are compatible with any system of ownership; examples of well-run nationalized enterprises are as common as examples of inefficient, unprofitable private ones." Rider, *supra* note 131, at 589. *See also* Baev, *supra* note 8, at 6.

248. Organisation for Economic Cooperation and Development: an economic body created in 1960 to help wealthy western countries become more wealthy. The following states are members: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

249. Richard Parker, *Clintonomics for the East; Eastern Europe*, FOREIGN POL'Y., Mar. 22, 1994, at 53.

250. This resource flow was the result of structural adjustment programs imposed on Third World countries by the IMF and World Bank. "The policy was immensely successful [for the West], effecting as it did an astounding net transfer of $178 billion from the Third World to commercial banks through loan repayments between 1984 and 1990. So massive was the decapitalization of the South that a former executive director of the World Bank exclaimed: 'Not since the conquistadores plundered Latin America has the world experienced a flow in the direction we see today.'" Bello & Cunningham, *supra* note 226, at 11.

251. *See generally* ALICE H. AMSDEN ET. AL, THE MARKET MEETS ITS MATCH: RESTRUCTURING THE ECONOMIES OF EASTERN EUROPE (1995). *See also* Doug Henwood, *Bloc Busters: Free Market Fundamentalists Pray for Rain*, VOICE LIT. SUPP., March 7, 1995, at 22 (reviewing AMSDEN ET. AL).

252. *Id.*

ological and artificial form of socialism (state socialism 1947-1989) is being replaced by an equally ideological version of capitalism.[253] A related ideological problem is the confusion of the terms "democracy" and "capitalism,"[254] which mystifies the actual meaning of each, and undermines successful transition.

The western press has reinforced the false dichotomy of state socialism vs. capitalism, and presented these caricatures as if they were the sole options for Eastern European policymakers.[255] Western governments and financial institutions (and their proxy local elites in Eastern Europe) all reinforce the following conventional wisdom about post-1989 reform:[256] *Homo sovieticus* is an artificial creature born of forty years of ideological coercion, who will become

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253. *See generally* Bryant, *supra* note 100.

254. The common use of the term "democracy" together with "free enterprise" mystifies the meaning of each and clouds policymaking processes. A recent check of the NEXIS news library showed that, in stories after 1989 mentioning Eastern Europe or Hungary, "democracy" was uttered in the same breath as "capitalism" (or some version thereof) more than four thousand times. This search was conducted in the NEXIS NEWS Library, CURNWS and ARCNWS Files on Jan. 14, 1995 with the search phrase "(HUNGAR! OR EAST! EUROPE!) AND DATE AFT 1989 AND (DEMOCRAC! w/10 (CAPITALIS! OR FREE MARKET OR FREE ENTERPRISE OR LAISSEZ FAIRE))." The search found 4,198 stories. There is no necessary connection between the two concepts either in theory or reality. "Not to worry, say the multinational elites. From virtually all the organs of established opinion we hear the mantra 'free-market capitalism and democratic institutions' as if the mere repetition of this linkage might conjure up the fusion so desired. In Eastern Europe, the White House and the International Monetary Fund insist, only 'economic reform' — mass firings and draconian cuts in social services — can open the door to Western aid. . . " Nelson Lichtenstein, *Citizen Worker: The Experience of Workers in the United States with Democracy and the Free Market During the Nineteenth Century*, 258 NATION, No. 13, Apr. 4, 1994, at 459 (reviewing book of the same title by David Montgomery). History generously demonstrates that capitalism flourishes in both democratic and authoritarian political systems. Capitalist systems dominate North America and Western Europe and Latin America, and are emerging throughout Asia. Only in the first two areas have democratic institutions taken root along with capitalism. Even in Western Europe and North America, democracy is not the result of capitalist production relations, but has developed in spite of it. Capitalism is often an anti-democratic way of organizing a society, because in all societies which have undergone capitalist development, income inequality and the distribution of resources within society become more polarized and the political process becomes captive to monied interests. It is only the intervention of the state (through democratic processes) which puts the brakes on capital accumulation and the increasing immiseration of the majority of the population. Thus, in the United States, for example, as capitalism reached a crisis in the 1930s, the state had to mandate wealth redistribution through legislation (Fair Labor Standards Act, Wagner Act, etc.) in order to prevent the collapse of the capitalist economic structure. In Latin America and Asia, where democratic institutions are far less powerful, income inequality is usually greater than in North America and Western Europe. *See generally* SAMIR AMIN, MALDEVELOPMENT: ANATOMY OF A GLOBAL FAILURE (1990). *See* UNITED NATIONS DEVELOPMENT PROGRAMME, *supra* note 182, and WORLD BANK, WORLD DEVELOPMENT REPORT (1994) (for figures on income inequality).

255. Bryant, *supra* note 100, at 74.

256. AMSDEN ET AL., *supra* note 251, at 5.

extinct when the socialist state collapses. *Homo economicus*, capitalism's self-interested rational actor, will replace the other, and thereafter serve as the natural embodiment of human nature. To this end, the state must be divorced from the economy, and to assist in the transformation western investors should create or purchase private or privatized firms, restructure them, and guide their poor Eastern European cousins into the club of advanced capitalist countries in Western Europe. The West's burden is to contribute its superior technology, management skills, work ethic, and capital to help Eastern Europeans in the transition. Everybody wins in the end.[257]

This is utopian nonsense. *Homo sovieticus* has not disappeared, and support for the right to employment, and economic equality remains high in Eastern Europe, despite the disappearance of the socialist state. There is nothing "artificial" about people wanting to live in a society where everyone has a decent income and economic security. There is no evidence, either, that *homo economicus* is a more natural or desireable creature. Western corporations and governments are playing a large role in the Eastern European transition. Thus far, however, they have shown only their interest in milking Eastern European economies by exploiting cheap labor and new markets. The West has yet to demonstrate any positive impact on the transition process.

The effects of the foregoing factors—western aid, the IMF, and free market ideology—are to bind Hungary to the destructive path of privatization and foreign investment. Thus, the economic policy of the new socialist government is indistinguishable from that of the center-right Democratic Forum coalition it replaced in the 1994 election.[258] This in spite of the fact that the socialists won an overwhelming majority in that election due to popular disgust with rapid privatization and foreign investment.

257. This description of the conventional wisdom about development in Eastern Europe is drawn generally from Bryant, *supra* note 100.

258. Hungary offers more favorable terms to prospective foreign investors than other Eastern European countries, and continues to give foreigners a major role in its modernization program. *See supra* notes 69-74 and accompanying text. The new socialist government is also committed to continuing Hungary's privatization policy. Prime Minister Horn made these guarantees at a "Financial Times" conference in Budapest in late 1994. *Premier and Finance Minister on Foreign Investment*, BBC Summary of World Broadcasts, Nov. 16, 1994, *available in* NEXIS, NEWS Library, CURNWS File. "[Socialist finance minister] Bekesi said Hungary would encourage foreign investment by accelerating privatization of state banks and big utilities in the power and telecommunications sectors." Michael Shields, *Hungary to Start Social Security Reforms in 1995*, REUTERS, Nov. 14, 1994, *available in* NEXIS, NEWS Library, CURNWS File (reporting that Socialists will cut social welfare spending and continue privatization).

The huge gulf between government policy and the will of the majority is evident from the socialist's plans to continue post-1989 privatization and foreign investment practices. Most people are harmed by this practice and do not want it continued. On the other hand, western institutions exert enormous influence on Hungarian economic decision-making. The logical conclusion is that economic decision-making in Hungary is more a function of the desires of western governments and financial institutions than a function of majoritarian desires within Hungary.[259]

IV. The Duration of Massive Inequality

Downward economic trends and inequality will continue into the long-term future as capitalist social relations of production become further entrenched through privatization and foreign investment and become embedded in the legal culture. This reality contradicts the claims of elites (both Hungarian and Western) who argue that the present suffering is a necessary transition preceding the creation of a prosperous market economy in the future.[260] The dominant theory is that Eastern Europe is only behind the West temporally, so success is just a matter of catching up with the West.[261] This theory is correct in the sense that enormous sacrifice is needed to create a capitalist economy. A full-fledged market economy will undoubtedly exist in the near future if Hungary continues to pursue its privatization program and other reforms of the past five years. What is wrong about this neoclassical theory is its

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259. *See* Woodward, *supra* note 150.

260. "All in all, the leading opinions maintained that through abolishing the remnants of the state, a free market would automatically result within two to three years in tangible growth and rising living standards." Bakos, *supra* note 17, at 1191. Of course, what constitutes a "prosperous" or "successful" economy is an essentially contested concept. Many economists measure success by reference to gross domestic product, the strength of the currency, or stock market activity. Other economists take measures of income inequality, homelessness, or infant mortality as indicative of the health of an economy, and hence, a society. The latter criteria are largely dismissed by neoclassical economists. *See supra* notes 232 and 234.

261. Traditional capitalist theory (and hence western economic development theory) holds that private property is the basis for material well-being and political freedoms. For the best and most famous articulation of this argument, *see* MILTON FRIEDMAN, CAPITALISM AND FREEDOM (1962). Friedman argues that private ownership of property is the best way to organize society for production and guarantee personal liberty, because rights to private property are a bulwark against the power of the state. Post-1989 revolutionary reform in Eastern Europe has been largely informed by the works of Friedman and Kornai (*supra* note 164). NOVE, *supra* note 181, at 188. Under this view, every country in the world ought to be able to develop successfully along the pattern established by Great Britain, continental Western Europe, and the United States. The only impediment to successful development is state interference with production relations, which distorts "normal" economic activities and infringes on private property rights, rights which are the basis of freedom.

appraisal of the ultimate success of this system. It *will* exist, but will not be successful, at least not for the majority of the population, for whom the suffering caused by market reforms will have become permanent.[262]

> The ideologues of capitalism say that Hungary can move "from rags to riches" if Hungarians will only make sufficient sacrifices, if they will work hard and accept material deprivation today as the cost of a radiant future tomorrow. The Hungarian dream of upward mobility in the global order is bolstered by the prevailing wisdom that Hungary's development was held back by its communist past, so that shedding that past will automatically bring development. This view simply fails to take into account the problems of late entry into a capitalist world system.[263]

There are a variety of structural "late entry" problems opposing Hungarian efforts to join the West.

First, capitalist development does not exist in a historical and cultural vacuum. Eastern Europe is naively attempting to replicate what it took Western Europe more than three hundred years to accomplish: the construction of reasonably successful market systems in which some amount of personal freedom and social welfare coexist with the free market.[264] But now these Western European countries, with their progeny the United States, exert near hegemonic control of the world economy. The wealthy countries of Western Europe and North America dominate terms of trade and the policies of the international lending institutions.[265] In roughly the last two decades, American hegemony has waned, and the hegemony of free market principles *per se* is now what drives world eco-

262. This result was predicted by Samir Amin less than one year after the genesis of Eastern European revolution. "A significant minority in the East - perhaps 20 percent - might benefit from the restoration of capitalism. But in light of the inadequate levels of development and international competitiveness achieved by the socialist countries, this minority could never attain the Western standard of living that fuels their aspirations without grinding down the mass of people." Samir Amin, *The Future of Socialism*, MONTHLY REV. July 1990, Vol. 42, No. 3, at 10. *See also* KREGEL ET AL., *supra* note 16, at 109-18 for a discussion of this idea:

> The new rulers [in Eastern Europe] and their Western advisors appear to impose the task of repeating the Great Transformation [the transition to capitalism in Western Europe] in a 'Big Leap Forward' on the people in the former command economies. This time it is called 'Shock Therapy' or 'Big Bang.' By 1992, the contention that the new 'Big Leap Forward' will anew end in disaster has become certainty. The increasing weaknesses of the economies to be transformed are now apparent. In none of the transformation economies [has] the decline of production, investment and employment. . . come to a halt or. . . been reversed.

Id. at 109.

263. BURAWOY & LUKACS, *supra* note 227, at 170-71.

264. *See* Waelde & Gunderson, *supra* note 18, at 347 and 349-55.

265. *See generally* AMIN, *supra* note 254.

nomic relations.[266] This creates an almost insurmountable structural barrier to a late entry into the global economy.

Second, the neoclassical vision of economic development (through privatization, price deregulation and foreign investment) introduced to post-1989 Hungary is not a new idea. Before coming to Eastern Europe, this strategy was applied in Latin America and East Asia, with mostly disastrous results. Two countries' recent histories demonstrate how privatization and foreign investment not only magnify inequality, poverty and social tensions within societies, but also wreck long-term economic prospects.

Bolivia, under the tutelage of Harvard economist Jeffrey Sachs, underwent drastic reforms in 1985 to control its hyperinflation. (Sachs became famous in 1990 as the architect of Poland's "shock therapy" program.) Inflation was quickly brought under control, and Bolivia also agreed to open its economy to foreign capital.[267] After 1985, Bolivia privatized most of its economy and deregulated prices. As in Hungary, the IMF encouraged Boliva down this development path.[268] The lasting effects of "shock therapy" in Bolivia have been disastrous. According to Mr. Sachs himself, "Bolivia used to be a miserably poor country suffering from hyperinflation and now it's a miserably poor country without inflation."[269] In 1994, Bolivia was still the poorest country on the continent, and income inequality had grown to extreme levels.[270] Half the popula-

266. *Id.* This is all the more true after the disintegration of the Soviet Union in 1991. Now there is no real alternative to the expansion of capitalist production relations throughout the world. The sad experience of totalitarianism in the Soviet Bloc is popularly understood as the failure of socialism. Thus, socialism today is largely discredited as a viable economic system. Unfortunately, there is no existing or emerging alternative to the "victorious" capitalist system as a way of organizing productive forces in a society.

After the Soviet Union fell apart, "Eastern Europe's resources, land, and people became additions to the area of third world exploitable territories. Members of the Club of Seven now assume that they will indefinitely carry on the governance of financial doings of the planet. Their hold on the world economy . . . is unchallenged. The issue of third world development for them means bringing those regions—perhaps Eastern Europe as well—under the formulas of the multilateral lending agencies [IMF], increasing the austerity and hardship levels in order to reduce the socially necessary cost of labor." Landau, *supra* note 119, at 29.

267. *See Manana,* LAT. AM. WEEKLY REP., May 16, 1986, at 7, *available in* NEXIS, NEWS Library, ARCNWS File; *Bolivia: Economy Becomes Completely Open to Foreign Investment*, EUROMONEY TREASURY MANAGER, Nov. 11, 1990, *available in* NEXIS, NEWS Library, ARCNEWS File.

268. EUROMONEY TREASURY MANAGER, *supra* note 267.

269. Alexander Cockburn, *Beat the Devil*, NATION, Jan. 8, 1990, at 42.

270. WORLD BANK, supra note 254, at 220-21.

tion lives in abject poverty,[271] and the enormous class divisions make civil insurrection a constant threat.[272]

Malaysia is another example of this process. After the IMF imposed strict loan conditions in 1984,[273] Malaysia completely reorganized its economy to attract foreign investment. Like Hungary, Malaysia passed laws giving foreign investors generous tax benefits and guaranteeing them profit repatriation and currency exchange.[274] Malaysia is now "extraordinarily dependant on foreign companies"[275] and is the quintessential example of a foreign investment-led development strategy. Malaysia's economy has grown markedly since embarking on this program. There have even been some declines in poverty in recent years.[276] The World Bank has been quick to congratulate itself on the "success" of this economic development.[277]

What is usually forgotten in stories about Malaysia, however, is the darker side of the foreign investment regime: in Malaysia there is no minimum wage.[278] There are no enforceable workplace health or safety laws.[279] There are no enforceable labor laws.[280] Workers (especially those employed by foreign-owned companies in the huge electronics industry) are "continu[ally] subjected to a myr-

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271. *USA: Sachs Appeal - Simple Economic Solutions*, EUROMONEY, Feb. 13, 1992, *available in* NEXIS, NEWS Library, ARCNWS File.

272. Will Hutton, *Selling the Capitalist Miracle*, GUARDIAN, Mar. 2, 1992, at 21.

273. Donald Shoultz, *Southeast Asia Nations Assail IMF Conditions*, AM. BANKER, Aug. 7, 1984, at 2.

274. Nancy Yoshihara, *Malaysia Looks West to Attract Foreign Investment*, L.A. TIMES, Oct. 2, 1987, § 2, at 2. *See also* P. Prashanth, *Malaysia: Why Foreign Investors Keep Coming*, Inter Press Service, Apr. 3, 1990, *available in* NEXIS, NEWS Library, ARCNWS File.

275. Anatole Kaletsky, *A Way to Break the Dam*, TIMES (London), Mar. 4, 1994.

276. Lokman Mansor, *Malaysia: Another RM200M to Help Hardcore Poor*, BUS. TIMES (Malaysia), Sept. 15, 1993, *available in* NEXIS, NEWS Library, CURNWS File.

277. *Id.* Not everyone accepts the World Bank's story about foreign investment-led poverty reduction in Malaysia, however. Martin Khor, of Malaysia's Third World Network, calls the World Bank "one of the greatest promoters of poverty and environmental destruction in the world." Brad Knickerbocker, *Human Rights Versus Development*, CHRISTIAN SCIENCE MONITOR, June 25, 1992, at 15.

278. MALAYSIAN DEVELOPMENT AUTHORITY, LABOR LAWS IN MALAYSIA: A GUIDE FOR INVESTORS, Oct. 31, 1984. This is a violation of the international labor convention, which requires all countries to establish a minimum wage. *See* INTERNATIONAL LABOUR OFFICE, MINIMUM WAGE FIXING CONVENTION (No. 131) of 1970, SUMMARIES OF INTERNATIONAL LABOUR STANDARDS 47 (1989).

279. Amii Larkin Barnard, *Labor Law in Malaysia: A Capitalist Device to Exploit Third World Workers*, LAW & POL'Y INT'L BUS., Mar. 22, 1992, available in NEXIS, NEWS Library, ARCNWS File.

280. *Id. See also* Lance Compa, *Labor Rights and Labor Standards in International Trade*, L. & POL'Y INT'L BUS., Sept. 22, 1993, at 65.

iad of abuses"[281] and often work in the most deplorable conditions.[282] Women are frequently physically abused and raped while at work.[283] Foreign investors strictly forbid Malaysia's government from improving working conditions, and threaten to take their factories elsewhere if workers are allowed to organize.[284] While absolute poverty may have declined somewhat in Malaysia, the gap between rich and poor is enormous,[285] and the country is a police state.

These negative effects are generally the price to be paid for relying on foreign investment as a route to development. Similarly, Singapore, Hong Kong, and South Korea have all proven that economic success is possible for developing nations—under highly oppressive conditions.[286] Given the recent history of political freedom under Soviet-dominated rule, it is doubtful that any Eastern European government will sacrifice its new-found democratic institutions in order to mimic the authoritarian Asian development model. Unfortunately, it may be impossible for any society to develop a successful western-style capitalist economy without resorting to authoritarian political rule.[287]

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281. Barnard, *supra* note 279. *See also World Workers Body Condemns Malaysia at ILO*, The Reuter Library Report, June 12, 1992, *available in* NEXIS, NEWS Library, ARCNWS File.

282. Barnard, *supra* note 279.

283. *Id.*

284. Russ Arensman, *Malaysia Heads for Labor Showdown*, ELEC. BUS., Sept., 1990, at 45, 50. American companies have been the worst violators of workers' rights in Malaysia. For example, in 1986, General Instrument Corporation told the Malaysian Ministry of Labour that "if there is any union of any kind, it is quite likely that GI corporate will sell this opto-electronic business, and it may mean closing the off-shore plant in Malaysia." *Id.* at 47. American electronics firms ban union brochures and pamphlets from the workplace. Kimori Mai, *Malaysia's Workers - Jolting the Electronics Industry*, MULTINATIONAL MONITOR, Sept. 1989, at 11-12. Motorola also told its employees that the company would relocate if a union was formed. *Id.* at 11.

285. The ratio of income of the richest twenty percent of households to the poorest twenty percent was 11.67 in 1989. The richest ten percent of households received 37.9% of all income. WORLD DEVELOPMENT REPORT, *supra* note 254, at 220-21.

286. *See* William Safire, *Singapoverty*, N.Y. TIMES, Feb. 2, 1995 (critiquing this type of development).

287. Full democracy cannot co-exist with radical economic reform. Economic reform is painful for the vast majority of the population, and if more people see themselves as losers in the transition process or in the new system than see themselves as winners, economic reforms will be rejected in a functioning democracy. Thus, the only way to accomplish radical reform which is painful for a majority of the population is through authoritarian decision-making, which forces the population to accept the economic reforms. This is the story of capitalist development among the "Little Tigers" of Southeast Asia — Singapore, Taiwan, and Malaysia. The World Bank has recently indicated that development under authoritarian conditions may be the only way for poor countries to integrate into the global economy successfully. "Tolerance of inequality is important in shaping attitudes toward reforms. The one value that socialist systems have successfully inculcated is equality, and this value may under-

Third, the neoclassical view dismisses the importance in economic development of access to natural resources, assumes that natural resources are not limited, and ignores the fact that some countries hoard and/or squander these resources to the detriment of other countries.[288] It is no surprise that the West has the biggest slice of the resource pie. It has traditionally maintained its superior position in the distribution of world resources through colonialism (and concomitant resource extraction) and more recently through neo- or economic colonialism. That is, since the emergence of the capitalist system, the structure of world trade and resource flows were at first enforced by the British navy, but after World War II were enforced by the successor to the British navy, the American-controlled Bretton Woods system[289] and, to a lessor extent, the direct or theatened use of the American military and coercion of foreign governments through foreign aid. Capitalist development in Western Europe would probably not have occurred successfully without the massive theft of labor and natural resources from the Americas, Africa and Asia from the 16th to the 19th centuries.[290] Modern Eastern Europeans do not have this luxury. Invading neighboring countries to expropriate resources from them is obviously not a policy option for Hungary and other Eastern European countries.[291] Thus, another ingredient of capitalist development is missing.

A final impediment to "catching up" with the West is the fact that the EC intentionally blocks the entry of Eastern European exports into EC markets.[292] When the Soviet Union disintegrated in

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mine pro-market reforms under conditions of democracy." ADAM PRZEWORSKI, DEMOCRACY AND MARKET 178 (1991).

288. This is an incredible irony in liberal economic theory: human nature is posited as self-interested and acquisitive, and the aggregation of individuals into societies creates self-interested societies which compete for natural resources. Liberal economic theory does not carry this assumption to its logical conclusion, however: some self-interested countries will accumulate a grossly disproportionate share of resources to the detriment of other self-interested countries. The obvious liability upon economic development caused by a lack of resources is not generally considered by liberal economists when applying their theories to Third World or Eastern European development.

289. *See* ROBERT GILPIN, THE POLITICAL ECONOMY OF INTERNATIONAL RELATIONS 131-42 (1987).

290. This argument is explained in ERIC WOLF, EUROPE AND THE PEOPLE WITHOUT HISTORY (1982).

291. Note, however, that Russia can, and still does, get away with maintaining its colonial empire through violent force. *See* Sonni Efron, *Chechen Village Massacre by Russians Cited*, L.A. TIMES, Apr. 14, 1995, at A1.

292. Lionel Barger, *The New Hypocrites*, INT'L ECONOMY, Sept./Oct. 1993, at 26. *See also The New Iron Curtain: Trade Barriers*, BUS. WK., Nov. 7, 1994, at 63. "The Iron Curtain has been replaced by an equally divisive wall of trade barriers between Western and Central Europe. There are twenty anti-dumping measures imposed by

1991, Hungary and other former Soviet bloc countries lost their biggest trading partner. They also partially lost the Council for Mutual Economic Assistance (CMEA)[293] trading structure that kept some state enterprises going. The wealthy EC, which has officially pledged its support to helping the region develop, has not helped Eastern Europeans compensate for the loss of their traditional CMEA markets by lowering EC trade barriers against products from the East. The EC, in fact, has no real desire to help the former Soviet bloc countries at all.[294] The EC wants Eastern Europe to be successful enough so that EC companies can profit from investments there, but not so successful that Eastern European products will genuinely compete for market share in the West. For a variety of reasons, then, while privatization and foreign investment-centered reform can speed economic growth, this route to the market will not substantially improve most people's quality of life in Eastern Europe.

V. Alternatives to the Present Course

The state socialist systems of Eastern Europe were clearly in great need of reform.[295] Unfortunately, the course of capitalist development over the last five years has ignored the question of distributive justice,[296] and has increasingly blocked democratic

the European Union in place. Central Europeans are shut out of German, Italian, and French agriculture, steel, and textile markets." *Id.* *See also* Whitney, *supra* note 5. "East European officials complain that when their companies can produce goods more cheaply than Western competitors, West European governments protect their industries by imposing tariffs or punitive quotas on the East Europeans." *See also* ECONOMIST, *supra* note 146. "Meanwhile, western countries have been inexcusably cautious in opening up to exports from the East." *Id.*

293. Regional trading organization set up by the Soviet Union in 1949 and imposed on the Soviet bloc countries of Eastern Europe as a way of increasing economic specialization and economic interdependence. SCRUTON, *supra* note 11, at 75.

294. Barger, *supra* note 292.

295. State socialism produced some victories in terms of distributing material resources to guarantee social welfare, but did so through an oppressive top-down centralized planning mechanism which disallowed democratic participation in the economy. State socialism is completely bankrupt as an organizing principle and has been rejected by majorities in every country in East Europe, including Hungary. Most people prefer the old social welfare guarantees to the new free market poverty and uncertainty, but almost no one wants to return to the oppressive dictatorial aspects of the state socialist system. A further catalyst for reform is the fact that the old system was organized, both politically and economically, by the Soviet Union, which no longer exists. Eastern European countries lost their biggest trading partner in 1991, and cannot return to the old system which largely revolved around the Soviet Union.

296. "[P]overty, unemployment, inequality, social justice and the principles of democratic governance have not been addressed effectively in the past five years and . . . policies relating to those issues have not been integrated into economic policy and structural reform." INTERNATIONAL LABOUR OFFICE, EDITORIAL: UNEASY PATHS TO

participation in economic decision-making as well.[297] The post-1989 transitional regime of privatization through massive foreign investment is both counterproductive to the goal of sustainable economic progress and out-of-sync with popular concepts of democracy and justice. Hungarians, for example, value the economic elements of democracy much more than its political elements.[298] Everywhere in Eastern Europe "majorities define democracy in primarily economic terms."[299] Any alternative to the present course must therefore concentrate on providing social welfare for all citizens. This can only be accomplished through an active state sector.[300] The current transformation process is failing, in large part, because it has ignored this indigenous conception of democracy. Instead, it has imposed a western-style free market economic and political system onto Eastern European societies,[301] creating an artificial polit-

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SOCIAL JUSTICE, NEWSLETTER, CENTRAL AND EASTERN EUROPEAN TEAM, Budapest, June 1994, at 3.

297. *See generally* Daniel Singer, *Ex-Communists and Rough Beasts*, 259 NATION, No. 16, Nov. 14, 1994, at 580. "What we have been watching in the past five years throughout the East is a battle for power and property between privileged elites, with the working people occasionally striking to defend their own immediate position and at other moments being used as electoral fodder." *Id.*

298. This fact is unequivocally demonstrated by opinion polls in Hungary which asked people to describe which thing is most important in a successful democracy. Twenty-six percent said: "A government that guarantees that basic economic needs of its people will be met." Nine percent said: "A government that guarantees economic equality among its citizens." On the other hand, this survey found little support for the traditional western conception of political democracy, revealing that only three percent believed that having "at least two strong political parties competing in elections" was the most important thing in a democracy, and only two percent thought that "freedom to criticize the government" was the most important thing. Mary E. McIntosh & Martha Abele Mac Iver, *Coping With Freedom and Uncertainty: Public Opinion in Hungary, Poland, and Czechoslovakia 1989-1992,* INT'L J. PUBLIC OPINION RESEARCH, Winter 1992, at 375, 382. This data is from United States Information Agency (USIA) surveys conducted in Eastern Europe from November 1991 to January 1992. (The Hungarian survey questioned 999 adults and all surveys contain a margin of error of four percentage points.) This strong support for the economic meaning of democracy was found in every other country surveyed (the Czech Republic, Poland and Slovakia) as well. *Id.*

299. *Id.* at 387-88.

300. "Stemming poverty in this period of unprecedented structural change can only be a public affair. *There is no valid alternative to rising social expenditure shares of GDP throughout the transition period.*" INTERNATIONAL LABOUR OFFICE, CENTRAL AND EASTERN EUROPEAN TEAM, NEWSLETTER, STEMMING TIDES AND BUILDING BRIDGES - SOCIAL PROTECTION DURING TRANSITION, Budapest, June, 1993, at 2.

301. Workers had no voice in economic decision-making during state socialism, and they have none now, after five years of reform. Both actually existing socialism and free market capitalism have failed to put into practice any notion of workplace democracy. In 1956, two thousand Hungarian workers died over that issue, but now that state socialism is finally gone, the spirit of that revolution has not returned. *See supra* note 61 (discussing the origin of the 1956 uprising and its agenda). Instead, a cheap and superficial form of "freedom" is emerging. This type of freedom limits popular participation in decision-making to an election held every several years, in

ical ethos that emphasizes values like voting,[302] competition of political parties,[303] and free speech.[304]

The essential core, therefore, of successful reform in Eastern Europe should be the institution of *economic* democracy, not just *political* democracy.[305] This goal must be put ahead of neoclassical standards for measuring the health of an economy[306] and a society. The Hungarian government should, therefore, reevaluate its commitment to foreign investment and privatization in light of these policies' social welfare effects. Any reformulations of the reform project must consider two broad issues with regard to privatization and foreign investment. First, are either necessary?[307] Second, if they are, how should they be put into practice?

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which the populace chooses which representatives of the upper-class (sometimes former socialists, sometimes former dissidents) will run the country until the next election. The West heralds this "freedom" as proof of the superiority of its system. But the freedom to speak, travel, vote—all of the West's political ethos—is empty rhetoric if economic development serves only the interests of the richest quarter of the population.

302. The USIA data, *supra* note 297, confirmed that Hungarians do not perceive the freedom to vote for candidates from competing parties as very important. Seventy-three percent of respondents disagreed with the statement "Voting gives people like me some say about how the government runs things." McIntosh, *supra* note 298, at 381.

303. *Id.* at 382.

304. *Id.*

305. *See* Standing, *supra* note 245, at 16.

306. *Id.* The classical liberal measures of economic success in developing countries are balance of payments, currency convertability, the level of autonomy of the banking system, the level of private ownership of the means of production, the flexibility of wages and prices. These factors are not really connected to the overall level of human welfare in a country, and are certainly not connected to the distribution of wealth therein. *See also* notes 232 and 234.

307. Of course, it is impossible to answer these questions without reference to a goal for the economic structure of society. I explore these problems starting with the assumption that any society with permanent and massive disparities in income levels is undesireable. The question I frame here is thus "what type of economic reform can be achieved without marginalizing large segments of the population?" I assume that near-absolute income equality is not a goal worth pursuing because of the obvious impossibility of redistributing wealth on regular basis. The goal I have in mind, which underlies this discussion of alternatives to the present course, would consider as a maximum tolerable amount of inequality a decile ratio of around 3, or slightly higher than that achieved under state socialism. In other words, the average income of the top 10% of households should not be more than three times greater than that of the bottom 10% of households. *See supra* note 182 for a discussion of the decile ratio. This measure of inequality is meaningless, of course, if overall economic conditions are so deplorable that most everyone is in poverty. Many western free-market advocates decry the "shared poverty" of socialism. In Hungary, however, this was never a reality. Under early state socialism Hungary experienced enormous economic growth and living standards comparable to those of Austria and the poorer OECD countries, such as Greece and Portugal. Societies which emphasize economic equality do not have to exist in "shared poverty." Sweden is the obvious example. Conversely, societies emphasizing individual opportunities are not necessarily wealthy, and in fact, most capitalist countries are impoverished and have op-

Under state socialism, even in liberal Hungary, the state owned and operated the bulk of the economy, even enterprises as small as corner grocery stores, coffee shops, and cinemas. This type of micro-management of the country's economic life was an absurd outgrowth of state socialism's official ideology. It seems clear that some amount of private enterprise was an inevitable result of the 1989 revolutions. Small-scale privatization (and new business creation) occurred naturally after 1989, because of the relatively small amounts of capital required. The creation of small new businesses has somewhat offset the simultaneous rise in unemployment and poverty. While it was an absurdity for the state to intervene at this micro level, the "commanding heights" of the economy definitely benefited from state ownership and direction throughout most of socialism's forty year reign in Hungary.[308] The question of ownership and control of large-scale enterprises and industry was, and remains, a very different problem than that of ownership of the corner grocery store. Even assuming that privatization was necessary at the large-scale enterprise level, however, it could have been effected more incrementally, so as to mitigate the harm (in terms of unemployment and poverty creation) due to sudden layoffs. The state should have phased in restructurings, lay-offs and plant closings over a longer period, lessening the human costs of transition.

It also possible that Hungary may be unable to join the West without substantial privatization through foreign investment. If so, then, the creation of massive inequality and poverty is the price to be paid for entry into the club of advanced capitalist countries.[309]

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pressive political systems. Almost all of Latin America and parts of Asia are examples of this condition.

308. State ownership created enormous economic growth in Hungary after World War II. The command economy brought Hungary into the twentieth century and significantly raised living standards. Hans-Magnus Enzenberger observed the following in Hungary in 1985:

> Hardly anyone remembered that before the Second World War there had been millions of agrarian proletarians in Hungary living below subsistence level, without land or rights. Many emigrated to find salvation; hundreds of thousands wound up as beggars. . . After bitter conflicts and endless argument, the Kadar regime has definitely closed the gap between town and country and made possible an agricultural specialization that achieves large surpluses. . . . Hungarian socialism has put an end to misery and servitude and achieved its most revolutionary successes.

David Schweickart, *Economic Democracy: A Worthy Socialism that Would Really Work*, 56:1 SCIENCE & SOC'Y 12 (Spring 1992).

309. It is also possible that poverty and social and economic inequality are to some extent unavoidable under any development scenario. Of course, even if this is the case, the economic policies chosen by the Hungarian government will either mitigate or exacerbate this suffering, and will determine which groups bear the burden of most of it.

Hungary, along with the Czech Republic and Poland, seems to be set on the route to EC membership. The only question is whether the social costs of this path to the free market will create social tensions that cause the total collapse of the reform project, thereby also destroying the liberal political project in these countries.[310] Ultra-rightist and nationalist movements may then form the next governments in much of Eastern Europe.

(a) *Worker Ownership*

The remaining state enterprises should either not be privatized, or be privatized in a more democratic and redistributive manner[311] through worker buy-outs or, as a last resort, by groups of Hungarian investors.[312] Both post-1989 Hungarian governments have dismissed worker ownership as an option because western governments and local elites share an ideology of reform opposed to any type of collective ownership.[313] But limited experience since 1989 reveals that worker ownership can be economically and socially successful in Hungary,[314] and can avoid the more deleterious

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310. McIntosh, *supra* note 298, at 388.

311. Standing, *supra* note 245, at 17. "[T]he process of privatisation offers the great, and possibly fleeting, prospect of creating a new basis for redistributive justice and economic democracy, and in the process providing one major source of income for a citizenship income guarantee, without which 'social consensus' is likely to be a new euphemism, describing a process by which a large mass of losers are policed in the interest of the winners or perceived winners in the market economy." *Id.* at 16-17. For examples of how this new euphemism works, *see* Lisa Pope, *Riot Report Finds Watts Similarities*, HOUSTON CHRON., Oct. 23, 1992, at 20, and Carla Rivera, *Riots' Causes Same as in '60s, State Panel Says*, L.A. TIMES, Oct. 2, 1992, at A1.

312. This latter suggestion (Hungarian investors) solves only half of the problem, however. It keeps more profits in the country, thus slowing decapitalization, but does not mitigate growing income inequality within Hungary itself.

313. Maurice Glasman, *The Great Deformation: Polanyi, Poland, and the Terrors of Planned Spontaneity*, at 203-06 (cited by Bryant, *supra* note 100). *See also* BURAWOY & LUKACS, *supra* note 227, at 23. Some workers also initially rejected the idea of worker ownership because they associated it with the old state socialist ideology. Even Lech Walesa sold-out the Solidarity agenda of 1979-1980 (which demanded worker democracy) in favor of IMF-inspired "shock therapy" (which rejected worker democracy). Glasman, at 206. Worker ownership has nothing at all to do with state socialism, and emphasizes a de-centralized economy rather than a centralized one. There is a law providing for employee buy-outs of state enterprises (Act XLIV of 1992). It has not resulted in much growth of worker owned firms, however, because the government favors foreign investment.

314. *See generally* Robert Wisner, *A Socialist Shortcut to Capitalism? The Role of Worker Ownership in Eastern Europe's Mass Privatizations*, 19 N.C. J. INT'L L. & COM. REG. 123, 129 (1993). In 1993, Hungary successfully sold the country's oldest continuously operating factory, the Herend Porcelain Manufacturing Company, to its 1,500 employees. Judith Ingram, *Capitalism is Cast in Hungarian Porcelain*, N.Y. TIMES, July 10, 1993, at 41. The workers' decided to buy Herend and run it themselves to stop management's plan to enter a joint venture with a foreign investor. BURAWOY & LUKACS, *supra* note 227, at 164-65.

effects of the current privatization through foreign investment strategy.[315] The sale of state enterprises to workers is a radically different type of privatization.[316] Worker ownership offers many advantages over traditional capitalist investor-ownership created through privatization and sales to foreigners.

First, the income distribution produced by cooperative ownership is more egalitarian.[317] In fact, worker ownership "may be the only means of realizing a relatively equitable society."[318] Worker ownership may thus mitigate the growth of inequality in the transition process.[319] This is because workers typically elect the firm's management, and the median voters are blue-collar workers. When wages are determined democratically, therefore, there is less disparity between the top and bottom pay scales. The level of income equality both within firms and throughout society is important because income distribution is still a salient value in Hungarian society.[320]

Second, because labor productivity is related to equity in the firm's internal pay schedule,[321] worker ownership is likely to increase this labor productivity. People work harder if they believe that their wages are more a function of the amount of work they do than a function of their rank in the firm's managerial hierarchy.[322] This is especially true in the Eastern European transition economies.[323] Further, worker ownership does not harm productivity or growth, at least not any more than does capitalist corporate owner-

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315. Wisner, *supra* note 314, at 123. My analysis of the feasability and desirability of worker ownership in Hungary is drawn primarily from this work.

316. *Id.* at 124.

317. Saul Estrin, *Some Reflections on Self-Management, Social Choice, and Reform in Eastern Europe*, 15 J. COMP. ECON. 349, 356 (1991). A recent study of wages and salaries in the Italian cooperative sector revealed that the ratio of managers' pay to unskilled workers' pay was only 1.67. In the privately owned sector, this ratio was 2.86. *Id.* at 357.

318. Wisner, *supra* note 314, at 141. The adverse effects of restructuring (layoffs, decreasing wages, loss of job security) would probably be suffered more gradually under a worker-ownership scheme, giving displaced workers time to plan for the future and retrain or find other employment.

319. *Id.* Traditional investor ownership in a capitalist economy does not promote egalitarian income distributions because "corporations plan for their own benefit, for their own profit at the expense of whoever bears the cost." William Dugger, *Democratic Economic Planning and Worker Ownership*, 21 J. ECON. ISSUES 87, 93 (1987).

320. *See* McIntosh, *supra* note 298. Hungarians support need-based or equitable pay scales both in absolute terms and relative to the West. *Id.*

321. Estrin, *supra* note 317, at 359.

322. Witztum, *supra* note 186, at 98.

323. *Id.* at 97-98.

ship.[324] Worker owned firms probably also have some important efficiency advantages over investor-owned firms.[325]

Third, worker participation in tough economic decisions mitigates dissatisfaction with economic hardships and strengthens political stability. No matter how economic reform proceeds in Eastern Europe, some tough times are ahead for at least the near future. Difficult allocative economic decisions (layoffs and wage decreases, for example) are often required in firms, but the workforce accepts these decisions as more legitimate when workers themselves have a hand in making those decisions. This legitimacy will further the development of social and political stability, because most frustration at the government now is due to the perceived arbitrary and unjust distribution of economic hardship.[326] A related point is that the development of democracy in Eastern Europe may be frustrated without worker-ownership.[327]

Fourth, because workers share the profits of worker-owned firms, they have an interest in effectively monitoring each other and their management. This monitoring enhances economic performance. Worker ownership "may therefore also offer some discipline of management when private capital markets are weak,"[328] as they are in Hungary.

Fifth, the relative absence of strikes and labor disputes in worker-owned firms increases efficiency and productivity both at

324. Estrin, *supra* note 317, at 352. *See also* Avner Ben-Ner and Derek C. Jones, *The Productivity Effects of Employee Participation in Control and in Economic Returns: A Review of the Literature and Some Policy Implication for Emerging Market Economies*, *in* Working Paper (Industrial Relations Center, University of Minnesota, and Department of Economics, Hamilton College).

325. Henry Hansmann, *Worker Participation and Corporate Governance*, 43 U. OF TORONTO L. J. 589, 595 (1993). "Profit-sharing incentives, mutual and delegated monitoring, better training, and less alienating work — these factors all tend to enhance workers' effort and dedication, so much so that it is likely that LM [labor-managed] firms are in fact *more* X-efficient [internally efficient] than CM [capital-managed] firms; that is, they can achieve higher productivity with lower supervisory costs and higher worker satisfaction." Marc Fleurbaey, *An Egalitarian Democratic Private Ownership Economy*, 21 POL. & SOC'Y 215, 220 (1993). There is also evidence that movement toward greater equality in society as a whole leads to economic growth superior to that produced by societies with greater disparities in income. This contradicts the traditional neo-classical assumption of an "equality-efficiency trade-off." David Gordon et al., *An Equality-Efficiency Trade-off?*, DISSENT, Fall 1990, at 510-12.

326. *Id.* at 354.

327. Owen Fiss, *Capitalism and Democracy*, 13 MICH. J. INT'L L. 908, 917 (1992). "After laboring in a hierarchically organized workplace for eight hours, without any real say in the structure or performance of his or her tasks, the citizen is unlikely to have, or be inclined to exercise, the independence of judgment and critical acuity essential to democratic politics." *Id.*

328. *Id.*

the firm level and in the economy at large.[329] This is particularly important in Eastern Europe, which witnessed the devastating effects of labor disputes in the Polish economy after the Mazowiecki government introduced massive "shock therapy" privatization and deregulation in 1990.[330] Violent labor unrest due to market reforms is also a recurring event in the Romanian mining industry.[331] Hungary has not experienced large-scale labor unrest after 1989, but the potential for it is clear as workers become increasingly embittered by unemployment and declining real wages. A taxi drivers strike in Budapest in 1990 showed that concerted action by only a few hundred people could almost completely shut down the city's economic life.[332]

Finally, creating a democratic economy based on worker ownership is manifestly feasible in Eastern Europe because the law of property rights is still unsettled. There is a unique opportunity to draft laws that promote conceptions of property conducive to worker ownership and the creation of a more egalitarian economy. Conversely, worker ownership in the West has faced difficult barriers because there it is difficult to "unbundle"[333] entrenched legal concepts of property to create the conditions in which worker owned firms can prosper.[334]

There are two main criticisms raised against worker owned firms. One criticism is specific to the Eastern European transition economies. If Hungary is going to join the West and compete in a world market, some modernization and restructuring is necessary. Worker owned firms, however, do not have the capital to restructure and modernize factories to put production on a level capable of competing with the West. Opponents of worker ownership argue that privatization without foreign investors is thus impossible be-

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329. Estrin, *supra* note 317, at 360. *See also* Will Bartlett et al., *Labor-Managed Cooperatives and Private Firms in North Central Italy: An Empirical Comparison*, INDUS. & LABOR REL. REV. (1992), at 116.

330. *See* Jeff Madrick, *Poland's 'Big Bang': Too Much Too Fast?*, N.Y. TIMES, May 20, 1990, at 13.

331. *See* Roxana Dasculu, *Romanian Government Faces Winter of Strikes*, REUTER EUR. BUS. REP., Nov. 16, 1992, *available in* NEXIS, NEWS Library, ARCNWS File.

332. Cab and truck drivers protesting a dramatic rise in gasoline prices completely blockaded all six road bridges crossing the Danube River in Budapest for three days in October 1990. The government was forced to back down and partially rescinded the price increase. *See* Carol Williams, *Hungary Forced to Pull Back on Huge Gas Price Boost: Taxi Drivers, Truckers Agree to Suspend a Crippling Blockade*, L.A. TIMES, Oct. 29, 1990.

333. Dugger, *supra* note 319, at 95-97. Property rights are not an indivisible entity. They can be unbundled and "reallocated or rescinded entirely. Unbundleing can penetrate into the very heart of corporate capitalism and reallocate rights to workers and to democratic planners in an orderly fashion." *Id.* at 97.

334. *Id.* at 95-97.

cause Hungarians have only a small share of the capital needed to buy-out and restructure all the enterprises the state wants to sell. This argument is at least partially correct,[335] but usually overstated, and wrongly concludes that state enterprises had to be sold for cash to foreign investors. State enterprises could have been given to workers, or sold to them at deep discounts, or sold to foreign investors as minority stockholders. Also, many state enterprises were already profitable and needed no restructuring to compete in western markets. The claim that state owned enterprises were so inefficient that they would all immediately fold without massive upgrading is simply false. About one-third of the Hungarian state sector was profitable and could have been privatized through worker ownership without any foreign investment whatsoever. Unfortunately, almost all these profitable firms were sold to foreign investors. The remaining state owned firms which need restructuring to compete in the West can raise only limited amounts of capital from Hungarian investors. To the extent that international financial institutions are unwilling to lend money to workers, the state should maintain public control over private investments by requiring the Hungarian banking system to finance worker buy-outs.[336] This is not a return to the old state socialist planning mechanism, but a way of making ownership transition feasible. It is hard to imagine that the effects of this could be much worse than the aforementioned long-term disadvantages of foreign control of the economy. If anything, this proposal would give new worker-controlled firms several years to emerge, restructure their enterprises, and prove themselves, rather than providing them with a continuous subsidy, as under state socialism.

The other major criticism is one raised against worker ownership everywhere: workers, even when they do possess sufficient capital, will refuse to invest it in the firms they own because they themselves may not see the benefits of that investment in their own lifetimes.[337] Thus, the investment time horizon of worker owned firms is extremely narrow and lack of investment causes these firms to become inefficient and outmoded.

335. Total Hungarian savings were only around two billion dollars in 1990, but the value of state assets the government wished to privatize at that time was around 30 billion dollars. David Fairlamb, *Eastern Europe: Grow Your Own Institutional Investors*, INSTITUTIONAL INVESTOR (Reuter Textline), Aug. 31, 1990, *available in* NEXIS, WORLD Library, ALLWLD File.

336. *See generally* Fleurbaey, *supra* note 325.

337. Jensen & Meckling, *Rights and Production Functions: An Application to Labor-Managed Firms and Codetermination*, 52 J. BUS. 469 (1979).

This is an empirically baseless attack which the western press and mainstream opinion has echoed for years.[338] The experience of worker owned firms clearly refutes this criticism. An empirical study of Italian firms, for example, showed that "there was virtually no difference between cooperatives and private firms in the time period over which investments were evaluated."[339] Similarly, worker owned firms have prospered for decades without this under-investment problem.[340] There are examples of successful worker-owned firms in France, Israel, Italy, Spain, and Sweden that can serve as models for Eastern European development along this path.[341] Also, because the median worker will stay with a firm for fifteen or twenty years, the firm's time horizon is probably not that low after all.[342] An investment horizon of fifteen years is actually longer than that of most traditional investor-owned firms.[343]

(b) Regional Trade

Second, the countries of Eastern Europe should expand their regional trading arrangements. The Visegrad Treaty[344] of 1992 strengthened economic cooperation among the Czech Republic, Hungary, Poland and Slovakia, but has not gone far enough in promoting regional cooperation. Since 1989, the countries of Eastern Europe "have been locked in a battle to lure the biggest foreign investments. . . "[345] That is, the competition for foreign investment creates a kind of race to the bottom in terms of tax holidays, lower wages and other concessions to foreign companies. This competition discourages true economic development, frustrates workers'

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338. "For example, virtually every article on employee ownership ever published in an American law review cites the classic article by Jensen and Meckling. . . which 'proves' that labor-managed businesses would be so inefficient that no investor would ever lend money to them." Alan Hyde, *In Defense of Employee Ownership*, 67 CHI.-KENT L. REV. 159, 175 (1991). If anyone ought to understand the benefits of worker ownership, it is American lawyers, who commonly organize themselves in worker-owned firms. All of the professional classes seem to favor worker ownership for themselves, while claiming it will not be practical for blue-collar or unskilled workers.

339. Bartlett, *supra* note 329, at 112.

340. *See generally* Hansmann, *supra* note 325.

341. Henry Hansmann, *When Does Worker Ownership Work? ESOPs, Law Firms, Codetermination, and Economic Democracy*, 99 YALE L.J. 1749, 1759. "[T]here are in fact a great many successful, long-lived, employee-owned and managed firms in the United States and elsewhere. These firms have survived without government subsidy, often in hostile environments." Hyde, *supra* note 336, at 168.

342. Hansmann, *supra* note 341, at 1774.

343. *Id.*

344. *See generally* Andras Inotai & Magdolna Sass, *Economic Integration of the Visegrad Countries*, E. EUR. ECON., Nov./Dec. 1994, at 6.

345. Laura Zelenko Bloomberg, *Competition vs. Cooperation in Eastern Europe*, FIN. POST, Mar. 1, 1995, at 45.

rights, and depresses wages, all of which will harm the countries of Eastern Europe into the long-term future. Hungary must, therefore, encourage the development of regional agreements regulating the terms of foreign investments. This might allow Eastern Europeans to strengthen their bargaining positions *en banc* against Western investors, and demand fair prices and decent working conditions from western owned firms.

Related to this is foreign trade. Hungary and its neighbors should develop their own trading arrangements to prevent the EC from exploiting them individually.[346] This would benefit Eastern Europe as a whole and decrease reliance on trade with Western Europe, thereby reducing the amount of economic coercion Western Europeans can apply in the East.

Conclusion

This article has attempted to analyze the post-1989 free market revolution in Hungary, focusing on the human costs of this process. The dominant events in this historically unique market transition are privatization and foreign investment. These two events are important both as practices and as ideologies. In practice, market reform over the course of the past five years has been a monumental disaster in terms of its impact on social welfare. As ideology, these ideas have inhibited the development of a more democratic and egalitarian version of economic transformation.

Although economic reform was necessary following state socialism's collapse, identifiable factors have prevented a deliberate and gradual reform that could have mitigated at least the more outrageous suffering visited upon large numbers of people in Hungary and elsewhere in the region. Western aid and international financial institutions have perpetuated ideologically-based reforms and aggravated the harms resulting from this economic transformation. Future reform efforts should take more seriously the human costs necessarily implicated in an economic reform program. In the long-run, even the political democracy established after the revolutions in Hungary and in the rest of Eastern Europe will be threatened if today's patterns of inequality continue into the future.

346. "The non-aligned nations have not utilized their collective potential to bargain for a more just system and instead have capitulated individually to the great enforcers of third world 'free enterprise:' the International Monetary Fund [IMF] and the World Bank." Landau, *supra* note 119, at 29. Hungary signed the the Central European Free Trade Agreement (CEFTA) in December, 1992, and ratified it in September, 1993. *Hungarian Parliament Ratifies Central European Free Trade Agreement*, Agence France Presse, Sept. 8, 1993, *available in* NEXIS, NEWS Library, CURNWS File. CEFTA will gradually dismantle trade barriers among Eastern European countries. The CEFTA was signed by all the Visegrad countries. *Id.*