THE HUNGARIAN TRANSITION EXPERIENCE, 1989–2006: LESSONS FOR CUBA

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Multi-country transition studies, by their very nature, tend to mask issues and strategies that were pivotal in the path of specific countries. For this reason it is crucial to rely more on case studies of country experiences, like Hungary's, to gain a detailed understanding. Consequently, the successful Hungarian transition experience during 1989–2006 is discussed in this paper.

Why do we think that the Hungarian experience is relevant for thinking about the Cuban transition? Hungary is the third largest economy in Central Europe, after Poland and the Czech Republic. The country shares many similarities with Cuba: a population of 11 million inhabitants, a midsize economy, historical development elements like: central economic planning, modernization attempts from above, import substitution strategies, a high development of its human capital (especially in education), a very advanced social service sector for its level of economic development; a high foreign indebtedness, a high external dependency, a high energy vulnerability, and a similar peripheral situation in the international economy. Hungary's cultural homogeneity has been a major factor determining a peaceful transition without the explosion of centrifugal social or ethnic forces.

CONDITIONS IN HUNGARY IN 1989: THE "GOULASH" SOCIALISM EXPERIENCE

In 1989, the Hungarian economy had some characteristics that distinguished it from the other socialist countries in Central and Eastern Europe, including the former Soviet Union: (a) a small, but dynamic, private and cooperative sector in agriculture, manufacturing, construction and services activities that had begun in 1982 and generated approximately 10% of GDP; (b) a public sector and state owned-enterprises (SOE) with some degree of autonomy where the central controls were through indirect means, such as: subsidies, taxes, restrictions to imports, etc.; (c) rationing and queues were less common than in other socialist countries and there was no significant monetary overhang because consumer prices were progressively increased and liberalized for 80% of total consumer goods; (d) important foreign trade with Western economies, especially with Western Germany; and (e) stable and good relations with the IMF and the World Bank since its 1982 accession. Hungary received several loans and technical assistance from them, particularly in the areas of banking and monetary reforms and tax reforms. (f) Also, as of July 1989, Hungary received support from the European Union (EU) to reconstruct the economy through PHARE (*Pologne, Hongrie, Assistance à la Restructuration Economique*). See Figure 1.

THE BEGINNING OF THE SYSTEMIC CHANGES AND THE TRANSFORMATIONAL RECESSION, 1989–1995

Hungary chose a gradual, but continuous and fast-paced, reform process to establish a European social market economy instead of the "big-bang" followed by other former socialist economies, such as: Bulgaria, Czechoslovakia, East Germany and Poland. The objective was to avoid the high social costs that they

Figure 1. Hungary: Some Important Economic Reforms Prior to the Beginning of the Transition Process

Year	Measures
1968	Establishment of the New Economic Mechanism that began simultaneously with the so-called Prague's Spring. Resumption of private agriculture (the agricultural markets and production showed great dynamism)' partial autonomy given to SOEs; establishment of taxation for SOE income.
1971	Partial recentralization of large SOEs (reversion of the 1968 measures).
1972	The SOEs would have a ceiling on wages (the wage-fund control) to limit the number of employees and to reduce wage increases.
1979	Price reform to simulate international prices.
1981	Legalization of small private-owned enterprises.
1982	Entrance into international financial institutions (IMF and World Bank). Hungary received the first loan from the IMF in 1982 and from the World Bank in 1983. The exchange rate was unified for trade and tourism transactions.
1985	Self-governing councils were established for the SOEs and they chose their own management. Consumer prices continued to increase.
1986	The bankruptcy law was approved.
1987	Elements of a monetary policy were started. Commercial bank operations were separated from the central bank.
1988	Extensive price liberalization; a tax reform was implemented to emphasize the personal income tax and the value added tax, as well as to eliminate ad-hoc taxes; subsidies were reduced. Foreign investment with 100% ownership was authorized and protected from nationalization and expropriation. A new law for private enterprises was approved.
1989	The transformation law was approved and the corporatization of the SOEs was initiated.

Figure 2. Hungary: Main Objectives and Policies at the Beginning of the Transition

Horizon	Objective	Policy Instruments
Short-term	Macroeconomic balance	Balance the budget (eliminating the fiscal deficit); restrictive monetary policy; competitive exchange rate; to continue external debt servicing.
	Liberalization	Continue eliminating subsidies and liberalizing prices; relax imports restrictions.
	EU Association	Conclude negotiations to join the EU as associate member.
Medium-term	Institutional development	Establish and develop fundamental financial institutions (commercial banks, pension funds, insurance companies, and equity and markets). Develop and support a competition policy.
	Ownership change (privatization)	Privatize SOEs, land, housing; compensate, but not to restitute, former owners.
	Labor market reforms	Develop new mechanisms for unions and to promote collective bargain negotiations.
	Prepare for EU accession	Adopt the EU standards, practices and policies.
Long-term	Accession to the EU	There were no specific policies, but it was understood that it would depend on Hungary's future performance.

associated to such process. The transformation strategy had long-term elements (to joint NATO and the EU), medium term elements (microeconomic, structural and institutional changes), and short-term elements (macroeconomic changes). (See Figure 2). A decision was made that the country had to export more and to attract foreign direct investment or it "would perish" given its high external foreign debt, mainly with Western commercial banks, which it decided to continue to serve. Later on, however, the civil society organizations represented in SAPIM (see below), considered that the process of reforms was too fast.

The newly-elected democratic government began a gradual but determined reform process in March 1990 with support from the IMF and the World Bank to achieve the external balance that was in increasing difficulties due to the negative impacts of the First Gulf War, the collapse of the COMECON and the fiscal deficit associated with the transformational recession. The initial program of reforms, the Kupa Program, included measures to establish the fundamental financial institutions of a market economy, requiring from them international standards for capitalization, accounting and provisions for bad loans, accompanied by the establishment of an independent Central Bank. A new, draconian bankruptcy law was approved, which mandated that an SOE that did not pay its debts after 90 days had 8 days to declare bankruptcy, in which case it had to be restructured or liquidated. The maximum amount of loans that the Central Bank could provide to the Central Government was limited to 3% of the budgetary income and the rest had to be financed through bonds. 84% of the prices were liberalized and the Office of Price Control was transformed into to one to promote commercial competition. The forint became convertible for all current account transactions.

During the initial liberalization, the inflation grew at an annual average rate of 27.4% in the four-year peri-

Table 1. Hungary: Macroeconomic Indicators, 1989–2006

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 Estimate
Output and expenditure																		
GDP	0,7	-3,5	-11,9	-3,1	-0,6	2,9	1,5	1,3	4,6	4,9	4,2	6,0	4,3	3,8	3,4	5,2	4,1	3,9
Private consumption	na	-3,6	-2,7	0,0	1,9	0,2	-7,1	-3,0	1,7	4,6	4,8	5,0	5,7	9,8	7,8	3,2	3,8	1,2
Gross fixed capital formation	na	-7,1	-10,4	-2,6	2,0	12,5	-4,3	6,7	9,2	13,2	5,9	7,7	5,1	10,1	2,1	7,7	5,6	-1,8
Exports of goods and services	na	-5,3	-13,9	2,7	-10,3	13,6	48,2	12,1	22,3	17,6	12,2	21,0	8,1	3,9	6,2	15,7	11,6	18,0
Imports of goods and services	na	-4,3	-6,1	0,7	20,0	8,8	22,3	9,4	23,1	23,8	13,3	19,4	5,3	6,8	9,3	14,1	6,8	12,6
Industrial gross output	-5,0	-9,3	-18,4	-9,7	4,0	7,8	4,3	3,6	12,8	13,7	7,2	9,6	0,4	1,8	5,9	3,9	4,3	8,6
Agricultural gross output	-1,8	-4,7	-6,2	-20,0	-9,7	3,2	2,6	6,3	-3,3	0,6	0,9	-7,9	16,5	-9,8	-0,7	54,4	-2,4	-6,1
Employment																		
Employment (annual average)	-0,7	-3,3	-10,3	-4,4	-11,7	-2,0	-1,9	-0,8	0,0	1,4	3,1	1,2	0,3	0,1	1,3	-0,3	0,2	0,9
Unemployment (end-year)	0,5	1,4	8,2	9,3	11,9	10,7	10,2	9,9	8,7	7,8	7,0	6,4	5,7	5,8	5,9	6,3	7,3	7,5
Prices and wages																		
Consumer prices (annual average)	17,0	28,9	35,0	23,0	22,5	18,8	28,2	23,6	18,3	14,3	10,0	9,8	9,2	5,3	4,7	6,8	3,6	3,9
Gross average monthly earnings in economy (annual average)	na	27,2	33,4	24,3	21,9	22,6	16,8	20,4	22,3	18,3	13,9	13,5	18,2	18,3	12,0	6,2	8,7	8,2
Government sector																		
General government balance	na	0,0	-2,9	-6,1	-6,0	-7,5	-6,7	-5,0	-5,9	-8,0	-5,5	-3,0	-3,5	-8,4	-7,2	-6,5	-7,8	-9,2
Interest and exchange rates																		
Deposit rate weighted average (fixed for less than 1 year)	na	28,5	29,4	16,1	16,6	22,9	24,4	18,6	16,3	14,4	11,9	9,9	9,4	7,4	8,7	9,1	5,2	7,4
Exchange rate (end-year)	62,5	61,5	75,6	84,0	100,7	110,7	139,5	164,9	203,5	219,0	252,5	284,7	279,0	225,2	207,9	180,3	213,6	191,6
Exchange rate (annual average)	59,1	63,2	74,8	79,0	92,0	105,1	125,7	152,6	186,8	214,5	237,3	282,2	286,5	257,9	224,3	202,7	199,6	210,4
External sector																		
Current account	-1.437	127	267	324	-3.453	-3.900	-1.655	-1.788	-2.054	-3.387	-3.762	-4.011	-3.201	-4.643	-7.205	-8.767	-8.128	-6.528
Trade balance	537	348	189	-48	-3.246	-3.623	-1.466	-1.697	-1.321	-1.886	-2.177	-2.930	-2.234	-2.076	-3.271	-3.082	-1.961	-524
Merchandise exports	6.446	6.346	9.258	10.028	8.094	7.605	14.750	16.176	19.360	23.567	25.633	28.822	31.054	34.684	43.325	56.720	63.071	73.374
Merchandise imports	5.909	5.998	9.069	10.076	11.340	11.227	16.216	17.872	20.680	25.453	27.810	31.752	33.288	36.760	46.596	59.802	65.032	73.898
Foreign direct investment, net	187	311	1.459	1.471	2.328	1.097	4.772	3.335	3.715	3.070	3.060	2.151	3.573	2.722	479	3.542	5.412	3.055
Memorandum items																		
Population (end-year, million)	10,4	10,4	10,3	10,3	10,3	10,2	10,2	10,2	10,2	10,1	10,1	10,0	10,2	10,1	10,1	10,1	10,1	10,1
Current account/GDP (in per cent)	-4,6	0,4	0,8	0,9	-9,0	-9,4	-3,7	-4,0	-4,5	-7,2	-7,8	-8,5	-6,1	-7,1	-8,5	-8,6	-7,4	-5,8

Source: Source: European Bank for Reconstruction and Development

od from 1990 to 1993, but it was never higher than an annual 35%. The high inflation rate was attributable to the effects of the establishment of the VAT that was used as a mechanism to improve economic efficiency, to administered price increases for electricity and gas, and to currency devaluation (about 15%). The deficit in the current account of the balance of payments also improved considerably, although later it deteriorated due to the transformational recession that was accompanied at the end of the period by a major rearrangement of the composition and orientation of foreign trade, from Eastern to Western Europe, with COMECON and the USSR disappearing, with the latter undergoing a major recession as the Commonwealth Independent States. There was an increase of the fiscal deficit because public expenditures decreased less than public incomes (see Table 1). In addition, the exchange rate during the period 1990 to 1993 moved from supporting external competitiveness to a stabilization instrument to fight inflation, the monetary policy was liberalized, although negative real interest rates prevailed for deposits.

The four year period 1990–1993 was characterized by a deterioration in most of the economic indicators, with an annual contraction rate of 4.8% in GDP (18% cumulative decline), an annual reduction in industrial production of 8.4% and in real investment of 4.5%, and an increase in the unemployment rate from 1.4% in 1990 to 11.7% in 1993 (see Table 1). Total employment contracted consistently. In contrast, real wages and private consumption decreased at slower rate than the GDP.

RECOVERY AND SUSTAINED ECONOMIC GROWTH, 1995–2005

The second stabilization and structural reform package, the Bokros program, approved in March 1995, was a radical and comprehensive program. It tried to restore external stability, eliminating the commercial trade deficit in 1995, when there was the danger of the Tequila effect, due to the competitive deterioration of the forint, which had been revaluated to fight inflation, and to the fact that the authorities wanted to recover competitiveness while using at the same time the exchange rate as an anchor to reduce future inflation. Additionally, public expenditures increased while fiscal income decreased amidst the transformational recession, to face the effects of this process on the Hungarian society, in general, and low-income groups, in particular. The fiscal deficit had been financed with bonds that were bought by the commercial banks. The financial situation of the social security system was strained due to the large number of new retirees resulting from the rationalization of the SOEs. Total employment decreased every year from 1990 to 1993 (see Table 1).

The stabilization component included the devaluation of the forint by 9% and the establishment of a crawling peg system, a temporary surcharge to import taxes, the freezing of wages for employees of SOEs and the public sector, the introduction of tuition payments at public universities, the pegging of social benefits to family incomes, and a substantial modernization of the pension system that increased the age of retirement and imposed penalties for earlier retirement because the accumulated pension obligation was very high relative to the GDP. The major components of the structural reforms also included accelerating privatization, reducing the size of the public sector, and increasing the opening of the economy. The policy of inflation targeting was too ambitious and reduced the credibility of the Central Bank because it was not coordinated properly with the fiscal goals.

The four-year period from 1994 to 1997 was characterized by a remarkable improvement in economic performance. GDP expanded an annual rate of 2.6%, industrial production at an annual rate of 7.2%, and real investment at an annual rate of 7.1%. Additionally, there was a reduction of the annual inflation rate to 22.2%. The unemployment rate decreased to 8.0% in 1997 and by the end of the period, total employment began to expand.

In 1998, the civil society organizations (SAPRI), the Hungarian Government and the World Bank did a detailed joint evaluation of the problems faced during the reform process in four main areas: the reduction in coverage and quality of social services; negative effects of the fast liberalization and deregulation processes; negative impacts of the fast privatization process; and changes in the public services that were privatized without proper regulation mechanisms. The final report was presented in 2001.

In the four-year period from 1998 to 2001, Hungary continued improving its economic performance. There was an annual expansion rate of 4.9% in GDP, industrial production grew at the annual rate of 7.8%, and real investment grew at the annual rate of 8.2%. The average annual unemployment rate fell to 6.7%, the inflation rate fell to 10.8%, and wages increased in real terms. The deposit rate was consistently higher than the inflation rate. Employment expanded continuously through the period. The government did not keep a competitive exchange rate because the sterilization operations to eliminate the excessive foreign exchange reserves were considered very expensive and the country adopted a regime of exchange rate flotation. The economic expansion in this period was based on the expansion of public expenditures.

The continuous economic growth, the gradual reductions of the inflation and the unemployment rate, the positive state of most of the macroeconomic indicators, as well as the absence of any major social and political tensions, made possible that, at the end of the 1990s, Hungary declared that it had completed a successful transition.

SOME FUNDAMENTAL REFORMS AND THEIR TIMING

Liberalization and Deregulation

The program of price liberalization in 1989–1990 was designed for 4 years, but later on it was trimmed to 3 years.

Stabilization

Hungary chose a gradual stabilization program due to its initial conditions, where there was not any significant monetary overhang because Hungary had used inflation during the 1980s to eliminate any excessive monetary stock. Later in the 1990s, when the economy began to deteriorate due to a situation of inflationary recession, created by external conditions and the transformational recession, Hungary took severe measures to overcome that situation, but in this occasion again it still decided to reduce the inflationary pressures gradually.

External Opening

Initially, Hungary kept strict controls on capital movements, particularly short-term capital flows. Subsequently, they were progressively relaxed in order to join the OECD first, and the EU later.

Privatization of State-Owned Enterprises

For this purpose two state agencies were established: a State Property Agency, in charge of supervising the privatization process; and an Agency to Administer State Assets, in charge of managing those SOEs that would not be privatized.

Hungary chose to gradually privatize the large SOEs, including those in some strategic sectors—banking, pharmaceuticals, energy and chemicals—to external groups. In this regard, the preferred method was cash sales through public auctions, a variant of the English method, instead of making fast mass privatizations by distributing *vouchers* to the general population. The Hungarian authorities considered that this latter method would benefit the nomenclature rather than the people. In addition, Hungary wanted to attract foreign exchange, investments, modern technologies and management methods to improve efficiency and relieve capital shortage. The gradual process of privatization would also allow developing an entrepreneurial class interested in buying SOEs, with price and trade liberalizations creating favorable conditions to develop efficient enterprises.

Hungary kept hard budgets to eliminate or restructure the inefficient SOEs. A draconian bankruptcy law included a process of automatic insolvency declaration, and mandated the obligatory reorganization or liquidation of insolvent SOEs. It was considered that the bankruptcy law would have a healthy general effect on the economy despite its negative impacts, particularly on commercial banks and on some enterprises that were profitable, but had liquidity problems.

The small enterprises were sold to nationals at the beginning of the transition process through the municipal governments, most of them to their former managers and employees. They had to pay at least 50% of the appraised value of the enterprises. This privatization covered all economic sectors and assets, but the authorities decided to keep the property of agricultural lands for nationals and to limit them to a maximum amount of 300 hectares.

Later, in 1995, as part of the Bokros Plan, the privatization process was extended to SOEs in public services and in the financial sector, including commercial banks and insurance companies. The method of privatization used, jointly with the tax incentives offered and the human capital quality of the labor force, allowed Hungary to attract high levels of foreign direct investment (FDI), and to modernize the enterprises and the public services.

The justification for this type of privatization was that there was not any significant monetary overhang, hence the authorities wanted to sell the enterprises for cash, and to attract foreign technology and management. Also, subsidized credits were granted to nationals to buy enterprises. The government decided to make compensations by vouchers or bonds instead of restitutions.

As a result of the type of privatization process, foreign capital took a dominant position in the Hungarian financial sector. Towards the end of the 1990s, foreign commercial banks represented 68% of the total, the highest percentage in the entire region. Also, as a consequence of the privatization process during the first decade of the transformation, the new Hungarian exports were concentrated mainly in manufactured goods by multinational enterprises in areas such as automobiles, electronic equipment, communications, and computers. These manufacturing plants were established by the multinational enterprises, taking in consideration Hungary's comparative advantages in terms of geographical location, its friendly legal framework as well as its relative cheap but highly qualified human capital, which conditions were much more attractive than in other countries of the region.

Reform of Public Service Enterprises

After an ambitious privatization process of public service enterprises, Hungary is currently second to the United Kingdom in Europe regarding the proportion of public service enterprises in the private sector. Nevertheless, Hungary has been criticized for still lacking an appropriate regulatory framework to promote more public concessions in public services.

Social Services Reform

Hungary had a very generous and generalized system of social benefits, which Kornai called a premature welfare state. This situation was significantly reconsidered when the crisis of the mid 1990s, leading to the decentralization of the services to the municipalities, to better focus the state social services on groups in greater need, to reform the social security by partially privatizing it and by increasing the retirement age, as well as to eliminate some benefits that offered perverse incentives, such as the overly generous disability benefits. In the education sector there has been an expansion of private services. In the health sector there has still been much emphasis on the curative health and the cost of medicines and drugs has substantially increased. The process to decrease social expenditures has been quite difficult, and has centered the discussion of public policies over the last years.

Institutional Reforms

From the beginning of the transition Hungary gave great importance to the institutional and microeconomic aspects of a market economy that it would have to adopt to join the EU, and to attract FDI. Thus, it established international accounting and capitalization standards for the commercial banks and other financial enterprises, a draconian law of bankruptcies, market friendly legislation and some tax incentives for FDI that favored and significantly helped to make a successful transition.

Hungary has also shown advanced ratings of democratic reforms, according to Freedom House, occupying the 4th place among the 29 former socialist countries in Europe and Asia (see Table 2). Hungary occupies the first place in civil society, the third place in national governance, judicial framework and independence, and control of corruption ratings, after Slovenia and Estonia, the fourth place in electoral process and local governance ratings, and the 8th place in the independent media ratings.

Table 2. Hungary's Relative Position in Democratic Transition among 29 Countries in Asia and Europe, 2006

Democratic Reform Indicator	Rating[a]	Rank
Democracy Score	2.14	4
Electoral Process	1.75	4
Civil Society	1.50	1
Independent Media	2.50	8
National Governance	2.25	3
Local Governance	2.25	4
Judicial Framework and Independence	1.75	3
Corruption	3.00	3

Source: Freedom House, Nations in Transit, 2007.

a. Ratings are based on scale of 1 to 7, with 1 representing the highest level and 7 the lowest.

Although the relative corruption ratings for Hungary are low, it is more and more evident corruption is a ballast. Hungary, as other post communist countries, suffers this phenomenon, which affects all society and has its roots in the old socialist system.

MAIN CONCLUSIONS

Hungary has achieved a successful economic and political transformation to a prosperous social market economy and to a parliamentary democracy with political alternation. It also joined the EU as of May 1, 2004. Furthermore, Hungary did not take advantage from any reduction of its high initial external debt as Poland did.

Ever since the EBRD began to estimate the economic transition indicators in the mid 1990s, Hungary has shown the highest indicators of economic reforms among the 29 former socialist countries of Europe and the USSR (see Table 3), both for the first stage reforms (trade liberalization, small scale privatization, large scale privatization and price liberalization), as well as for the second stage reforms (enterprise restructuring, competition policy, banking reform, non-bank financial reform, and infrastructure reform). The percentage of the private sector in the economy is 80%, the highest among the former socialist countries in Central Europe and the former USSR.

Table 3. Hungary's Relative Position in Economic Transition among 29 Countries in Asia and Europe, 2006

Economic Transition Indicator	Rating[a]	Rank
First Stage Economic Reforms		
Trade and Foreign Exchange Liberalization	4.33	1
Small Scale Privatization	4.33	1
Large Scale Privatization	4.00	1
Price Liberalization	4.33	1
Second Stage Economic Reforms		
Enterprise Restructuring	3.67	1
Competition Policy	3.33	2
Banking Reform and Interest Rate Liberalization	4.00	1
Securities Markets and Non-bank Financial Reforms	4.00	1
Infrastructure Reform	3.67	1
Telecommunications	4.00	2
Railroads	3.33	3
Electricity	4.00	1
Roads	3.67	1
Water and Waste Water	4.00	1
Private sector share in GDP (%)	80	1

Source: EBRD, Transition Report, 2007.

a. Rating of 5 represents the highest level.

Hungary has a one-digit unemployment rate although it has a low labor participation rate. If Poland can be considered a successful example of an initial "big bang," Hungary is a successful paradigm of a gradual but relentless transition reform, the success of which is due to the firm political determination to maintain the transformation changes independently of the incidental slips associated to the disappearance of COMECON and the transformational recession. Hungary had clear and consensual objectives to joint the EU and to compete with other Central European transition countries for foreign direct investment.

The Hungarian transition experience has been the result of an indigenous process involving an in-depth dialogue among the power, civil society organizations and the people, based on their own vision of the transition process and their values and traditions, which lent legitimacy and continuity to the process.

Hungary, in spite of many severe inherited distortions from socialism, had better initial conditions to carry out the transformation of its socioeconomic structure. In effect, the communist regime, long before the beginning of the transition, had made some major market reforms, which combined with the negotiated and consensual political transition, generated proper conditions to attract major flows of foreign direct investment that became the main engine of economic development and modernization.

To initiate the transition process in a gradual manner was the right decision. When unfavorable external conditions aggravated the transformational recession during the first years of the transition, Hungary used a drastic adjustment to change that situation, to recover the economic growth and to change the transition. Subsequently, it gradually reduced the inflation.

For several years, the transformation of the economic system had major and deep negative social impacts, particularly the deterioration of the standard of living of important sectors of the population that experienced reductions in real wages and the increase of unemployment (see Table 1). Nevertheless, the sparking disillusionment with market reforms did not destabilize the new political system. Hungary kept significant benefits from the welfare socialist system, which contributed to lessen, at least partially, the social tensions derived from the speed and hardness (in amplitude and intensity) of the economic adjustments. On one hand, an ideological-psychological element served to support the economic reforms, specifically the perception that they, although painful, were indispensable, since they constituted a *sine qua* *non* condition in order to joint the EU. On the other hand, the independent labor movement was weak and the population was relatively old.

Starting in 1995, the economy has continuously grown, with an increase in real wages and a decrease in unemployment. Social expenditures have been a main issue of economic policy since 1998, and have created strong fiscal pressures on the government.

The parliamentary type of political system of Hungary turned out to be very effective to take care of the social demands from the transformation, and to generate political stability by establishing alliances to negotiate, prepare and implant public programs.

LESSONS FOR CUBA

Main Positive Lessons of the Hungarian Experience

1. Hungary made some reforms under state socialism, hence when the systemic transformation began, it already could count on accumulated social capital in terms of institutions, values, behaviors, and standards of a market economy, as well as experiences dealing with international financial institutions. Hungary did not begin from scratch the establishment of the new institutions and economic policies that the transition process required, and used several of the existing institutions.
2. These initial conditions, particularly the experiences with some market reforms and with the international financial institutions, were crucial to achieve a transitional success.
3. The generalized gradualism applied during the transition process was successful, because it was transparent and relentless. That is, the important factor was the speed of the process of reform as a whole and not only at the initial stage of the process. This diverges from the conventional wisdom that considers that gradualism means indefinite delays in critical reforms and, therefore, is condemned to fail.
4. Certain institutional measures, i.e., the bankruptcy law, the income and value added taxes, the banking reforms and the fast adoption of international standards for private financial institutions, had a significant impact in support of the macro- and microeconomic policies that were applied. In addition, the decision to join the EU pressed Hungary to adopt the institutions required for such objective.
5. It was essential to have clear and consensual objectives: joining the EU with a model of a social market economy, as well as understanding the restrictions imposed by the external context that Hungary faced, i.e., the need to compete for FDI with other countries in transition in Central Europe and to service the high external debt. These objectives and knowledge lent continuity to the transition process and allowed overcoming the occasional short-term problems that developed.
6. Hungary successfully took advantage of its outstanding human capital (highly educated and skilled labor force) and of its geographical location to attract FDI.
7. The use of compensation vouchers instead of restitution allowed for the immediate use of the existing assets and the modernization of large enterprises.
8. The total or partial sales of the large SEOs by means of public auctions for cash to foreign strategic investors and, to a lesser extent to nationals, allowed a fast process of technological and managerial modernization, to increase exports, as well as to attract a high and important amount of FDI; making popular capitalism a reality at the same time.
9. Hungary opened its capital account gradually and kept certain controls on short-term capital movements.
10. Hungary promoted development and dialogue with the civil society organizations.
11. After some years of transition and reforms, it is convenient to make a joint evaluation of the process by the civil society, the government and the international financial institutions.

Some Negative Lessons of the Hungarian Experience

1. After the severe adjustment in the period 1995–1998, the two main political coalitions put emphasis on increasing social expenditures for low income groups and wages for public employees well beyond the real possibilities provid-

ed by public income, thus weakening the fiscal situation. This is one of the main economic problems of the country. In 2006, the government adopted a fiscal austerity program that is also being reinforced by a restrictive monetary policy from the Central Bank.

2. Hungary delayed targeting social expenditures for the low-income groups, which should have been addressed from the beginning of the transition. It also kept an overly generous system of labor disability benefits which gave rise to perverse incentives that favored labor absenteeism.
3. The inflation targeting policy in the late 1990s was too ambitious, was rushed, reduced the Central Bank's credibility, and led to unhealthy tensions between the central government and the Central Bank.
4. Small and medium-size enterprises had poor access to the financial institutions and other public policy opportunities. A tax simplification scheme was implemented for these enterprises only in 2003.
5. The excessive emphasis on FDI as the main engine of economic growth limited the linkages between the most dynamic sectors, with multinational companies being mainly export-oriented, while the medium and intermediate sectors had an orientation towards the internal market. As a consequence of this insufficiency, the multinationals-driven industry shared during the 1990s some of the characteristics and limitations of the "assembly plants" in Latin America and of the enclave activities worldwide. Therefore, despite the solid advances Hungary has registered in terms of reintegration to the international economy, the model that emerged presents some problem areas that Hungary has to improve on. That is, Hungary has grown on bases that still need to be strengthened.
6. The system of public concessions for financing public infrastructure services has not been used properly and has limited the attraction of FDI in these areas.
7. Hungary has lost external competitiveness as a consequence of the exchange rate appreciation since 2002, as it had happened towards the end of the period 1990–1994. At the time of this writing, the restrictive monetary policy of the Central Bank tends to strengthen the forint, and to reinforce the loss of competitiveness.
8. Fighting inherited corruption has not been a top priority.

FINAL THOUGHT: A VISION OF THE FUTURE—A MUST-HAVE CONDITION

$$\mathbf{P\ (\Pi > 0)} \sim \left\{ \mathbf{\Pi\ (X_P)} << \mathbf{\Pi\ (X_F} \mid \mathbf{W} \cup \mathbf{C)} \right\}$$

The probability (p) for a beneficial change (**$\Pi > 0$**) to happen is co-integrated with the confidence that it is much less beneficial to continue with the clearly understood but unsatisfactory present conditions (**X_P**) than to pursue a clearly identified, attractive and plausible future state (**X_F**), if the way (**W**) to get there at a perceived cost (**C**) is realistically articulated, understood and legitimated by the agents of change.

In Hungary, towards the end of the goulash socialism, the axiomatic promise of freedom and democracy (**X_{F1}**) would not have been enough for the Hungarian people, conscious of their relative well-being but dissatisfied with the stagnation and exhaustion of their prospects (**X_P**), to accept the costs (**C**) of a systemic change, should it not have been accompanied by a clear opportunity (**X_{F2}**) to join the European Union and NATO to address their need for progress, freedom, democracy and security in a pragmatic, consensual and multilateral way (**W**).