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# PROPERTY RIGHTS IN HUNGARY: *The Key To Its Economic Transformation?*

by George R. McDowell and Dezso Kovacs



**T**

he success of the first McDonald's in Budapest gave rise to the opening of a second one in 1989. It also stimulated the establishment of a chain of City Grills, a Hungarian "copy-cat" fast food restaurant, throughout Budapest. The transforma-

tion of the Eastern European planned economies is being accomplished through the influence of corporate America—or so we are told by the news stories about McDonald's and the TV ads about joint ventures to produce light bulbs. But all that discussion about the influence of Western capitalism on former Eastern Bloc countries may be misleading.

Institutionally, there is little significance in the agreements between individual multinational corporations and the governments that permit the entrance of enterprises like McDonald's or General Electric. The truly significant economic transformations will be the arrangements that convert a grocery store in Kecskemet or a fruit juice business near Bakescsaba from a state-owned establishment to a private business in the hands of workers who want to own it.

This is true, even in Hungary, where private enterprise evolved in the midst of a socialist economy well before the fall of the Berlin wall. The point is that observers of Hungary and of Eastern and Central Europe should focus on truly significant economic changes rather than on the fact that McDonald's can make hamburgers and General Electric can make light bulbs most anywhere.

## Private Property

There is a lot of "private property" in Hungary! Most people "own" their apartment or a small house and yard. Fruits and veg-

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etables from about 1.6 million small, part-time producers in backyard and other private plot gardens comprise one-third of the value of all agricultural output. The private plot production arose in response to various forced collectivized farming efforts that lasted from 1948 into the 1960s. While some of these "private plots" are associated with cooperative farms, most are owned by factory workers and retired people.

There also are the established rights of private entrepreneurship to buy and sell goods and keep the profits, whether they are the profits from private garden plots, hairdressing services, or computer software—a growing Hungarian industry. Many Hungarians are involved in the private market economy, with their government's blessing, and have been for decades.

The rights of entrepreneurship evolved more through government neglect than government action. Consequently, there is little in the way of legal protection of private contracts, or recourse when contracts are broken. Indeed, there is some evidence of the emergence of a Mafia-like organization that "governs" the fruits and vegetables market. In August 1990, several senior members of the national police were arrested. They had carried out a "hit" to enforce property rights in the gray market in fruit and vegetables.

## Old Capital and New Capital

Despite the appearance of considerable economic freedom and an economy in rapid transition from central planning, there remain significant difficulties in the Hungarian economy. The dilemma is that while the establishment of new private enterprises is permitted and encouraged, few of Hungary's 10 million people have much capital to invest. Most existing capital in industry, retailing, and agriculture is owned or controlled by the state. Few people have equity in anything outside their homes. They have little to show for 40-some years of dutiful socialist work.

Actually, for many, their socialist work was not exactly dutiful. Many people worked harder in their own small enterprises than they did in the jobs they had with the state. The joke of the socialist worker has been, "they pretend to pay us, we pretend to work."

Still, the accumulation of a lifetime of work at the state job and at home, is a small house or flat and a garden plot. It would have



*State farms occupy about 14 percent of the land.*

been less had the Hungarian Socialist leadership been more repressive. Many Hungarians believe the tolerance was greatly influenced by the 1956 Revolution, which served to warn the regime that people's aspirations were not to be discounted. Nevertheless, very few Hungarians have any capital.

### **Privatization—"privatizacio"**

The direction of the economic transformation of Hungary is easy to identify and the government wants to proceed towards the conversion of state-owned and controlled capital to private ownership and control. The tough question is HOW to convert the thousands of government owned and operated enterprises—the corner grocery stores, drug stores, beauty parlors and restaurants; the truck factories, pottery works, and other light and heavy industry; and the state and cooperative farms—into privately owned and operated businesses.

Unfortunately, the debate over privatization in Hungary has been captured and converted into a debate over the ownership of farm land and land tenure. It is as though the "private property" transformation, necessary in the Hungarian economy, is synonymous with land ownership. This policy diversion is the result of a movement by one part of the ruling coalition, the Small-Holders Party, for a return to small-holding agriculture. The Party actually polled 11.78 percent of the electoral vote in the last elections.

The Small-Holders Party argues that the last time "private property"—as in private ownership of tracts of agricultural land—was legal in Hungary was in 1947. They want to return to the ownership that existed then, regardless of whether the earlier owners or their heirs are still cultivating the land. It was the last time the Small-Holders Party was in power and they had accomplished a major land reform subdividing many of the large, private estates among small-holders.

Another major dimension of the Small-Holders Party position is their emphasis on a fee simple type of ownership as being the only "private" form of property. They are unwilling to accept any kind of collective or joint ownership of land or other agricultural assets. Thus they argue that all lands, houses, shops, and other properties expropriated or voluntarily given to cooperative farms should be returned to their 1948 'original' owners. When faced with the argument that many very large and successful cooperative farms would be disrupted, they suggest that if there has to be collective ownership for economic efficiency, it should be based on the historical claims in the land. The Small-Holders point to the success of the private plots as evidence of the economic efficacy of small scale

agriculture. The fact that much of the land subject to sub-division is unsuitable to fruit and vegetable production is overlooked.

There were about 1,440,800 small private farms (small-holders) in 1949 at the end of the land reform and the beginning of forced collectivization. Most of these were operated for no more than three years before they were forced into the cooperative farms and collectivized production starting in 1948-49. Large estates not yet subdivided became state farms under the forced collectivization that continued until the early 1960s.

On the face of it, particularly to Western observers, the Small-Holders' position seems fairly logical and reasonable. Americans have a predisposition to believe that state-controlled, huge farms are necessarily inefficient. However, the Small-Holders' position is opposed by most Hungarians. It is opposed officially by the major party in power—the Democratic Forum—and the major opposition party—the Free Democrats. Yet debate rages, often dominating the political arena.

The debate involves a number of issues with significant implications for the transformation of the Hungarian economy:

- the existing character of Hungarian agriculture and its economic importance;
- the circumstances of the 1945-1948 land owners or their heirs and the validity of their claims; and
- the character of rights reform necessary to solve the ownership of non-agricultural, state-controlled enterprises.

### **Hungarian Agriculture Today**

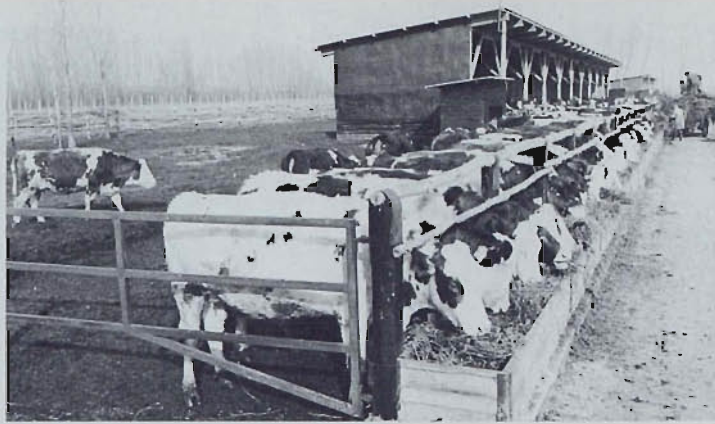
Today Hungarian agriculture, particularly the large-scale state and cooperative farms, appears reasonably productive and very modern. However, it is difficult to discuss efficiency and productivity when input and output prices are controlled, and there is a full employment mandate to the managers. There are indications that agriculture has been one of Hungary's most successful sectors under socialism. It may also be the most progressive agriculture in what was "Eastern Europe".

According to the University of Economics in Budapest, agriculture accounts for roughly 18 percent of gross output, 21 percent of national income and 22 percent of national exports.

The cooperative farms average about 4,000 hectares, the state farms about 7,600 hectares. Much of what Americans consider "production agriculture" is performed by the cooperative farms on about 76 percent of the agricultural land, accounting for about 50 percent of the value of agricultural product. They employ modern and sophisticated agricultural technology comparable to that in the

United States. Much of the corn seed stock came from Pioneer or DeKalb. Interestingly, some of that modern technology, greatly labor-saving in its purpose, may have been inappropriate under the full employment mandate of the cooperative farms.

Consider the 600-cow dairy, part of a cooperative farm near Pecs. They have two "double 12" herring bone milking parlors with automatic take-offs. All the milking is handled by four women. The cooperative manager still faces the common problem of finding profitable employment for the farm's entire labor



*Hungarian large-scale agriculture is progressive and may be competitive internationally.*

force. Another cooperative farm started a pasta factory to increase employment and earnings. Others run public restaurants, bathing suit factories, construction companies, and metal galvanizing factories. The organization of non-agricultural enterprises by both cooperative and state farms is commonplace and constitutes a significant part of rural economic development in the country.

The state farms, occupying about 14 percent of the land, tend toward an agro-industrial function in both input supply and processing. They also provide a substantial part of Hungary's production-oriented agricultural research. Boly Kombinat, the largest state farm, devotes about 12,000 of its 22,000 hectares to corn and soybean seed production. It has formal relationships with Pioneer and Dekalb, and for nearly three decades its poultry hatchery has had a license agreement with Shaver, a major Canadian international breeder.

There is considerable anecdotal evidence that Hungarian large-scale agriculture is progressive and may be competitive internationally. It is clear that farm managers in Hungary, as compared to elsewhere in the Eastern Bloc, were able to assert some decentralized leadership under a more benign "central planning" regime. The progress may also reflect the technological bias of professional managers who faced "soft" farm level budget constraints. Thus, through 40 years of central planning, a technological transformation from a peasant, feudal agriculture to a modern one has been accomplished.

## The Future

It is not obvious that production increases will occur from subdividing land into farms of immediate post World War II size. It is possible that much of the equipment and machinery is totally unsuited to a smaller scale of production, and much of the land in question is not suitable for intensive cultivation. For those who argue that agriculture is a declining cost industry, there may be sufficient evidence to support a continuation of the large-scale farming enterprises, though perhaps not the huge complexes now in the cooperative or state farms.

It seems clear that the simple, land reform type of change in property rights represents an overly simplistic view of the institutional changes necessary, given the complexity and sophistication of Hungarian agriculture.

## Land Issues

Contemporary land rights questions in Hungarian agriculture are complex. Two major questions provide the focus. Where have the 1948 small-holders gone, and the corollary, where did they come from?

The 1945-48 land reform distributed land, taken mostly from the estates of landed elites, among about 650,000 small-holders. Of the small-holders in 1949, about 45 percent to 50 percent were created by the land reform. They were given land and control over it for about three years. Further, the estate owners whose land was expropriated were not compensated.

With the Soviet-inspired collectivization of agriculture beginning about 1948-49, the owners of the redistributed lands were forced into the first agricultural cooperatives. But during the

early 1950s several hundred thousand Hungarians left the cooperatives they had been forced into. Sometimes the reasons for leaving were economic self-interest, but there was little choice under the severity of the early socialist regime. During the 1950s period of "building socialism in the villages," sometimes violently, more than 500,000 peasants were sentenced for a variety of offenses. Land, thus abandoned, reverted to the state.

Because of the 1956 'event,' most of the agricultural cooperatives were dissolved. In 1958, after a long debate within the regime, there was another reorganization of agriculture. During the ensuing three years most small-holders were forced into producers' cooperatives. Something over 11 million acres of land formerly in private, small holdings were moved into cooperatives. Then from 1962 to about 1978 a major centralization proceeded in these cooperatives, further reducing the agricultural work force and the number of cooperative farms. It was during this amalgamation period that many cooperatives initiated non-farming enterprises in an effort to provide employment for the remaining work force.

Before 1967, land transactions were permitted only with the state, and many of those who left the land retained ownership and implicitly, membership in the cooperatives. A 1967 law tied individual land ownership with active work in the cooperatives. It also enabled collective ownership of land. When the law became effective January 1, 1969, original land owners or their successors who had left the cooperatives or died were "bought out" at very nominal prices and the land became indivisible and cooperatively owned. By 1985 the land controlled by the cooperatives was owned in the following ways:

Cooperative, indivisible ownership	.....57 percent
Member owned	.....39 percent
State owned	.....4 percent

Dezso Kovacs in his paper, "Going Forward By Going Forty Years Back?" summarizes the result of this 40 years of turmoil in Hungarian agriculture and in the ownership of agricultural lands by setting forth the following classes of claimants on the land:

- The original (1948) owners of the land or their successors who work in the framework of the cooperative and whose land is part of the 39 percent above. Under current law they may take their land out of the cooperative.
- The original (1948) owners or their successors who no longer work in the cooperative and who were compensated for their land at a government-set, artificially low price. Their lands are now in the indivisible, cooperatively owned category above.
- Individuals who brought no land to the cooperative but who work for and, thereby, are members of the cooperatives. They are claimants on the common ownership lands.

The Small-Holders Party actually includes original small-holders of the 1949 era. During a visit in a regional party office several elderly gentlemen said, with considerable justifiable pride, that they had been members of the earlier Small-Holders Party that had successfully enacted the post-World War II land reform. Clearly their position on collective ownership is in reaction to the 1967 law and demonstrates their desire to reverse the forced sale of the land which ensued. They represent claimants in the second category above.

## Other Property Rights Reform and Property Claims

Some of Hungary's major dilemmas in its move to a market economy are embodied in, and symbolized by, the issues involving ownership of agricultural land. Specifically it is in the resolution of the claims by those whose lands were forcibly 'purchased,' and those who believe they have a claim by virtue of their work on the land in the cooperatives—the 2nd and 3rd categories above.

Unfortunately, the claims involve the very same lands, now held in indivisible, common ownership. Indeed, as is described above, the restoration of one set of claims, by fee simple types of property rights, denies the other claims.

These conflicting claims typify the issues involved in transforming the entire Hungarian economy and, for that matter, any Eastern European economy. The special images associated with ownership of land are simply a further confusing and confounding overlay in the agricultural sector.

In September 1990 a claim by the pre-Socialist drug store owners appeared in the Hungarian press. They want their stores back. They argued that they had been unjustly treated by the Socialist government, that restitution of their property is clearly and uniquely in the public interest, and is consistent with a move to a market economy. There was little or no discussion of the claims of the workers in the now state-owned drug stores.

There is a factory near Veszprem that produces world-class porcelain—Herendi porcelain. The factory was very profitable during the socialist period. Its management clearly organizes, coordinates and supports the unique artistic talents of its workers. Facing foreign investment and privatization, the workers want a say in the character of, and even a part of, the company's future ownership. And what of the managers claims? Should the State sell off this successful business? Should it continue a claim of partial ownership of the factory, particularly since it promises to be profitable in the new economy? If the state sells all the successful enterprises, might it be stuck with only the marginal factories in the new economy? What is the public interest?

We know that without some level of community agreement about property rights, they mean little. Indeed, that may be the lesson of Eastern Europe. Despite the liberalization over the years of the Hungarian Socialist regime, many Hungarians attribute recent changes to actions by Gorbachev. When the Soviet gun disappeared, so did commitment to the system of property rights it had imposed. Abandonment of that system was swift.

One solution to the porcelain factory is a form of stock ownership in the company for the various claimants. Will that work in

agriculture? The Small-Holders say no, land is special and should not be owned in common. Others point out that many small-holders were given their land and only had it for about three years. Many have nothing to do with farming now—an argument that the Small-Holders' claims are not valid.

Others say you can't correct past injustices by creating new injustices that ignore the claims of those who spent their career on the land or in the factories. Most Hungarians, and most political parties, are concerned that drastic land reform will cause a significant productivity decline in the sector offering the greatest opportunity in a European and global marketplace in a transformed domestic economy.

## Possibilities and Precedence


There are already significant changes taking place in the structure of Hungarian agriculture. It is taking place where existing rights are clear. Twenty-six members of the cooperative farm with the dairy near Pecs are leaving to form a wood products business. Some of them are members who still own a claim to land and are taking it out of the cooperative. It is considerably less than 100

hectares and not significant for farming but quite useful in establishing a site for a new rural manufacturing enterprise. They are using a voluntary cooperative as their ownership form.

All over Hungary groups and individuals are splitting from government-controlled cooperative farms to form new enterprises and new ownership forms—some cooperative and some not. One can imagine that many of the enterprises the cooperative farms organized in the past may be spun off as independent businesses. That is certainly possible for the swimming suit factory, the

pasta factory, and even the dairy operation. As ownership rights are solved in these enterprises, it will likely lead to solutions with respect to land rights and even industrial ownership. However, it seems likely some kind of collective land ownership will prevail.

For Americans viewing the changes in Eastern and Central Europe, it is perhaps useful to broaden our perspective about the character of land ownership and property rights that support all types of private enterprise in other European countries, as well as the United States. A great deal of private farming in Western Europe is carried out by long-term tenancy on state, church, and private lands. The largest farmland owner in Britain is the National Trust. Many of the North American and European skiing resorts are based on land use rights, rather than ownership rights. The grazing rights to public lands are significant in the U.S. beef and lamb industries.

The outcome of the Hungarian approach to privatization is not yet clear. It is certainly more complex than starting a McDonald's with new capital in Budapest or Moscow. However, if the Hungarians are able to solve the privatization problems in agriculture, Hungary may be able to rapidly transform the rest of its economy. They may also very well provide the rest of us with some new insights and models for property rights that can make our society more productive. 

In April 1991 the Hungarian Parliament passed a law to provide partial compensation to those who had lost property, including land, as of June 8, 1949. That was the day a new Hungarian Parliament was formed by the communists following an undemocratic election. The new law proposes compensation by vouchers or "compensation shares" that will be exchangeable for state owned property, state owned land, bank credit in certain cases, and some kinds of insurance. The new law, which was immediately referred to the Constitutional Court for review, has yet to be implemented. Indeed, several of its provisions have been found by the court to be unconstitutional.