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**POLITICALLY**, economically and socially, the period of turmoil in Eastern Europe looks set to continue for some time yet. As the economies of Bulgaria, Czechoslovakia, East Germany, Hungary, Poland and Romania begin to find their feet however, with Western assistance, so the opportunities for industry and trade in many different directions will emerge at increasing tempo. Apart from the special circumstances created by economic and ultimately political union between the two Germanys, the probings and investigations for the possibilities of importing, joint ventures, contracting, franchising and other arrangements continue apace. All these same opportunities exist in the textile, hosiery, knitting and garment industries in the same or greater degree than any other.

The first step however is access to as much detailed information as is available and then to investigate the possibilities and opportunities in the light of this. Such marketing exercises are invariably more immediately productive if carried out with the co-operation of local experts.

Knitting International will be playing its part in these initial stages. Our European editor, Ralph Innes, will be travelling extensively throughout Czechoslovakia, East Germany and Hungary in July to provide on-the-spot reports from knitting industrialists, trade officials and government spokesmen.

In the meantime, since Hungary has become a focus of much attention because of its long tradition of fashion, textiles and knitting, we are publishing the text of an article "Hungary: Emerging From A Knitting Chrysalis", by Karoly Lazar of Habselyem Knitting Mills, Budapest which was presented to the Textile Institute Knitting Group Conference in London last month.

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# SPOTLIGHT ON EASTERN EUROPE: HUNGARY: EMERGING FROM A KNITTING CHRYSALIS

## Karoly Lazar Examines The Past, Present And Hoped-For Future

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**T**HE HUNGARIAN knitting industry was founded at the end of the 19th century with the first factory being established in 1885. A more rapid development of this branch of industry began only in the 1920s. After World War I the knitting industry accounted for only 5 per cent of total textile production. Even so, the importance of the knitting industry quickly became recognised and in the general post-war boom, many knitting mills were established. In 1921 only eighteen knitting factories existed; eight years later their number was 71 and in 1938 there were 95.

During World War II Hungarian industry including the knitting industry suffered massive losses. Many factories became totally or partly ruined and practically no industrial plant was left undamaged. About a quarter of total textile capacity fell victim to the fighting.

Restoring the industry and setting production in motion again needed a relatively short time. This was achieved with Soviet help because a significant part of production went out as reparations. At the end of 1948 the textile industry was again producing the same quantity it had done in 1938.

1948 was the year of nationalisation of companies of more than 100 employees. Seventy-five or 87 per cent of the factories came under public ownership. One year later came the smaller ones, up to 10

employees. Most knitting mills belonged to this category. Each knitting workshop came under state control and the total reorganisation of production began. Small and medium sized workshops and mills were closed down or merged into larger ones. By 1949 the number of knitting companies decreased to 26. The production profile of the factories was regulated in uniform respects, competing production lines were stopped and big specialised companies were established to produce well defined groups of goods. Concentration of the factories went on later, too, and by 1953 there were only 13 knitting companies, each relatively very large.

Output increased rapidly. This was really necessary because after the long war people were poor and there was a shortage of clothing. The main goal of the government was to put an end to the shortage of goods and their quality and variety were of secondary consideration. The significance of quality became obvious only by 1958 but the pre-condition of change was the modification of the structure of the knitting industry. The knitting industry played an important role in this. In previous years technical development had been neglected. Pre-war machines were used in the factories and they could not afford to buy new ones. This situation improved only at the end of the fifties but mainly in the sixties. It is characteristic of

the development that knitwear production in 1963 was 4.6 times more than it had been in 1949.

In the early sixties the textile industry again experienced a strong reorganisation. The strategy for textile companies changed and concentration increased again: the number of knitting mills decreased to ten. The concentrated companies usually preserved the plants of their predecessors. These huge companies had therefore many plants and many thousands of employees.

This was the period when Habselyem Knitting Mill, the company where I work, was established in its present form from two smaller former factories.

### Merger Goal

The goal of these mergers was to establish companies where technology was very specialised and homogeneous and where a group of goods was produced under one roof for the whole country. Habselyem specialised, for example, in the production of warp knits.

The second half of the sixties offered significant opportunities for the development of the knitting industry. In 1968 the "new economical mechanism" was introduced. This offered good conditions for modernisation of the factories. This new system of economy management released the previous constraints of pro-

duction profiles and gave much more freedom to company managements to decide the directions of development. They made the best of this opportunity. Big cities could not, however, make sufficient workers available to increase the industry, and for this reason many new plants were built in small towns and villages.

This was a significant development in Hungary, since the industry had been concentrated in big centres to a much greater extent than in other countries. Now it had to be changed. Each knitting mill intended to grow so they built new factories everywhere in the country. Remember that this was the period of nylon shirts, polyester jersey dresses and the big boom of knitwear. Also textile factories of the cotton and wool industry bought knitting machines and established knitting sections. (What is strange and probably a failure was that they did not usually use their own yarns in their own factories but bought synthetic yarns for this purpose. Their own yarns served mainly their traditional weaving production. They did not learn how to produce good knitting yarns and we are experiencing the disadvantage of this even today).

A further improvement of the situation was given by the programme known as "reconstruction of the textile industry" in the seventies. The main goal of this was to increase textile output primarily for the home market but also for export. Textiles and especially knitwear were very important in exports to the Soviet Union because Hungary obtained oil and raw materials in return. A typical result of this action was the exchange of machinery and modernisation of production. The Government granted an equivalent of some 80 million pounds sterling in the form of preferential credits to the textile industry over a ten year period. From 1970 to 1980 the total value of machinery of the textile industry was trebled, the volume of production increased by 150 per cent and its value doubled. Also two new knitting factories were established. Statistics from the year 1982 show that 70 per cent of the knitting machines running at that time had been bought between 1970 and 1980.

1981 was the Hungarian knitting industry's most successful year. Knitwear production amounted to 22,000 tons in that year — it had never been more previously and has never been surpassed since. This is why we were so optimistic in the early eighties. Official pronouncements of that period promised that light industry as well as the knitting industry would play an important role in the future. Optimistic predictions were made about consumption of the home market and of potential exports. The basis of this optimism was that a reduction in purchase tax for textile goods had been promised for the home market and officials thought this would result in an increase in demand.

However, the reduction of purchase tax did not happen. Although professional circles were often sceptical about these

forecasts, official announcements still said that a big reconstruction in the textile industry, similar to that of the previous period, could be repeated. I personally was a member of the team in 1984 which formulated recommendations for the National Economic Plan 1986-1990 concerning the textile industries. We were assured that an equivalent of some 31 million pounds sterling would be available for the knitting industry during these five years in order to renew its means of production. This would have been very important because despite the significant investments of the previous decade there remained many out-of-date machines working in the industry and also machines, bought in the seventies, that were not always of the highest technical level.

But today it has become clear that those ideas were not realistic and by the end of the eighties the whole Hungarian economy as well as the development of the knitting industry turned in a completely different direction.

### The Present

Political changes in Hungary in the last two years have served to bring the contradictions in the economy to the surface. Although we could feel the troubles by various symptoms, the picture, painted by bureaux and mainly by government officials, was not so dark as it seems today. Of course, we were aware of the huge debts of the country but we were always given a more cheerful picture than the reality. An ever-recurring headache was to obtain materials which we had to buy for convertible currency, sometimes even causing stoppages in production. But we thought the trouble temporary and trusted in the new credits which we thought would help us overcome the difficulties. But disquieting symptoms kept growing and experts soon began to doubt the reality of the high-falutin' plans.

The present problems of today's Hungarian knitting industry can be traced to more than one reason. One of them — which I personally believe to be the most important — is the gap in the technical level of our production from that which is recognised as up to date. But this is a consequence — a consequence of the previous direction of a central economy, which did not allow continuous technical progress and ranked above quality of production. At the same time a mistaken wage policy did not make it possible to increase wages and salaries in the knitting industry even to the level of the industrial average. This in turn is responsible for the decreasing number of skilled workers in this industry.

As a result therefore the structure showed wages and salaries play only a relatively small role. There was little incentive for companies to take meaningful steps to improve productivity using new technical solutions. Managements tried to compensate the decreasing number of workers by over-simplifying the technological processes and by eliminating important operations, not by effective increases in productivity.

Other handicaps being experienced by

the Hungarian knitting industry are that labour discipline has slackened and also the organisation of production cannot be optimised because of the frequently repeated shortage of raw material or spare parts which have to be bought for hard currency or because discipline in shipments of Hungarian suppliers is very poor.

The main goal of the knitting industry was for a long time, as with other industries, to increase its production as quickly and to as great an extent as possible. This was necessary at the beginning because of the shortage certainly of goods — and later in order to increase exports, but the Hungarian knitting industry could not follow the changes in quality which were demanded by developed countries to which Hungary wished to export. This is why Hungarian knitwear found better markets for itself in less developed countries which meant there was again not enough technical development stimulus.

The reconstruction in the textile industry in the 1970s gives a good example of the preposterousness of the situation. Its first goal was again to increase the quantity of goods. The view was that concentration should be on the production of medium quality goods rather than higher quality, higher value goods which could be sold more readily in more demanding markets, at a better price. The concept that technical development should serve this aim could not prevail. So it happened that important finishing processes which could have meant better products were again neglected. I could give you many such examples.

It is interesting that even the national economic plan for the years 1980 to 1985 did not prescribe for the textile industry that it should increase its exports in convertible currency. The main point was the export to the Soviet Union because Hungarian knitwear played an important role in supplying Soviet consumers. Our Soviet partners gave us raw materials and energy in return. (This remains important today too). But in the middle of the decade it became obvious that preference had to be given to exporting for hard currencies. The financial regulations had been modified in this sense and resulted in a big increase in textile exports in convertible currency to developed countries: it had been about 73 million pounds sterling in 1980 and grew to 104 million pounds sterling in 1988. Also the knitting industry took its share of this. It increased exports of some 12.5 million pounds sterling by more than 50 per cent. At the same time knitwear exports to CMEA/Comecon countries (mainly to the Soviet Union) increased in higher ratio, by 80 per cent. But while increasing exports to developed countries really met the interest of Hungary, export to less developed CMEA countries was also considered essential. This was already well known at that time and shows that the short term interest of the factories could not be reconciled with the long term interests of the country due to the inertia of the economic mechanism.



The importance of export in an industry which imports two thirds of its raw materials cannot, of course, be questioned. But it has also created anomalous consequences which contravene the interests of the domestic industry. Export and mainly export for convertible currency is a priority interest for each producer. This is also a policy of spinners, for example, to keep exporting their products. This was not allowed till 1984 but the restriction has been lifted since then.

Domestic textile factories obtain only the residue and the quality leaves much to be desired. Since spinning capacity is limited and they send their best products abroad, the domestic knitting mills must fight for this rest which is of questionable value. They must use it on their knitting machines and the result is, of course, poor quality, poor productivity, much waste — and less exportable knitwear. If they wish to export — and they do want to because they must if they wish to survive — they have to import good quality yarns for much hard currency which makes their products expensive.

The grave economic difficulties of the Hungarian economy hindered textile factories in going ahead with that technical development they had earlier thought to tackle with great ambition. There are only a few companies which have enough reserve to keep investing. (I am proud to be able to tell you that Habselyem belongs to this minority). Although the government incites companies to invest in order to increase their exports and have created preferences for investments in the form of credits which can be applied through tenders, these credits are so expensive that again only a few companies are able to draw on them. Leasing is in many cases more beneficial to business but this is also very expensive. A great advantage of leasing for Hungarian companies is that payment of the total amount can be deferred.

The number of employees in the state owned textile industry has decreased dramatically. In 1975 it still provided work for 136,000 people, in 1988 this came to 93,000 and one year later, in 1989, only 89,000. In the state owned knitting industry the number of employees was 29,000 in 1975 which fell to under 23,000 by 1988. This is obviously related to the very low level of salaries. The official average net income in the state owned industry amounted to an equivalent of 948 pounds sterling a year in 1988. This ran to 804 pounds sterling in the textile industry and only 708 pounds sterling in the knitting industry. This latter is particularly low in Hungary where the official minimum cost of living wage is about 500 pounds sterling a year.

Inflation in Hungary is officially about 20 per cent which is much higher than it was in the previous decades. This high inflation rate and a combination of many earlier constraints have changed consumer habits as well as the purchasing of garments. This has meant serious consequences for the knitting industry too.

The real value of the personal incomes has fallen since 1979. People have con-

tinued to spend even less money on clothes. In 1980 clothing represented 8.9 per cent of the total consumption; by 1988 this was only 6.2 per cent. If we calculate this consumption not in value but in pieces, the purchase of garments was 22 per cent more in 1980 than it had been in 1970, but it fell by 6 per cent below the 1970 level in 1988. This illustrates very well the sad trend.

Still, all these factors do not necessarily mean an absolute reduction of consumption. The Hungarian people can much more easily travel abroad than they could earlier and there was a short period during the last two years when the official selling of hard currencies in Hungary was liberalised. As a consequence, people could go abroad to shop. Many Hungarian tourists bought clothes, knitwear, sportswear, pantyhose etc. abroad besides a great number of video-recorders and deep-freezes. (Our Austrian friends can of course tell you stories about these "invasions"). This shopping abroad reduces domestic purchases of course, but official statistics do not/cannot reflect this.

Another phenomenon which distorts the official statistics is a boom in the second-hand trade in every kind of clothes, the reason being the enormous rise in selling prices of new clothes. This second-hand trade is not always legal and has become surprisingly large-scale. A part of this is the illegal import which means that tourists from Poland and also from some neighbouring countries come to Hungary to sell very cheap goods on the black market. There are innumerable garments, too, in their supply. The Hungarian authorities have closed their eyes to this activity so far, but, of course, it is again missing completely from official consumption statistics, and probably plays an important role in figures which show a big decrease of garment consumptions in the shops.

High quality fashionable lingerie is a feature of the Habselyem range.



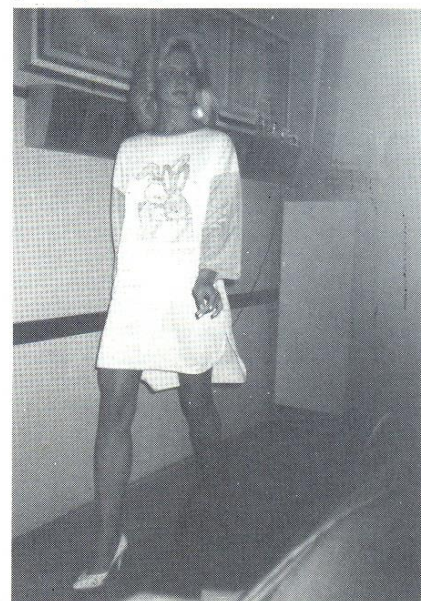
The liberalisation of official imports has created very strong competition for the domestic knitting industry. Hungary imported garments and other apparel goods officially to a total value of 59.2 million pounds sterling in 1988. More than a half of this amount, 31.5 million pounds sterling, was knitwear. It is only too obvious that such imports provide big competition for the Hungarian knitting industry, especially if we take it into consideration that the biggest part of this import comes from Western Europe and from the Far East. The first excels in being fashionable, high aesthetic content, excellent quality; the strength of the latter is its cheap price.

### Private Sector

Another big competitor of the State-owned knitting industry is the private sector. The private sector has never disappeared completely in Hungary but until the last few years it was severely limited. There were always small private workshops using one or two V-bed flat knitting machines or stocking machines. The owners sold their products in their workshop directly to customers or they gave them to private retailers who took the goods on to open markets. In recent years this private sector has grown rapidly. Even bigger workshops, and more recently private factories have been established. At one time these were sometimes illegal or semi-legal, lately entirely legal, in many cases having up-to-date machinery. Nowadays there are private dyehouses as well.

These workshops, sometimes in very primitive circumstances and using very poor quality yarns but with very low production costs, produce fashionable, though sometimes rather poor quality knitwear. On the other hand, some of these small factories make really very nice and good things. Because they are fashionable and look good, they can be

Fun garments are also manufactured, with printing a widely used means of embellishment.





sold at good prices. Sizes of the private industry can be described by the official data: there were 3,649 craftsmen in Hungary producing knitwear and they had 925 officially registered employees in 1988. These figures show that the majority of these private artisans worked officially alone, only every fourth enterprise had one registered employee. These numbers have certainly changed since 1988, mainly the rate of employees, but I cannot at this time give you newer data at this moment.

There were almost 38,000 private shopkeepers in Hungary in 1988, 6,544 of them retailing all kinds of clothes. The number of knitwear retailers can be estimated at about 1,300. According to some non-official estimates this figure has increased by 10 per cent since that time. Nowadays, however, there are signs showing that this number will be rendered stable soon because further demand is limited and too many knitwear retailers cannot exist side by side.

These retailers attribute great importance to selling fashionable knitwear and buy from the producers as cheaply as possible. Many of them are connected to persons who often go abroad and bring them fashionable goods, even if it is not always legal. But they know and follow with attention foreign fashion magazines and mail-order catalogues; they travel a lot, so they are well-informed about new fashion trends and they can motivate their suppliers to produce fashionable goods for them.

In this way the so-called "boutique trade" represents the highest aesthetic level in Hungary retailing expensive but high-level clothes.

#### Mass-Production

Besides, this also means cheap mass-production goods are strongly represented in private shops. Officials close their eyes to the poor quality of private trade but try to be hard on the quality of products sold by the State-owned trade. This inequality causes different production costs and is, of course, disadvantageous for the State-owned factories compared to private workshops.

The State-owned home-trade itself is being reorganised and today those who run State-owned shops have the right to buy goods from private suppliers. They can buy much more cheaply in this way of course, than if they buy through State-owned wholesalers, but — this is also obvious — they do not sell the goods more cheaply. The main part of the rest is their own profit. This is the reason why many knitting mills, State-owned ones as well, open their own retail shops and sell their products directly to both private and State-owned retailers, as well as wholesalers. Habselyem has, for instance, three public retail shops and another one where we sell directly to retailers.

The consequence of this situation is that large State-owned wholesalers, which were previously practically the only customers in the home market of the big knitting mills — both State-owned ones and co-operatives — complain of decreasing

demand. This is what official statistics actually show; and they give orders for only about half of the quantity they used to give earlier. This creates many problems for knitting mills: they struggle with financial problems, they must reduce their capacity, dismiss employees and they must concentrate on exports.

The export to CMEA countries is today much less economical than it was years ago, not only for the state but also for the individual companies. It has therefore been severely reduced. Export to developed countries is also limited because of production costs, quality levels, backwardness in technology and, in some cases, also of the quota system. The Hungarian knitting industry is not therefore in an enviable position.

#### The Hoped-For Future

What can we do in this situation? Hungary has a great knitting tradition. There were some famous factories before World War II, well known not only in the country but in the West, too. One of Habselyem's predecessors, Silk and Woollen Factory Ltd., for instance, exported a great deal of its knitted underwear to Great Britain and had a trade office in London. There are a good many experts in Hungarian knitting mills. We have three secondary technical schools, a polytechnic university and a technical college for the education of technical staff including personnel for the knitting industry. There is an important textile research institute in Budapest. The College of Applied Arts gives talented designers and stylists to the industry. All of these exist despite that which I have already mentioned: the income level is extremely low in this industry. Those people who come and remain in the knitting industry are those who really love it. I think this is a foundation on which one can build.

Where the Hungarian knitting industry really needs help is its technical level. Wages and salaries in today's Hungary are not so low that they can simply be disregarded or written down among the cost of production if we take into account that companies have to pay 45 per cent social security after wages and salaries. Two years ago, when personal income tax was initiated in Hungary, each employee received a compensation which represented the sum off the income tax. The reason of this was to maintain the net income on the original level after the taxation of the first year. This step has increased direct labour costs by an average of 14 per cent.

Overhead costs are very high relatively too.

The priority of the knitting mills is therefore to increase productivity, in order to decrease unit costs. This depends partly, no doubt, on work intensity which does not require investment. By better organised work and a better wage system workers can work faster and better utilise their working hours.

There were some political reasons earlier which hindered this endeavour.

But this does not form enough reserve. It is unfailingly necessary to establish an increase in productivity by technical means. It is necessary to replace the old and slow machines, working at low efficiency, by new ones which can produce more fabrics and better quality.

It should be necessary to supply the machines with auxiliary equipment which is able to help increase efficiency and reduce the rate of manual labour and the standing time, both in knitting and making up. It should be necessary to complete dyeing and finishing plants by up to date, computer controlled dye-kitchens and by special finishing machines which can give a satisfying handle, surface and other properties to the fabrics. It should be necessary to have equipment which helps to save material since material is very expensive in Hungary as well and the knitting industry is forced to import a big part of it which is paid for in hard currency. We must improve, therefore, the utilisation of material, partly by means of improving fabric quality, partly in cutting by using computers in lay planning in order to optimise material consumption.

Indirect labour costs represent a large proportion of the production costs in our Hungarian industry. There is too much bureaucracy and administration in our work, the efficiency of which is not satisfactory. Telecommunication systems are poor, there are not enough computers used in data processing, administrative work is too much and slow. There are too many people doing this work in the factories. If we want to reduce our production costs we must reduce this part of work and we must dismiss people, substituting their work by better application of computers. This is not an easy decision at all and is completely against the tradition of the last forty years when it was one of the basic laws that everybody has the right to work. It really was one great achievement of the socialist system that there was practically no unemployment in Hungary. But now we have to face this problem.

#### Good Results

I am proud to be able to report the good results of Habselyem's technical development. In the last four or five years we spent a great deal of money to buy and to lease new machines and a big part of our machinery has been exchanged. This is a great financial burden on us but has been the only possibility to survive. Our good and extensive business connections prove that, also in highly developed Western countries. But the reorganisation of our administration is essential for us as well and we cannot ignore the above mentioned personal difficulties.

Another area where we need help is in marketing. Hungarian knitwear has no international reputation today. It is usually ranked among mass products, along with those cheap goods coming from developing countries in the Far East. For this reason Hungarian knitwear cannot be sold in developed Western European

countries at a price which can be obtained for a similar item produced somewhere in Western Europe or in North America. The difference is even bigger if the competing item bears a well-known brand name. This problem can be solved only if we co-operate with partners who sell our products under their brand name. There are already many such examples in Hungary and they have given very good results. Habselyem itself has important exports in this way, both in Europe and the USA.

### Foreign Capital

It is widely known that Hungary makes efforts to attract foreign working capital into its production. The knitting industry is not an exception either. New forms of companies are already appearing and providing a good framework for this. A great number of negotiations are already in progress. The main purpose of the Hungarian side is to ensure that the foreign partner helps by its capital, technical development and the improvement of efficiency of production along with improvements in quality. It is very important too, that this partner supports, using its existing business connections, the more effective selling of Hungarian products on the markets where they can be sold at a relatively higher price. And, last but not least, it is very important that the partner introduces high technology, a developed production organisation and strict discipline in technology and labour into Hungarian knitwear production, gives know-how to the producers and help find cheaper sources of raw materials.

A process has already begun in the Hungarian economy and also in the knitting industry: the breaking down of the previous great organisations. The huge companies were relatively easy to control by government offices and ministries. I suppose that this was one of the reasons to concentrate production units some decades ago. But these big companies show a powerful inertia against the key slogan of today: quick response. The abandonment of direct government control, constraint to dismissal of employees, searching for new selling possibilities, compulsion of reduction of production expenses — all these and many other facts enforce this trend. These small companies turn mainly into limited liability companies or joint-stock companies and would be very happy if foreign investors wished to take a share in their business. I think there is a lot of potential in such co-operations because these small organisations are in many cases very flexible and have inventive management.

The present Hungarian taxation and interest system is very disadvantageous both for big and small companies. Only a very small proportion of the profit may be used for technical modernisation and for wage increases. This small part is not enough at all to reduce the technological gap between the Hungarian industry and that of the developed countries — nay, this gap keeps getting bigger. Official

rates of interest on loans given by banks are today so high that they can actually be called usurious. I hope that the new government will find another way to solve the economic problems of the country than the continuous increase of taxes and interest rates because the present situation cannot be maintained without smashing this industry. Our friends abroad could help us if they came to Hungary to invest there and to introduce their up to date technologies and organisations.

And what can the Hungarian knitting industry offer to the foreign investor? A traditional culture of production, well educated experts, managers, engineers, technicians, designers and stylists, a great will to renew the industry — facts and motivations upon which a new organisation of industry can be founded. To come to Hungary means to come to a European country, with all of its culture and civilisation. Businessmen should take into account that production costs in Hungary are lower compared to those of the

Western world, quality is better and better controlled than in the cheapest developing countries, transport distances are shorter. Many foreign companies have contract work made in Hungarian knitwear factories. This is advantageous for the Hungarian partner from the point of view of finance and of the fact that they can learn up to date methods of work. And it is advantageous also for the foreign partner because work is usually cheaper in Hungary than at home.

Laws which help foreigners to take part in Hungarian companies have already partly come into force. They will probably be framed soon after the new Parliament and the new government have taken office. The Hungarian knitting industry needs this "blood transfusion" and I personally believe that our knitwear production can and will be renewed and make much profit for the individual companies, for their employees, for the country as well as for the overseas partners who invest in the industry.