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December 28, 1983

To: Members of the Executive Board
From: The Acting Secretary
Subject: Hungarian People's Republic - Recent Economic Developments

This paper provides background information to the staff report on the 1983 Article IV consultation discussions with Hungary and its request for a stand-by arrangement which was circulated as EBS/83/268 on December 16, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Ms. Salop, ext. 74897 or Mr. Stanyer, ext. (5)7187.

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INTERNATIONAL MONETARY FUND

HUNGARIAN PEOPLE'S REPUBLIC

Recent Economic Developments

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Approved by the European Department and the
Exchange and Trade Relations Department

December 23, 1983

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Hungary--Basic Data

Population (1982 average) 10.70 million
 GDP per capita (1982) SDR 1,959

National accounts 1982 (at current prices):

	<u>In billions of SDRs</u>	<u>Percent of GDP</u>	
Private consumption	12.7	60.8	
Public consumption	2.1	9.9	
Gross fixed investment	5.3	25.2	
Change in stocks	0.7	3.3	
Exports of goods and services	8.0	38.0	
Imports of goods and services	<u>7.8</u>	<u>37.2</u>	
GDP	21.0	100.0	
Selected economic indicators (changes in percent)			
	<u>1980</u>	<u>1981</u>	<u>1982</u>
Net material product ^{1/}	-0.8	2.5	2.3
Net material product used domestically ^{1/}	-1.9	0.7	-1.4
GDP ^{1/}	0.2	2.9	2.8
Private consumption ^{1/}	1.1	2.6	1.3
Gross fixed investment ^{1/}	-6.4	-4.3	-1.6
GDP deflator	5.3	5.5	5.7
Consumer price index	9.1	4.6	6.9
Real wages	-1.6	1.1	-1.2
Money supply (end of year)	13.8	7.6	9.5
Domestic credit (end of year)	8.2	8.9	6.1
Foreign trade with ruble area			
Exports ^{1/}	-1.2	3.9	3.3
Imports ^{1/}	—	-3.4	3.8
Terms of trade	-1.1	-3.9	-3.2
Foreign trade with non-ruble area			
Exports ^{1/}	2.2	1.7	10.7
Imports ^{1/}	-2.6	3.6	-2.4
Terms of trade	1.6	2.2	-1.1
Ratios to GDP (in percent)			
Gross value added in industry	37.6	38.1	38.2
Gross value added in agriculture and forestry	18.8	19.0	19.6
State budget balance	-0.6	-1.2	-1.4
Balance of payments on current account	-2.6	-3.9	-1.2
Balance of payments (in millions of SDRs)			
	<u>1980</u>	<u>1981</u>	<u>1982</u>
Trade balance	-110	33	460
Invisibles, net	-334	-794	-717
Of which: Investment income, net	(-299)	(-949)	(-871)
Current balance	-444	-761	-257
Of which: In convertible currencies	(-284)	(-617)	(-57)
Medium- and long-term capital, net	599	839	151
Short-term capital, net ^{2/}	183	-601	-905
Changes in reserves, etc. (-increase)	-338	522	798
Of which: In convertible currencies	(-330)	(450)	(832)
Use of Fund resources	—	—	215
Foreign debt in convertible currencies (end of period, in millions of SDRs)	7,127	7,474	6,994
Exchange rate (forint/U.S. dollar, period average)	32.523	34.314	36.631
IMF (as of November 30, 1983)			
Quota	SDR 375 million		
(New quota)	(SDR 530.7 million)		
Fund holdings of forint	SDR 838.8 million		
Hungary's holdings of SDRs	SDR 5.0 million		
Representative rate	Ft 44.8280 = US\$1		

^{1/} In volume terms.

^{2/} Including errors and omissions.

I. Supply and Demand

1. Overview of structure of production

The structure of gross domestic product has in recent years been marked by a moderate decline of the share of GDP originating in the socialist sector, to 96.5 percent in 1982 (Table 1). Including output generated within the socialist sector by individuals on their own account (on household plots and auxiliary farms, and through economic partnerships), private economic activities accounted for about 10.5 percent of GDP.

The share of industry in total output rose sharply as a result of the industrialization drive during the 1950s and to a lesser extent in the 1960s, but has stabilized at about 38 percent of GDP at producer prices during the past decade (Table 2). Almost all industry is state owned, with cooperative and private production accounting for only about 7 percent of gross industrial output in 1982.

In 1982, 99 percent of farming land was under socialist ownership, i.e., state farms or cooperatives. Of this, about 8 percent was cultivated privately on household plots and on auxiliary farms made available to employees of other sectors. Together with private farms, such household plots and auxiliary farms contributed close to one third of gross agricultural output. In recent years there has been a rapid expansion of ancillary industrial, construction, and service activities on farms. By 1982, such activities accounted for almost 26 percent of output in state farms and cooperatives. The authorities have encouraged this movement as it helps to fill gaps in supplies and to generate funds for investment, thus improving food supplies and the export potential of agriculture. It has also contributed to a recent reflux of labor to the agricultural sector.

Until 1957, agricultural output was sold to the State under a compulsory delivery system. Subsequently, this system was abolished and greater flexibility introduced in the marketing of agriculture products. At present, 80 percent of agricultural produce is sold to state purchasing agencies on a contract basis, while 20 percent is traded on the free market.

In 1982, the construction sector contributed 8 percent of GDP. About two thirds of building activities were carried out by state enterprises, one fifth by cooperatives, and almost 15 percent by private craftsmen and the contribution of own labor by the population in the construction of private homes. Services accounted for about one third of GDP at producer prices in 1982, with about 5 percent of total output in services generated in the private sector. Small private shops provided about 55 percent of repair, maintenance, trade, and other consumer services to households. In addition, since the liberalization of private activities at the beginning of 1982, there has been a strong increase in privately

operated units rented or leased from the socialist sector in retail trade and catering and in private transportation services provided by individuals who have kept their primary employment in the socialist sector.

2. Recent developments in production

With the change in macroeconomic policies since 1979 toward greater emphasis on external adjustment, GDP growth slowed from an annual average rate of almost 6 percent during 1971-78 to about 2 percent during 1979-82 (Table 2). Because of a rapid rise in depreciation and the more moderate deceleration of growth in the so-called nonmaterial services sector, the slowdown was more pronounced for real net material product (from almost 6 percent to 1.5 percent). Still, the production performance was at the highest limit of the planned growth rate of 2.0 percent to 2.5 percent in 1981, and overshot the highest rate foreseen in the 1982 plan by almost 1 percentage point (Table 3). Sharp production increases in the private sector partly explain some of these results, with the share of the private sector in GDP rising significantly from 1980 in response to various incentives which culminated in new legislation to legalize activities in the second economy and encourage new forms of private undertakings with effect from January 1, 1982. ^{1/} In 1982, the private sector is estimated to have contributed nearly one quarter of the overall growth (of 2.8 percent) in real GDP. A much larger contribution (2.3 percentage points), however, stemmed from exceptionally good crops. In 1983, the growth of GDP has slowed perceptibly, to about 0.5 percent according to preliminary estimates. In part, this reflects a loss of agricultural output due to a severe drought in the summer. However, output has also slowed in the other sectors of the economy, due primarily to sluggish demand in both domestic and foreign markets.

a. Industry

The period since 1975 has been marked by a continuous decline of the share of industry in total employment from 35.7 percent to 31.8 percent in 1982, while the share in gross output has remained roughly unchanged. With a slackening in the growth of both foreign demand and a weakening in domestic demand, the average annual rate of rise in total industrial production in the socialist sector slowed from 6 percent during 1971-78 to 1.5 percent during 1979-82. During the latter period, the increase in total sales of socialist industry (of 1.1 percent a year on average in volume terms) was paced by sales on foreign markets (which increased by 4.5 percent a year). Foreign sales grew particularly strongly in the food processing industry (average annual rate of 10.5 percent) and also in engineering (6 percent). Details of the rates of growth of output in the various branches of socialist industry in the recent period are set out in Table 4.

Data for the first eight months of 1983 show a continuation of the trend of previous years, as far as the output of sub-branches is concerned.

^{1/} Part of this growth is also to be explained by a better statistical coverage of these activities.

While the year-on-year growth in the volume of industrial exports accelerated to more than 8 percent, total sales stagnated and the increase in the volume of output slowed to 1 percent. For the year as a whole, gross output in industry is expected to expand by 1-1.5 percent.

b. Agriculture

Agriculture and forestry accounted for about 23 percent of employment and 20 percent of GDP in 1982. Exports of agricultural and food products represented one quarter of merchandise exports and one third of exports to the convertible currency area. Data on major crops, livestock, and yields are shown in Table 5.

Gross output in agriculture and forestry grew considerably during the 1970s, at an annual average rate of about 3.5 percent, paralleled by a marked improvement in the yields of major crops (especially wheat and corn). Following a poor harvest in 1979, gross value added increased by 4.6 percent in 1980, 3.4 percent in 1981, and 11.7 percent in 1982. As a result of one of the most severe droughts experienced in 40 years, a large shortfall in output is expected for 1983. At 1981 prices, gross output of agricultural products is expected to fall by 5-6 percent, as opposed to a planned increase of 1.2 percent. Compared to the Plan, major shortfalls are foreseen in the production of corn, sugar beet, sunflowers, and potatoes, while production of grapes, fruit, and vegetables are expected to be somewhat lower than planned. However, as a result of efforts to reduce intermediate costs, and of the fast growth of ancillary (nonfarming) activities with low overhead costs, the decline in the value added in agriculture and forestry is expected to be less dramatic and could be limited to 2-2.5 percent.

c. Construction

As a result of cutbacks in state and enterprise investment, the gross output of building companies in the state and cooperative sector fell by more than 4 percent a year between 1979 and 1982. However, during the same period, the building activity of socialist enterprises outside the construction sector quickened to an annual average growth of more than 5 percent, as such enterprises, notably the ancillary construction sections of agricultural cooperatives, demonstrated greater adaptability to changes in the structure of demand. Moreover, after virtual stagnation in the preceding four years, private building activities, including the contribution of own labor by households, grew by some 6 percent in 1982. Correspondingly, while employment in the construction sector proper fell by more than 5 percent a year between 1979 and 1982, the number of persons engaged in building activities outside the sector increased. All told, the number of persons employed in building activities fell by only 0.6 percent a year during the period, and overall construction output by 1 percent a year.

According to data available for the first eight months of 1982, the trend of previous years has continued for enterprises in the construction sector. Gross output was 2.8 percent and employment 4.1 percent lower than a year earlier.

d. Mining and energy

Hungary is not richly endowed with mineral resources, with the exception of bauxite, the deposits of which are among the largest in Europe. The economy is therefore heavily dependent upon imports of raw materials and energy, which are mainly obtained from the U.S.S.R.

Bauxite production increased from under 2 million tons in 1970 to 3 million tons in 1980, but declined subsequently to 2.6 million in 1982. In the first eight months of 1983 this downward trend was reversed as production increased by 16.5 percent over the same period of 1982. About 18 percent of bauxite output is exported, mostly to CMEA countries and to the Federal Republic of Germany, while the rest is converted into aluminum, part of which is also exported. Exports of bauxite and aluminum fell sharply in 1982, but picked up considerably in the first eight months of 1983, in line with a recovery of demand in foreign markets.

Developments in production, imports, and uses of energy are summarized in Tables 6-7. Historically, the major source of energy was coal, with about 87 percent of domestic use being covered by domestic production. With the development of energy-intensive industries, the share of oil and natural gas in total energy uses increased steadily during the 1970s to 65 percent in 1978. Despite a stagnation in energy requirements since the latter year, Hungary's import dependence in energy continued to rise, to 52 percent by 1980.

Energy policy since 1980 has aimed at reducing import dependence by cutting intermediate and final uses of energy, bolstering domestic production of coal and natural gas, and inducing shifts in energy consumption toward a greater reliance on domestically produced sources. Two major objectives are to lower the share of oil and natural gas in energy resources to 56 percent by 1985 (from 62 percent in 1980) and the dependence on imports to 47 percent (from 52 percent).

Price adjustments have been a principal policy instrument. Since 1980, the prices of crude oil, petroleum products, and coke have been linked to world market prices in the convertible currency area, and the price of natural gas to that of gas imported from the U.S.S.R. Oil imports from the U.S.S.R. are priced according to the Bucharest formula, i.e., a five-year moving average of world market prices, while the domestic producer price of oil is kept in line with the price of Saudi Arabian light crude. As with other raw and basic materials subject to this domestic pricing scheme, the difference between the lower import price and the domestic producer price is taxed by the State through the differential producers' turnover tax introduced at the time of the 1979-80

price reform. In order to encourage substitution, the price of domestically mined coal is set at a level which approximately covers production costs (i.e., about one third of the price of fuel value-equivalent hydrocarbons). At the consumer level, the authorities have not fully passed on the effect of the marked increases in the producer prices of energy since 1979. Moreover, lump-sum subsidies, to offset part of the effect of energy price rises without discouraging energy conservation, have been granted temporarily to agriculture and the construction materials industry. These subsidies have been gradually lowered over time and those on construction materials are scheduled to be phased out by 1984.

During 1980-85, some Ft 30 billion of preferential credits for energy-saving investments are to be extended by the National Bank or the State Development Bank. On June 16, 1983, the World Bank approved a loan of US\$109 million for an Industrial Energy Diversification and Conservation Project, aimed at improving the efficiency of major energy consuming industries. The authorities also intend to reduce import dependence by increased efforts to expand domestic coal, natural gas, and oil extraction, and to use domestic uranium reserves. The first phase of Hungary's nuclear energy program started production in late 1982; with a capacity of about 2,000 megawatts when completed, it is expected to meet about 5 percent of Hungary's total energy needs by 1985.

Partly as a result of the above policies, the ratio of intermediate inputs to gross output fell from an estimated 65.1 percent in 1979 (at 1981 prices) to 64.4 percent in 1982, with the bulk of the improvement occurring in the latter year. Whereas gross output in real terms grew at an annual average rate of 2 percent during the period 1979-82, energy uses in productive activities registered an absolute decline, and for the economy as a whole, energy use in 1982 differed little from that in 1978. As a result of these developments and a shift in the structure of energy consumption (a fall in the share of oil and gas to 62 percent), Hungary's dependence on energy imports had fallen to 50 percent by 1982. These trends were expected to endure in 1983 because of a continuing decline in the share of heavy energy using industries in total production, and a more rational use of energy in intermediate and final consumption.

3. Demand

Total domestic demand grew at an average annual rate of 5.7 percent during 1971-78 and was accompanied after 1973 by a sizable deficit on the foreign balance, which reached the equivalent of 9 percent of GDP in 1978. Following the introduction of adjustment policies in 1979, domestic demand fell at an annual rate of 0.7 percent through 1982 while the real foreign balance improved to a surplus of 1.8 percent of GDP. In 1982, domestic demand remained roughly unchanged, and the 2.8 percent growth in real GDP was attributable entirely to a further marked strengthening of the foreign balance, helped in part by a tightening of import restrictions in the latter part of the year (Table 2). In 1983, domestic demand is expected to fall by about 1.5 percent in real terms. This together with only moderately eased import restrictions and a more active exchange

rate policy is estimated to lead to a further notable improvement of the foreign balance--equivalent to about 2 percentage points of 1982 real GDP--despite continued adverse conditions in external markets.

a. Consumption

With the shift in the stance of policies, the rise in overall consumption slowed down to 2 percent a year on average during 1979-82, from 4.4 percent during 1971-78. Public consumption generally grew more rapidly than private consumption during the 1970s and the decline in the growth rate was less marked than for private consumption. In 1982, in a departure from the past general pattern, private consumption increased (by 1.3 percent) slightly faster than public consumption (1.0 percent).

Developments in households' income, consumption, and savings are summarized in Tables 8-10. During the period 1979-82, the average growth rate in real disposable income was about 1.5 percent a year, compared with 4.6 percent in the period 1971-78. Apart from a reduction in employment, the slower rate of growth was attributable to a decline in per capita real labor income of 0.6 percent a year on average, reflecting the containment of real earnings by the authorities, and to a deceleration in the average rise of real social benefits per capita from 7.4 percent a year during 1971-78 to 4.3 percent a year subsequently. In relation to plan targets, the growth in private consumption slowed as intended in 1979 and 1980, but the plan target was exceeded in 1981 (Table 3). In 1982, consumption again exceeded plan targets, despite a more pronounced decline in real wages, given that incomes from private activities were more buoyant than anticipated and the household savings rate remained unchanged.

Although real wages decreased sharply further in the first eight months of 1983, total cash receipts of the population were 8.3 percent higher than a year earlier, due to the buoyancy of incomes earned in private activities. For the year as a whole, wages and benefits earned in the socialist sector are likely to be roughly in line with plan targets, but due to the buoyancy of other incomes, instead of the planned reduction of 0.5-1 percent, private consumption is likely to remain stable or increase marginally in real terms.

b. Investment

(1) State and enterprise investment decisions and financing

Approximately 86 percent of investment in Hungary is undertaken by the socialist sector, either by the State or enterprises. State investments generally consist of projects, mainly in infrastructure and the development of raw material and energy sources, which are expected to influence the structure of the economy. In addition, projects which require large capital outlays are undertaken by the State. Capital formation outside the socialist sector consists mainly of private sector

investment in housing. On the basis of data available for the end of 1980, about 20 percent of the capital stock of the economy was owned by individuals, of which private housing accounted for about 40 percent.

Following the 1968 economic reforms, investment decisionmaking in the socialist sector was partly decentralized, with greater authority delegated to enterprises. The share of investments decided upon by firms and financed from their own resources has since grown significantly, although implicit state guidance has been maintained in many investment decisions. Enterprises cannot generally finance their investments fully from their own funds and must therefore depend in part on budgetary resources or bank credit (Table 11). The National Bank of Hungary grants investment credits to enterprises, provided that they can make a certain contribution to the financing of the projects from their own resources, that the projects yield a minimum return of 15 percent annually on the funds invested, and that the completion period of the investment is less than three years. In 1982, five preferential investment areas were defined: export promotion, import substitution, energy saving, recycling of materials, and technological innovations. For investment outlays falling under these categories, enterprises may receive interest rebates if certain additional requirements--typically relating to the amortization period of the credit and to the share of incremental production that is to be exported or substituted for imports--are met. Until 1979, the amounts of investment credit specified in the Plan were viewed as ceilings which could be exceeded to finance export-oriented projects. More recently, increases in investment credits for exports that exceed the planned amounts have been offset by reductions in credits for projects outside the export sector.

The five-year and annual plans contain specific targets for state investments, and the figures for enterprise investments are essentially forecasts. Owing to the weakness of the profit motive and the laxity of financial constraints, enterprise investment has tended significantly to overshoot the projections of the plan.

(2) Developments in fixed investment

Given the past record of overinvestment and concerns about the maintenance of the standard of living, the restrictive economic policies since 1978 have been concentrated on bringing about a fall in investment activity. Although, with the exception of 1979, investment plans continued to be exceeded, the average annual growth of gross fixed investment of about 6.5 percent during 1971-78 was followed by an average decline of about 2.8 percent through 1982 (Table 2). As a result, the ratio of gross fixed investment to GDP (at current prices) fell from a peak of about 35 percent in 1978 to 25 percent in 1982.

In 1982, as planned, state investment remained roughly unchanged at current prices, with a marked decline being manifest in the field of large state projects. However, the provisions of the Plan for investment outlays in the socialist sector were exceeded because of a

further overshooting (by nearly Ft 5 billion, or 4 1/2 percent) of enterprise investment. This occurred in the wake of more buoyant profits than anticipated in 1981, and despite the implementation of a wide range of measures to curtail enterprises' investable funds and raise the cost of investment. Thus, the rates of compulsory reserve fund contributions were raised with retroactive application to 1981 profits; the latitude of certain enterprises to retain more than 60 percent of depreciation allowances in their development funds was abolished; 4-6 percent of development funds were frozen; enterprises were induced to make early repayments of investment credits from their development funds and to use additional resources from development funds rather than bank credits to cover working capital needs; state investment support to enterprises and subsidies for the purchase of machinery by agricultural units were reduced; interest rates on bank credits were raised in July and October; the tax on construction was increased in midyear from 10 percent to 20 percent; and a new tax of 25 percent on new investment was introduced. Nonetheless, while investment grants from the budget and recourse to investment credits from the National Bank declined somewhat as against 1981, preferential state loans and fund transfers to supplement enterprises' own resources continued to rise, and investors mobilized Ft 4.5 billion of additional resources from their development funds (Table 11). Together with an upturn in private housing investment, the resulting overrun of enterprise investment held the decline in gross fixed capital formation in 1982 to only 1.6 percent in real terms, compared with the planned reduction of 4.5 percent.

Developments in the early part of 1983 indicated that investment outlays in the socialist sector were again more buoyant than targeted. In particular, state investment spending in the first half year was 18 percent higher (at current prices) than a year earlier and a further overshooting of enterprise investment was also foreshadowed. Against this background, the authorities introduced a new package of measures around midyear to contain investment spending: effective interest rates were raised; the early repayment of certain investment credits was accelerated further; unutilized reserves for investment credits and for budgetary investment appropriations were frozen; the rate of the construction tax was raised to 30 percent and a construction tax of 10 percent and investment tax of 15 percent was imposed on formerly exempted investment projects; and the rates for development funds to be frozen were raised by 2 percentage points. As a result, enterprise liquidity was curtailed by an estimated Ft 6 billion.

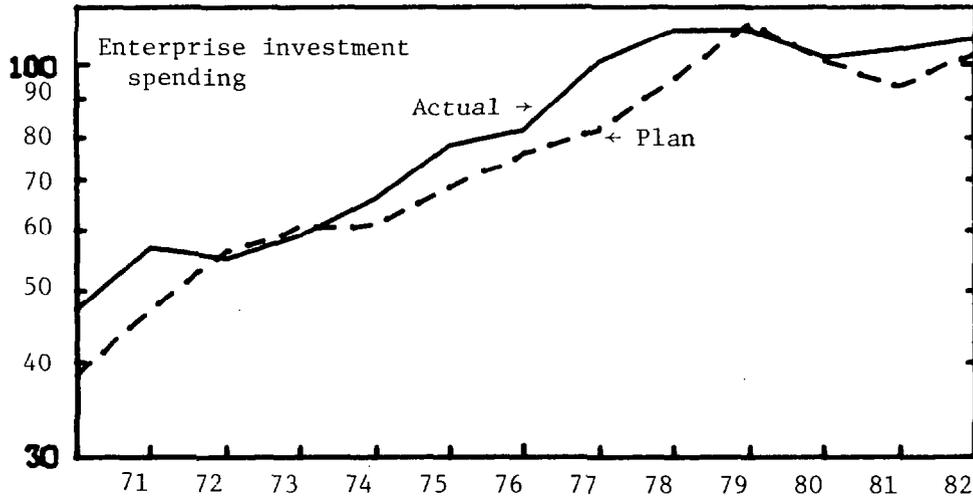
Since midyear, the year-on-year pace of socialist sector investment outlays has slowed down, but for the year gross fixed investment for the economy as a whole is expected to decline only by about 2 percent in volume terms, or less than the 4-6 percent reduction originally planned. Compared with the Plan, outlays by both the State and enterprises are expected to be stronger than programmed, with housing investment by private households developing much as expected. The overrun on state investment has occurred in two main areas: local authority investment has been stronger than foreseen, due to larger-than-expected contributions

Chart A

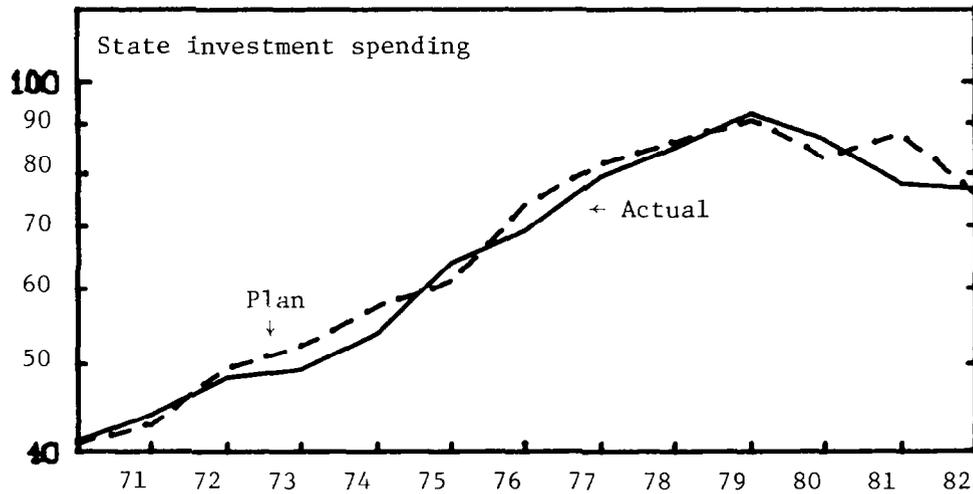
HUNGARY

Development of Fixed Investment

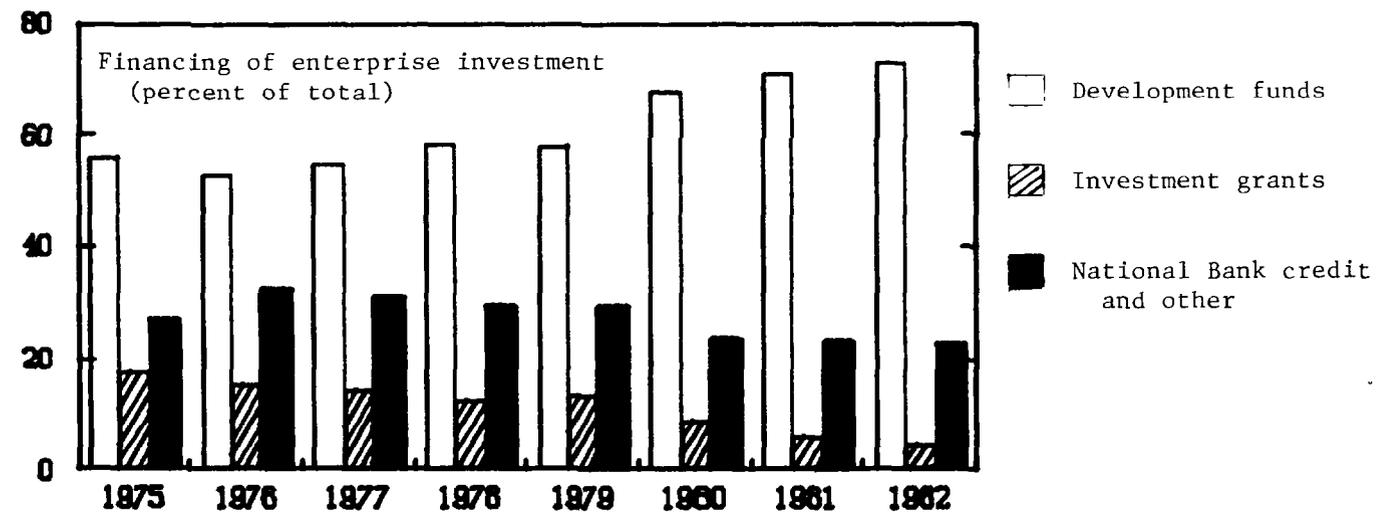
Billions of Forint



Billions of Forint



Percent



Sources: CSO, Statistical Yearbook, and data provided by the Hungarian authorities.



of enterprises and the population to the financing of infrastructural projects; and outlays on large state projects have surpassed earlier projections in part because of unanticipated deliveries of capital goods from the CMEA area related to the construction of the PAKS nuclear power plant. The latter development has been mainly accommodated by higher loans from the State Development Bank than initially foreseen. The overshooting of fixed investment expenditure of enterprises, meanwhile, has been accommodated by a stronger use of retained earnings and recourse to funds released by tighter inventory management.

(3) Stockbuilding

Changes in stockbuilding have influenced domestic absorption and the foreign balance strongly in recent years (Table 2). Enterprises have tended to maintain large inventories in part because of unreliable deliveries of major inputs from socialist country suppliers and generally easy financing conditions. Permanent stocks are financed from enterprises' development funds, while working capital credits from the National Bank are available for a temporary accumulation of inventories.

A sharp surge in stockbuilding in 1978 was followed by a more moderate development as economic growth slowed down, financing was tightened, and part of the remuneration of managers in 1979 was made contingent on a reduction of inventories. The pickup in stockbuilding in 1980 and 1981 stemmed in part from higher inventories of finished goods in circumstances of sluggish demand. In 1982, inventory accumulation declined, but by less than originally envisaged--despite a tightening of conditions for working capital credits--primarily because of the exceptionally good harvest and sizable advance deliveries of petroleum from the U.S.S.R. in the latter part of the year.

In 1983, the rate of stockbuilding is expected to fall somewhat more sharply. This was foreshadowed by a markedly stronger rundown of inventories in the first half of the year than in the same period of 1982, attributable partly to the deliberate policy of the authorities to contain inventory accumulation and to tighten import regulations, but also to the reversal of the stockpiling of crude oil from the latter part of 1982. This has been buttressed in the second half of the year by a rundown of inventories of farm products in the wake of the drought. For the year as a whole, the slowdown in stockbuilding may yield a negative contribution to GDP growth of close to 1 percent (against a negative contribution in 1982 of 0.6 percent).

4. Reform of the institutional framework of production

Along with the adoption of stricter demand management policies, since 1978 renewed emphasis has been laid on measures of structural reform aimed, inter alia, at improving the responsiveness of enterprises to market signals and at bringing about a more efficient allocation of capital and labor. Toward these ends, various efforts have been made to improve the institutional framework of production, including:

a. Initiatives to loosen the ties between enterprises and the traditional supervisory authorities. In the course of the 1968 reform, enterprises were freed from the constraints of plan instructions and centralized allocation of materials and were expected to develop as autonomous entrepreneurial units responding to the market and to macro-economic policy decisions applied uniformly across the enterprise sector. However, after the reform process was halted in 1972, enterprises became increasingly subject again to individual control by supervisory authorities; bargaining between the enterprises and the competent central or local authorities about the application of economic regulators and the allocation of financial resources became pervasive; and the correlation between profitability and efficiency was lessened.

A number of steps have been taken in recent years to reverse this process. First, with a view to reducing the scope for intervention in enterprise activities, in January 1981 three industrial branch ministries were merged into a single ministry of industry and their marketing and price setting responsibilities were transferred to the Materials and Price Board. Second, in an effort to loosen the pronounced dependence of large corporations on branch ministries, in 1983 the authorities broadened the role of such enterprises' supervisory committees--members of which include representatives from financial institutions and independent experts, as well as ministry staff. Third, during 1981-82 new legislation widened the scope for the establishment of boards of directors in trusts and large state enterprises and strengthened their decision-making authority. Fourth, regulations concerning the selection of top managers and the appointment of senior staff were modified in 1981-82 to foster open applications, selection by special committees representing a broad range of interests, and appointments for fixed terms.

b. Initiatives to lower the degree of concentration in the traditional enterprise sector and to restructure inefficient enterprises. Following the industrialization drive during the initial postwar period, there was a move to concentrate enterprises in large units in order to facilitate central control and promote large-scale production. Mergers were particularly pronounced in the first half of the 1960s, when the number of state industrial enterprises declined from 1,368 to 840, and again after 1972. The result was a virtual absence of small and medium-sized enterprises in the socialist sector. Whereas in market economies the share of industrial employment represented by enterprises employing 50 persons or less is typically about 15 percent, in Hungary this ratio was only 0.1 percent in the socialist sector in 1980. Following a review of the situation in 1979, it was concluded that the concentration process inhibited competition, hampered progress toward increased enterprise autonomy, and accounted for much of the sluggishness in the structural adaptation of industry.

A process of decentralization has since ensued. During 1980-82, 10 trusts (out of 25) and 4 conglomerates were dissolved; 26 enterprises were abolished; and 167 new independent units established. In July 1983, one of the largest trusts, the Csepel Iron and Metal Works Trust, employing a staff of 20,000, was broken down into 10 independent enterprises,

3 joint ownership companies, and 2 small enterprises. In similar moves, the VOLAN Trust, a nationwide conglomerate in transportation, is scheduled to be split into 20 independent enterprises at the beginning of 1984; and 18 large construction companies are to be reorganized in the course of the year.

In 1983, new regulations took effect to speed up the phasing out of inefficient enterprises. Loss-making enterprises are obliged to draw up and implement restructuring programs to eliminate losses. Failure to do so may entail a withdrawal of capital and labor resources, a replacement of managers, forced restructuring, or, as a last resort, the liquidation of the firm. To facilitate the restructuring process, new legislation was adopted in the spring of 1983 to permit the sale of inefficient state enterprises to entrepreneurial units in the cooperative sector.

c. New legal rules from the beginning of 1982 designed to promote the expansion of small and medium-sized enterprises in the socialist sector, to legalize private activities in the second economy, and to encourage new private undertakings.

In the state enterprise sector, the new legislation encourages the establishment of independent small companies and subsidiaries of existing firms, the contractual transfer of facilities of state enterprises to private operators, and the organization of staff economic partnerships. The members of such partnerships operate the equipment of the enterprise on their own time for the performance of specific tasks which, together with their remuneration, are contractually agreed with the enterprise. In the cooperative sector, new enterprise forms encompass small-scale cooperative associations, specialized industrial and servicing associations, specialized agricultural cooperative groups, specialized small cooperatives, and the independent operation of facilities by staff members on a contractual basis. New units in the private sector include independent economic partnerships and civil law companies, which supplement earlier existing forms of private activities in small-scale farming on household plots, auxiliary, or private farms, the operation of small enterprises in handicrafts, construction, retail trade, and restaurants, and the rental of rooms in private homes.

d. Measures to begin easing the administrative constraints that prevent companies from broadening the range of their activities. According to company legislation, the principal activity of an enterprise is stipulated in its founding statutes and can be modified only upon prior consent of the founding organization and the branch ministry. Some changes of existing rules in this area were introduced in 1982--allowing trading companies to organize their activities without territorial and sector constraints, and permitting the sharing of profits between trading and producing enterprises--and, beginning in 1983, retail traders have been permitted to deal directly with producers, circumventing the intermediation of wholesalers.

Table 1. Hungary: Breakdown of Gross Domestic Product by Social Sectors

	1975	1976	1977	1978	1979	1980	1981	1982 <u>1/</u>
(In billions of forints; at current producers' prices)								
State sector	376.3	397.6	439.4	475.1	507.3	476.0	513.2	550.9
Cooperative sector <u>2/</u>	96.5	100.6	110.6	117.9	122.2	125.3	140.1	151.0
Auxiliary farms of employees	<u>18.0</u>	<u>22.0</u>	<u>25.1</u>	<u>24.0</u>	<u>23.3</u>	<u>25.7</u>	<u>28.5</u>	<u>29.8</u>
Socialist sector	490.8	520.2	575.1	617.0	652.8	627.0	681.8	731.7
Private sector <u>3/</u>	<u>8.7</u>	<u>9.0</u>	<u>10.2</u>	<u>12.0</u>	<u>13.7</u>	<u>16.0</u>	<u>21.6</u>	<u>26.8</u>
Gross domestic product	499.5	529.2	585.3	629.0	666.5	643.0	703.4	758.5
(In percent of GDP)								
State sector	75.4	75.1	75.1	75.6	76.1	74.0	73.0	72.6
Cooperative sector <u>2/</u>	19.3	19.0	18.9	18.7	18.3	19.5	19.9	19.9
Auxiliary farms of employees	<u>3.6</u>	<u>4.2</u>	<u>4.3</u>	<u>3.8</u>	<u>3.5</u>	<u>4.0</u>	<u>4.1</u>	<u>3.9</u>
Socialist sector	98.3	98.3	98.3	98.1	97.9	97.5	97.0	96.5
Private sector <u>3/</u>	<u>1.7</u>	<u>1.7</u>	<u>1.7</u>	<u>1.9</u>	<u>2.1</u>	<u>2.5</u>	<u>3.1</u>	<u>3.5</u>
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: CSO, National Accounts; and data provided by the Hungarian authorities.

1/ Preliminary data.

2/ Including household plots privately cultivated by members.

3/ From 1982, including individual economic partnerships.

Table 2. Hungary: Gross Domestic Product

	In billions of In per-		Percentage changes in constant prices 1/							
	forint; at current prices	cent of total	1971-75	1976	1977	1978	1979	1980	1981	1982
	1982 <u>1/</u>									
Sources										
Industry	290.0	38.2	7.3	5.7	6.8	5.5	4.8	-1.1	5.0	3.7
Agriculture and forestry	148.5	19.6	3.9	-3.8	13.7	0.4	-1.7	4.6	3.4	11.7
Construction	60.1	7.9	7.4	5.8	7.0	4.4	2.9	-6.2	1.3	-0.7
Transportation and communications	70.5	9.3	5.2	2.2	5.1	4.0	3.4	-0.2	4.6	1.0
Other material sectors <u>2/</u>	86.1	11.4	7.6	5.0	6.5	4.8	1.8	-1.6	3.0	-0.5
Nonmaterial services	103.3	13.6	5.7	4.5	5.2	4.9	3.7	3.1	3.6	1.9
Total	758.5	100.0	6.2	3.3	7.6	4.1	2.8	-0.5	3.9	4.3
Customs duties and valuation	89.4	...	...	...	...	...	...	...	...	...
Gross domestic product	847.9	...	6.3	3.6	7.6	4.4	2.7	0.2	2.9	2.8
Uses										
Consumption	599.3	70.7	4.8	2.1	4.4	4.5	2.8	1.0	2.9	1.2
Personal consumption <u>3/</u>	(515.1)	(60.8)	(4.7)	(1.8)	(4.6)	(3.6)	(2.4)	(1.1)	(2.6)	(1.3)
Public consumption	(84.2)	(9.9)	(5.0)	(3.5)	(3.7)	(9.6)	(4.9)	(0.2)	(4.6)	(1.0)
Gross fixed investment	213.9	25.2	6.9	—	12.4	4.9	0.8	-6.4	-4.3	-1.6
Final domestic demand	813.2	95.9	5.4	1.4	7.0	4.6	2.1	-1.4	0.9	0.5
Stockbuilding <u>4/</u>	27.9	3.3	...	0.7	-0.6	4.7	-5.9	0.8	0.6	-0.6
Domestic demand	841.1	99.2	5.7	2.1	6.2	9.1	-3.5	-0.6	1.4	-0.1
Foreign balance <u>4/5/</u>	6.8	0.8	...	1.4	1.2	-4.9	6.4	0.8	1.4	3.0
Gross domestic product	847.9	100.0	6.3	3.6	7.6	4.4	2.7	0.2	2.9	2.8

Sources: CSO, Statistical Yearbook; IMF, International Monetary Fund, IFS; and data provided by the Hungarian authorities.

1/ Annual average percentage changes at 1976 prices through 1980 and at 1981 prices thereafter.

2/ Trade, water economy and other material sectors.

3/ Including social benefits in kind and net receipts from tourism.

4/ Percentage contribution to GDP growth.

5/ The foreign balance as a component of GDP does not account for factor payments (including interest) and net travel earnings, which are included in personal consumption.

Table 3. Hungary: Developments in Plan Aggregates

(Percentage changes in real terms)

	<u>Plan</u>	<u>Actual</u>	<u>Plan</u>	<u>Actual</u>	<u>Plan</u>
	1971-75		1976-80		1981-85
Net material product	5.5-6.0	6.3	5.4-5.7	3.2	2.7-3.2
Industrial production	5.7-6.0	6.4	6.0	3.4	2.7-3.2
Agricultural production	2.8-3.0	4.6	3.2-3.4	2.5	2.3-2.9
Gross fixed investment	5.5	7.0	2.1	2.5	1.4
Private consumption	5.2-5.4	4.7	3.9-4.2	2.7	1.4-1.7
Consumer prices	1.0-2.0	2.8	...	6.3	4.5-5.0
Real wages 1/	3.0-3.4	3.3	2.7-3.0	0.7	--
Net material product used	5.4-5.7	5.6	4.2-4.6	1.9	0.5-1.0

	Annual Changes									
	1976	1977	1978	1979	1980	1981		1982		1983
						Plan	Actual	Plan	Actual 2/	Plan
Net material product	3.0	8.0	4.2	1.9	-0.8	2.0-2.5	2.5	1.0-1.5	2.3	0.5-1.0
Industrial production	4.6	6.6	4.9	3.0	-2.1	3.0-3.5	2.8	2.0-2.5	2.4	1.0-2.0
Agricultural production	-2.7	10.3	2.0	-1.1	4.3	3.0	2.0	4.0-4.5	7.3	1.0-2.0
Gross fixed investment	--	12.4	4.9	0.8	-6.4	-4.0	-4.3	-4.5	-1.6	-4.0 to -6.0
Private consumption	1.8	4.6	3.6	2.4	1.1	1.5	2.6	0.5-1.0	1.3	-0.5 to -1.0
Consumer prices	5.0	3.9	4.6	8.9	9.1	4.5-5.0	4.6	4.8-5.2	6.9	7.5
Real wages 1/	0.1	3.8	3.1	-1.7	-1.6	--	1.1	-0.5 to -1.0	-1.2	-3.4 to -3.7
Net material product used	1.2	6.2	10.0	-5.5	-1.9	-1.5 to 2.0	0.7	-1.0 to -2.0	-1.4	-3.0 to -4.0

Sources: CSO, Statistical Yearbook and Statistical Pocketbook; and data provided by the Hungarian authorities.

1/ Per capita wages from socialist sector including agricultural cooperatives.

2/ Preliminary data.

Table 4. Hungary: Developments in Socialist Industry

	Gross	Employ-	Average year-on-year percentage change in gross production								
	production	ment									
	Percentage share	Percentage share	1971-75	1976	1977	1978	1979	1980	1981	1982 <u>1/</u>	1983 <u>1/2/</u>
	1982 <u>1/</u>										
Heavy industry	<u>65.8</u>	<u>59.4</u>	<u>7.2</u>	<u>6.1</u>	<u>6.2</u>	<u>6.6</u>	<u>3.7</u>	<u>-3.6</u>	<u>2.6</u>	<u>2.7</u>	<u>...</u>
Mining	5.9	7.4	2.0	0.2	3.8	3.2	0.9	-5.2	-2.8	2.7	-2.4
Electric energy	4.2	2.3	7.6	7.6	7.6	10.1	1.3	3.3	3.4	1.9	1.5
Metallurgy	9.4	5.6	5.0	3.6	4.2	2.7	1.9	-4.4	-1.6	1.5	-0.3
Engineering	24.0	32.3	7.8	5.5	6.9	6.0	3.7	-5.7	5.7	4.4	2.1
Construction materials	3.2	4.8	5.1	3.4	5.8	6.8	3.9	1.5	0.2	1.0	2.3
Chemicals	19.0	7.0	10.5	10.8	6.9	10.7	6.1	-2.2	3.1	1.9	1.2
Light industry	<u>13.6</u>	<u>24.7</u>	<u>5.7</u>	<u>3.0</u>	<u>4.1</u>	<u>3.2</u>	<u>0.4</u>	<u>--</u>	<u>3.1</u>	<u>-1.2</u>	<u>-1.5</u>
Wood processing	2.0	2.7	8.6	5.2	3.0	7.3	3.2	-1.8	-1.4	-2.0	0.2
Paper	1.3	1.0	7.4	5.1	8.2	4.3	2.6	0.8	4.8	1.7	0.3
Printing	1.0	1.2	7.8	2.1	7.8	8.8	4.9	8.1	8.2	3.4	2.6
Textiles	4.5	7.3	4.0	3.7	3.4	0.1	-0.7	3.2	2.1	-2.8	-1.9
Textile clothing	1.7	4.7	4.9	1.2	0.2	1.4	1.4	8.4	3.7	-2.6	-5.4
Leather, fur and shoes	2.3	3.8	5.1	-1.6	4.2	3.9	-4.5	-11.1	5.3	-0.2	0.7
Handicrafts	0.8	4.0	8.3	8.4	9.9	6.8	3.2	-3.8	5.0	-2.4	-8.8
Food processing	<u>19.1</u>	<u>12.6</u>	<u>4.7</u>	<u>1.4</u>	<u>9.9</u>	<u>0.4</u>	<u>2.6</u>	<u>2.5</u>	<u>3.0</u>	<u>4.3</u>	<u>3.3</u>
Miscellaneous	<u>1.5</u>	<u>3.3</u>	<u>7.8</u>	<u>7.6</u>	<u>8.6</u>	<u>9.6</u>	<u>5.7</u>	<u>-7.7</u>	<u>8.9</u>	<u>1.6</u>	<u>-6.7</u>
Total	100.0	100.0	6.4	4.6	6.6	4.9	3.0	-2.1	2.8	2.4	1.0

Source: CSO, Statistical Yearbook and Monthly Bulletin of Statistics.

1/ Preliminary data.

2/ January-August.

Table 5. Hungary: Agricultural Production and Average Yields of Selected Crops

	1976	1977	1978	1979	1980	1981	1982 <u>1/</u>
Index of gross production (1970 = 100)	122.2	134.8	137.4	135.9	141.7	144.5	155.1
Of which:							
Crops	122.1	136.8	138.2	133.8	143.1	145.4	159.1
Animal husbandry	122.3	132.5	136.5	138.2	140.2	143.5	151.1
Production of major crops (in thousands of tons)							
Wheat	5,148	5,319	5,677	3,709	6,077	4,614	5,762
Corn	5,141	6,077	6,655	7,396	6,673	6,993	7,959
Barley	749	708	763	710	929	903	871
Vintage	742	920	786	839	898	628	1,047
Fruit crops	1,482	1,606	1,393	1,414	1,653	1,791	1,935
Sugar beet	3,943	3,890	4,192	3,927	3,941	4,719	5,371
Vegetables	1,745	2,232	1,945	2,205	1,974	1,816	1,855
Livestock (in millions; end of year)							
Cattle	1.9	1.9	2.0	1.9	1.9	1.9	1.9
Pigs	7.9	7.9	8.0	8.4	8.3	8.3	9.0
Sheep	2.4	2.6	2.9	2.9	3.1	3.1	3.2
Poultry	43.4	43.3	43.3	41.2	42.8	42.8	45.4
	<u>1966-70</u>	<u>1971-75</u>	<u>1976-80</u>	<u>1981</u>	<u>1982 <u>1/</u></u>		
Average yields (in kilo- grams per hectare)							
Wheat	2,430	3,320	4,040	4,000	4,390		
Rye	1,160	1,510	1,640	1,560	1,570		
Barley	2,280	2,880	3,770	3,140	3,300		
Oats	1,390	1,820	2,400	2,880	2,170		
Maize	3,230	4,170	4,840	5,860	6,860		
Rice	1,980	2,350	1,460	2,990	3,780		
Sugar beet	32,520	33,000	33,650	38,750	42,560		

Sources: CSO, Statistical Yearbook, Statistical Pocketbook, and Agricultural Pocketbook; and data provided by the Hungarian authorities.

1/ Preliminary data.

Table 6. Hungary: Energy Resources

	1970	1975	1976	1977	1978	1979	1980	1981	1982 <u>1/</u>
(Indices, 1970=100)									
Total energy resources <u>2/</u>	100.0	114.5	119.0	124.7	131.5	135.7	135.8	133.3	136.5
Total energy requirements <u>3/</u>	100.0	118.4	...	...	138.7	138.7	138.7	137.8	138.5
(In percent of total energy resources)									
Coal and coke	50	36	34	33	30	29	29	29	29
Crude oil and derivatives of oil <u>4/</u>	30	39	39	40	42	41	37	36	35
Natural gas	13	19	21	22	23	24	26	27	27
Other <u>5/</u>	<u>7</u>	<u>6</u>	<u>6</u>	<u>6</u>	<u>5</u>	<u>6</u>	<u>8</u>	<u>8</u>	<u>9</u>
Total	100	100	100	100	100	100	100	100	100

Sources: CSO, Statistical Yearbook; and data provided by the Hungarian authorities.

1/ Preliminary data.

2/ Domestic production and imports.

3/ Excluding exports and stockbuilding.

4/ Including gasoline and LPG.

5/ Mostly electric energy imports.

Table 7. Hungary: Energy Balance

	1970	1975	1980	1985 <u>1/</u>	1990 <u>1/</u>
(In Pcal)					
Domestic production	145.1	144.0	149.0	174.0	197.0
Of which:					
Coal	91.0	73.0	69.0	72.0	82.0
Crude oil	19.7	20.0	21.0	20.0	20.0
Natural gas	30.0	43.0	50.0	58.0	55.0
Nuclear energy	--	--	--	14.0	30.0
Others <u>2/</u>	4.4	8.0	9.0	10.0	10.0
Imports	85.2	124.0	163.0	152.0	165.0
Of which:					
Coal	24.2	23.0	22.0	21.0	20.0
Crude oil and petroleum products	47.9	82.0	90.0	77.0	90.0
Natural gas	1.6	7.0	32.0	28.0	30.0
Electric energy	10.9	12.0	19.0	26.0	25.0
Others	<u>0.6</u>	--	--	--	--
Total resources	230.3	268.0	312.0	326.0	362.0
Exports (-)	8.0	6.0	7.0	6.0	10.0
Stockbuilding (-)	<u>5.0</u>	<u>5.0</u>	<u>4.0</u>	<u>5.0</u>	<u>12.0</u>
Total energy requirements	217.3	257.0	301.0	315.0	340.0
(In percent of total resources)					
Structure of resources					
Solid	50.0	35.8	29.1	28.5	28.2
Hydrocarbon	43.0	56.7	61.9	56.1	53.9
Other <u>2/</u>	<u>7.0</u>	<u>7.5</u>	<u>9.0</u>	<u>15.4</u>	<u>17.9</u>
Total	100.0	100.0	100.0	100.0	100.0
Origin of resources					
Domestic	63.0	53.7	47.8	53.3	54.4
Imports	<u>37.0</u>	<u>46.3</u>	<u>52.2</u>	<u>46.7</u>	<u>45.6</u>
Total	100.0	100.0	100.0	100.0	100.0

Sources: CSO, Statistical Bulletin; and data provided by the Hungarian authorities.

1/ Official projections.

2/ Includes some hydrocarbons and nuclear power.

Table 8. Hungary: Household Incomes by Major Sources

	Labor Income <u>1/</u>	Social Income			Other Income <u>2/</u>	Total Income	Memorandum item: Total money income
		In money	In kind	Total			
(In billions of forint)							
1982	357.1	102.4	75.8	178.2	3.9	539.2	427.3
(In percent of total)							
1982	66.2	19.0	14.1	33.1	0.6	100.0	79.3
(Annual average percentage change in per capita real income)							
1971-75	3.2	11.5	5.5	8.7	5.0	4.5	5.5
1976	-1.0	8.0	4.5	6.5	-19.6	0.8	0.5
1977	5.1	6.0	4.3	5.3	-17.8	4.9	5.2
1978	2.4	2.7	5.8	3.9	14.6	2.9	3.0
1979	-2.3	7.4	3.1	5.6	9.5	0.1	-0.2
1980	-1.6	5.7	4.3	5.1	-10.1	0.4	0.1
1981	2.0	3.3	3.8	3.5	28.0	2.9	3.4
1982 <u>3/</u>	-0.4	2.0	4.5	3.1	13.1	0.7	0.4

Sources: CSO, Statistical Yearbook; and data provided by the Hungarian authorities.

1/ After taxes and social security contributions paid by individuals; including labor income in kind.

2/ Mainly interest and rental income, net of taxes.

3/ Preliminary data.

Table 9. Hungary: Cash Receipts of the Population

	Wages <u>1/</u>	Earnings in Farm Cooperatives	Other Labor Income	Sales of Farm Products	Social Benefits in Cash	Other Receipts <u>2/</u>	Total Cash Receipts <u>3/</u>
(In billions of forint)							
1982	177.5	33.2	13.2	40.6	94.5	59.6	436.1
(Percentage changes on a year earlier) <u>4/</u>							
1977	8.1	8.3	-0.8	24.6	9.8	14.4	10.3
1978	9.8	6.7	4.4	6.6	7.4	11.3	8.6
1979	6.4	5.9	-3.8	6.6	16.7	17.5	9.1
1980	2.6	4.7	5.7	11.4	15.7	25.4	9.5
1981	4.4	11.6	5.7	3.6	8.4	17.1	7.4
1982	5.0	11.0	5.0	11.4	8.5	15.2	8.1
1983 <u>5/</u>	2.5	5.7	2.2	15.6	8.2	26.9	8.3

Sources: CSO, Monthly Bulletin of Statistics; and data provided by the Hungarian authorities.

1/ Excluding remuneration in cooperatives.

2/ Mainly including receipts from private activities, insurance receipts other than social benefits, and, through 1981, exchange of foreign currency into forint by nonresidents.

3/ Total cash receipts from outside the household sector derived from the balance sheet of the National Bank of Hungary. The figures deviate from total money incomes of households in Table 8, derived from the national accounts, in that they exclude income payments within the household sector, net interest income, and the cash value of certain benefits in kind, but include taxes and production expenditures of private activities, and taxes and customs duties paid by the population.

4/ Through 1981, the data on absolute levels in forint exclude transfers of incomes to checking accounts of households. Such transfers are included in the percentage changes of cash incomes, which are also adjusted for shifts in payments over time.

5/ January-August.

Table 10. Hungary: Household Disposable Income, Consumption, and Saving

	Disposable income <u>1/</u>	Consumption <u>1/</u>	Savings			Memorandum Items: Savings Ratios		
			Total	Housing	Financial <u>2/</u>	Total	Housing	Financial <u>2/</u>
	(At current prices, in level of forint)					(In percent of disposable income)		
1970	208.1	194.1	13.9	8.3	5.6	6.7	4.0	2.7
1971	223.1	209.6	13.5	9.4	4.1	6.1	4.2	1.9
1972	237.9	223.5	14.4	11.1	3.3	6.1	4.7	1.4
1973	258.8	241.7	17.1	11.7	5.4	6.6	4.5	2.1
1974	281.4	261.4	19.9	14.0	6.0	7.1	5.0	2.1
1975	306.9	284.9	22.0	14.7	7.3	7.2	5.8	2.4
1976	327.6	306.0	21.6	16.3	5.4	6.6	5.0	1.6
1977	359.6	332.6	27.0	18.2	8.8	7.5	5.1	2.4
1978	389.6	360.3	29.4	17.5	11.8	7.5	4.5	3.0
1979	422.6	399.6	23.0	20.0	3.0	5.4	4.7	0.7
1980	461.8	439.0	22.8	20.9	1.9	4.9	4.5	0.4
1981	501.1	473.8	27.3	20.0	7.3	5.4	4.0	1.5
1982	544.5	515.1	29.3	24.3	5.0	5.4	4.5	0.9

Sources: CSO, Statistical Yearbook; and data provided by the Hungarian authorities.

1/ Including social benefits in kind but excluding net receipts from tourism.

2/ Net of credits to households.

Table 11. Hungary: Sources of Investment Financing
in the Socialist Sector

(In billions of forint; at current prices)

	1975	1976	1977	1978	1979	1980	1981	1982 <u>1/</u>
State investments	<u>64.3</u>	<u>69.5</u>	<u>79.4</u>	<u>84.9</u>	<u>92.6</u>	<u>86.7</u>	<u>77.7</u>	<u>76.9</u>
State budget	38.7	40.6	49.3	50.5	57.2	54.7	37.2	32.5
Credits <u>2/</u>	12.7	15.9	18.9	21.2	21.4	19.8	22.3	23.6
Other <u>3/</u>	12.9	13.0	11.2	13.2	14.0	12.2	18.2	20.9
Enterprise investments	<u>77.8</u>	<u>81.8</u>	<u>101.1</u>	<u>111.6</u>	<u>111.4</u>	<u>103.0</u>	<u>105.1</u>	<u>108.8</u>
Development fund	43.5	43.1	55.3	65.1	64.2	69.5	74.7	79.2
Investment grants	13.5	12.3	14.4	13.9	14.6	9.0	6.2	4.9
National Bank credits	17.6	23.7	28.0	29.7	29.7	22.9	22.2	21.3
Other <u>4/</u>	3.2	2.7	3.4	2.9	2.9	1.5	2.0	3.5

Sources: CSO, Statistical Bulletin; and data provided by the Hungarian authorities.

1/ Preliminary data.

2/ Loans from the State Development Bank.

3/ Enterprise contributions.

4/ Preferential loans through the State Development Bank and transfers of funds from state budget.

Table 12. Hungary: Sectoral Breakdown of Investments

	<u>1982 1/</u> In per cent of total	<u>1971-75</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982 1/</u>
		Annual percentage changes; at constant prices							
Industry	32.1	6.2	8.0	23.3	3.3	-1.8	-11.5	-8.1	0.2
Heavy industry	25.2	5.4	8.9	22.8	1.8	1.6	-7.7		
Of which: Electric energy	(6.3)	(10.1)	(7.3)	(19.1)	(10.0)	(15.1)	(3.2)	(-9.0)	(0.9)
Light industry	3.3	8.5	1.5	3.1	9.9	-23.1	-19.8	—	7.5
Food industry	3.6	10.3	8.4	47.0	5.7	-4.9	-25.6	-8.0	-8.9
Agriculture and forestry	14.7	0.6	-5.7	8.8	9.5	-2.0	-11.2	8.0	-1.0
Construction	1.6	1.9	12.4	28.4	31.0	-17.1	-13.7	-24.2	-19.8
Transport and communications	11.5	8.6	-11.5	3.0	9.4	8.1	-4.0	-11.8	-4.2
Trade	4.4	16.3	2.3	-5.2	-0.6	5.2	16.6	3.2	-15.7
Water economy	5.7	11.8	5.8	8.9	4.3	8.9	-0.2	-0.1	-4.3
Nonmaterial services	<u>29.6</u>	<u>9.9</u>	<u>-3.1</u>	<u>9.1</u>	<u>0.9</u>	<u>3.9</u>	<u>-0.3</u>	<u>-5.4</u>	<u>-1.1</u>
Total investments	100.0	7.0	-0.1	13.0	5.0	1.0	-5.8	-5.1	-2.2

Sources: CSO, Statistical Yearbook and Statistical Pocketbook; and data provided by the Hungarian authorities.

1/ Preliminary data.

II. Employment, Incomes, and Prices

1. Labor force and employment

a. The labor market and labor force management

The labor market has been characterized for many years by evidence of labor hoarding and low productivity in several sectors paralleled by sectoral and regional shortages of labor. The overall labor supply has been adversely affected since 1975 by a gradual decline, at an annual average rate of about 0.5 percent, of the number of working age persons (Table 13), but this has been offset by a rise in the participation rate of the working age population, from 75.5 percent in 1975 to 79.3 percent in 1982. Although overall employment has fallen at an annual average rate of 0.3 percent, no unemployment has been recorded, given a withdrawal from the labor force of persons above the retirement age. ^{1/} However, with the slowdown in economic activity since 1978 having been more marked than the decline in the recorded labor force, a substantial reduction in the growth of labor productivity per gainfully employed person has resulted--from an annual average increase of 5.6 percent during 1971-78 to 2.5 percent subsequently.

Enterprises are legally allowed to lay off employees at no cost, provided they consult with trade union representatives and give notice to the competent local councils three months in advance. Nonetheless, until recently, labor mobility has essentially been the consequence of the employees' decision rather than that of the enterprises which--faced with soft financial constraints and a wish to avoid confrontations with local political interests and trade unions--have been reluctant to dismiss labor for efficiency considerations. The wage formation system has also failed to stimulate labor mobility, so that sporadic, but in some cases acute, shortages of manpower have persisted.

Against this background, in 1983 the conditions for re-employing dismissed employees were made more flexible and resort to dismissals was made less forbidding by the establishment of the legal framework for schemes of temporary financial support to and the retraining of laid-off persons. Similar provisions were instituted for new graduates unable to find employment. Furthermore, the new legal provisions for the restructuring of inefficient enterprises introduced in May 1983 compel such firms to release redundant labor. To facilitate the placement of job

^{1/} With the retirement age population having grown at an annual average rate of 0.6 percent, however, the participation rate of this age group fell from 13.3 percent in 1975 to 6.6 percent in 1982. While this may in part have reflected a diminishing inclination of retired persons to seek employment, the major cause appears to have been a decline in the number of jobs offered.

seekers with enterprises in search of additional staff, in 1982 initial steps were taken to set up a nationwide network of labor exchanges. Early experience suggests that the replacement of the previous rigid administrative system for reallocating labor by the new arrangements has been received favorably by both enterprises and the population. Legislation implemented at the beginning of 1982 to widen the scope for small scale enterprise and private undertakings is also contributing to better allocation of labor, particularly by enabling enterprises to pay higher incomes for work contracted out to private economic partnerships and professional associations among members of the staff. This not only increases the amount of working time available to enterprises, but also permits expanding firms--by circumventing tight wage regulations--to attract new employees.

b. The development of employment

The structure and development of employment are shown in Tables 14 and 15. In 1982, annual average employment in the socialist sector continued to decline, by 0.4 percent, and the share of this sector in total employment receded to 96.2 percent. Regular hours worked in the socialist sector fell by 5 percent in 1982 as a result of the spreading of the 5 day work week to virtually the entire sector and to an overhaul of the leave system. The effect of the loss in regular working hours was compensated by a variety of factors. Enterprises improved the organization of production, imposed more exacting performance requirements on employees, and widened the scope for overtime work. Actual hours worked were also extended by resort to the services of staff economic partnerships and professional associations. At the end of 1982, such partnerships encompassed about 36,000 employees, equivalent to 0.8 percent of total employment in the socialist sector; by the middle of 1983 the number of employees involved had grown to 68,000 or an estimated 1.9 percent of socialist sector employment.

The fall in employment in the socialist sector since 1978 has been mainly concentrated in industry and construction. Labor released from these sectors, and to a lesser extent from the trade, transport, and communications sectors, has been largely absorbed by the nonmaterial services and farm sectors. The shift of labor out of agriculture halted in 1978, and during the subsequent period employment in farming and forestry grew at an annual rate of 1.3 percent. This mainly benefited the ancillary construction, industrial, and servicing activities of farms, particularly in the cooperative sector. In cooperative farms, while the number of employees engaged in farming remained unchanged, total employment grew by more than 3.5 percent in 1982, mainly because of the enlarged scope for members to engage in ancillary occupations.

In the private sector, employment continued to decline in small scale farming, but picked up markedly in small private undertakings in trade, crafts, and various services. Total employment in the private

sector, excluding persons who maintained their jobs in socialist enterprises, grew by 6.7 percent in 1982, to 3.8 percent of total employment in the economy. Including persons contractually operating facilities of socialist enterprises and participating in enterprise economic partnerships and associations, about 270,000 persons were involved in private activities, accounting for 5.5 percent of total employment.

Fragmentary data for 1983 indicate that the decline in overall employment and the previous shifts in the pattern of employment have persisted. In the first half year, employment in the socialist sector, excluding nonmaterial sectors, fell by 0.8 percent against a year earlier; workers continued to move to the agricultural sector, and participation in new private undertakings grew substantially.

2. Incomes

a. Enterprise profits

(1) The regulation of enterprise finances 1/ 2/

In the Hungarian system of enterprise finances, profits equal essentially the operating surplus of enterprises (net value added minus labor costs), less production taxes plus subsidies (see Table 16). Profits subject to tax are also net of payments to a special fund for welfare and cultural services and to a voluntary reserve fund allowing importers of basic materials from the nonruble area to offset temporary fluctuations in import prices. Enterprises pay a municipal contribution on profits so defined. The remaining amount, after deduction of amortization payments on special state investment loans and other miscellaneous transactions, is subject to a general profit tax. The remaining profits are then mainly divided among the reserve fund, the development fund, and the sharing fund. The authorities influence the allocation of resources among these funds through specific rules and "financial regulators."

(i) Reserve fund. Each enterprise is obliged each year to place a proportion of after tax profits in a compulsory reserve fund until the fund reaches a certain minimum. 3/ The main role of the reserve fund is to cushion cycles in profit formation, although enterprises may also draw on this fund to cover certain inadequacies of the sharing and development funds. The ability to use the compulsory reserve fund is limited by statutory conditions and an obligation of reconstitution.

1/ The main deviations from the general system described in this section apply to agriculture, trade, enterprises providing municipal, cultural, and health services, the management of state-owned rental housing, and research and development institutions.

2/ For more details, see SM/82/186 (9/17/82), Annex II.

3/ These regulations have changed over time. At present, in general, 20 percent of after tax profits have to be deposited until reserve funds reach 6 percent of the sum of the enterprises' capital stock and the annual wage bill.

After fulfilling their reserve fund obligations, enterprises may use profits to pay premia and bonuses to senior management, and the remaining profits are divided between the development fund and the sharing fund.

(ii) Development fund. Placements in the development fund of an enterprise must be sufficient to meet the annual statutory and contractual payments obligations from this fund. The sources of the development fund include part of the remaining profits mentioned above, plus in most cases 60 percent of the enterprises' depreciation allowances on fixed capital, 1/ state investment support, and transfers of development funds from other enterprises.

(iii) Sharing fund. Allocations of profits to the sharing fund in excess of 2 percent of wages in the previous year are subject to a highly progressive tax. After payment of the tax on wage increases and a restitution of any shortages in the welfare and cultural fund, the remaining profits in the sharing fund can be used for various forms of remuneration to employees to supplement wage payments.

The income regulation system for enterprises allows the authorities to pursue structural and macroeconomic policy objectives not only by governing the disposition of profits, but also by providing a framework for dealing with enterprise losses. In the past, losses were generally covered from a company's accumulated reserve funds, credits, or the rescheduling of the debt of the enterprise, accompanied by measures aimed at improving the performance of the firms. Beginning in 1983, a more rigorous approach has been applied to loss-making enterprises. First, penalties have been increased--and may now entail downgrading or replacement of enterprise managers, foreclosing of banking mortgages, freezing or drawing away of depreciation allowances and working capital, and the sale of fixed assets and stocks linked to the unprofitable activity. If, despite the above measures, the profit situation of the enterprise does not improve, it is to be liquidated.

(2) Development in enterprise profits

The operating surplus of enterprises, after practically stagnating in 1980, rose by about 10.5 percent in both 1981 and 1982. The pickup stemmed in part from a stabilization in the ratio of material inputs to output. While the rise in the rate of input prices continued to outpace that of overall producer prices, the effect on the ratio of inputs to output was roughly matched by a reduction in the use of materials and energy, due partly to shifts in the structure of output in response to the changes in relative prices implemented in 1979-80. The drop in real terms of the ratio of intermediate consumption to gross output was particularly pronounced in construction and industry, where the ratio fell by about 4.5 and 2 percentage points, respectively, in 1982. The strengthening of the operating surplus benefited also from a marked

1/ The remaining 40 percent accrues to the state budget.

slowdown in the rise of depreciation on capital, partly due to the deceleration of the growth of the capital stock because of the reduction of fixed investment since 1979 and partly to valuation effects. ^{1/} In addition, the estimated increase in unit labor costs decelerated from 9.5 percent in 1980 to 3.5 percent in each of the succeeding two years, as a combined result of a pickup in productivity growth and slower increases in wages.

While the growth in enterprises' operating surplus was maintained in 1982, after-tax profits, which had rebounded from a 10.5 percent decline in 1980 to an increase of 16 percent in 1981, fell by 6.3 percent, as taxes were increased and subsidies lowered with a view to containing the growth of enterprises' investable resources. In particular, cuts were made in tax refunds to exporters, modernization grants, export support to agriculture, and other subsidies; and the rate of the social security tax was raised from 24 percent to 27 percent and the municipal contribution rate from 10 percent to 15 percent. As a result, the budget's net take from aggregate operating surpluses rose to more than 73 percent from 71 percent in 1981. Since the allocation of after tax profits to sharing funds changed little, retained earnings also fell, but allocations to sharing and development funds nonetheless continued to increase (Table 16), as enterprises augmented such funds at the expense of reserve funds. Specifically, withdrawals by enterprises from obligatory reserve funds increased by Ft 4.6 billion to Ft 13.5 billion--an amount considerably in excess of the accrual of new reserve fund deposits. Since relatively heavy withdrawals of reserve funds occurred in branches confronted with structural difficulties, such as metallurgy, light industries, and parts of engineering, they contributed to slowing down structural adjustment. In the framework of efforts to advance the reform of the economic system, the authorities have decided gradually to phase out the compulsory reserve fund scheme by the end of 1984.

The overall evolution of profits has masked large differences in the recent period among enterprises and branches. Mainly owing to changes in relative prices, the weakening of profits in 1980 mostly affected the manufacturing sector, while profits in some basic industries improved. In 1981, profits strengthened perceptibly in the manufacturing sector.

^{1/} The current practice of the valuation of the capital stock underlying the calculation of depreciation allowances creates a sizable upward bias in the recorded operating surplus. Items of the capital stock purchased up to 1968 are valued at 1968 prices and those from subsequent years at acquisition costs. In 1981 (the new base year for deflators), depreciation on capital was about Ft 14 billion higher at the prices of that year than at the acquisition prices from which the depreciation allowances for profit calculations are obtained; this bias raised the aggregate operating surplus of 1981 by 4.3 percent and profits before taxes by 7.3 percent above the level that would have corresponded to depreciation allowances at 1981 replacement costs.

In 1982, the erosion of profits occurred in most branches, with the notable exception of engineering and agriculture, which demonstrated greater adaptability to changes in the structure of demand. In agriculture, the good crop and the rise in ancillary activities also helped to strengthen profitability.

In the first half of 1983, data available from balance sheets of enterprises (excluding agriculture) suggest a strengthening of profits before taxes in most branches, in particular in manufacturing industry, transport and communications, and trade.

b. Household incomes

About two thirds of the gross income of the population are labor-related, while the remaining one third stems from social benefits in money and kind and a small amount of interest and rental income. Although the share of income from private activities has continued to grow, the remuneration of labor employed in state and cooperative enterprises has remained the dominant source, accounting for 79 percent of gross labor income in 1982.

(1) The wage system in the socialist sector

In enterprises of the socialist sector, wages and salaries have been subject to a more extensive system of regulation than other production expenditures. Since the 1968 economic reforms, wage regulation has aimed at controlling the purchasing power of households, while encouraging wage differentiation to stimulate a more efficient allocation of labor in an environment of greater enterprise autonomy. Wage controls were deemed necessary to counteract the general tendency of enterprises to accommodate excessive increases in earnings, due to such factors as the weakness of profit considerations, the absence of tight financial constraints, and the relatively low share of labor costs in the overall costs of production. Because the wage system has failed to perform satisfactorily, it was altered substantially in 1976, 1980, and the beginning of 1983.

In the course of the last overhaul, 1/ the scheme regulating the growth of the wage bill of enterprises was abandoned in favor of an exclusive focus of the system on wage rates. However, to maintain the interest of firms in a judicious use of labor, the new rules stipulate that 30 percent of savings in wages due to a cutback in employment from its lowest level within the past three years can be used by firms for

1/ The income formation system in force through the end of 1982 was described in Appendix III of Hungarian People's Republic, Recent Economic Developments, SM/82/186, (9/17/82).

tax-free increases in wage rates in the current year. ^{1/} Moreover, it had been widely recognized that the previous rule linking the latitude of enterprises to grant tax-free wage awards to an indicator measuring the increment of the performance of the firm over the preceding year discriminated against firms that had reached superior performance previously and discouraged enterprises from seeking markedly better results in a given year as this jeopardized their ability to pay higher wages subsequently. Therefore, the authorities replaced the incremental performance indicators by a new measure of performance, the level of profitability in a given year, defined as the ratio of profits before profit taxes to the sum of fixed assets and the wage bill. Accordingly, from 1983 on, most enterprises are entitled to grant a 0.12 percentage point tax-free increase in the average wages of full time employees for every percentage point of their profitability indicator, up to a maximum tax-exempt rate of increase of 6 percent at a profitability rate of 50 percent.

Whereas enterprises accounting for 50 percent of employees in the socialist sector at the beginning of 1983 are subject to the above performance-oriented scheme, wage formation in branches where profitability is considered to be largely beyond the control of firms continues to be determined substantially by the central authorities. The centrally determined schemes differentiate between branches in which labor saving is encouraged and branches in which the retention of employees is considered more desirable. In the former category, enterprises were entitled to raise wages free of taxation by a uniform rate of 2.2 percent in 1983 and to make an additional use of 30 percent of savings in wages; in the latter group, the uniform rate of tax-free wage increases was 2.7 percent and resort to wages saved by lower employment was not permitted. Tax-free wage increases were limited to 1.2 percent for weak enterprises that were reclassified from the performance oriented to the centrally controlled scheme upon their own request.

A further novelty in the wage system is that it incorporates incentives to promote exports to the nonruble area. Foreign trade companies are entitled to a Ft 50 tax free increase in average wages for every 10,000 FT in additional export receipts. Enterprises exporting goods and services may raise wages free of taxation by Ft 40 for every 1,000 FT of additional export receipts if the cost of earning US\$1 is below Ft 36 and by Ft 30 if the cost of US\$1 of export earnings is within the range of Ft 36-47.

Under the new regime of wage formation, the tax on wage increases was extended to remuneration from the sharing fund out of after tax

^{1/} In certain cases, discretionary approval has been granted by the authorities for enterprises to use 50 percent and 60 percent of wage savings, respectively, if cuts in staff reached 6 percent and 8 percent, respectively, without a decline in the value added of the enterprise.

profits, 1/ and a new highly progressive schedule for the wage tax was introduced. Tax liabilities of enterprises on increases in average remuneration from the sharing fund awarded in 1983 will be determined according to the following schedule, while three times these marginal tax rates apply to increases in the average wage rate proper:

<u>Average Remuneration in Percent of Average Wage of Preceding Year</u>	<u>Marginal Tax Rates in Percent of Average Remuneration</u>
0-4	100
4-8	150
8-12	200
12-15	250
15-18	300
18-21	350
21-25	400
25-or more	500

Special schemes of wage formation with respect to the definition of the performance indicator and the coefficient of tax-free wage awards are applied in some branches of construction, transportation, and trade, and experimental schemes were introduced in 30 industrial and construction firms, 72 agricultural cooperatives, and 18 state farms. A common feature of the experimental facilities in industry and construction has been that flat rate taxes have been imposed on the value added or the wage costs of enterprises, aimed at raising the cost of labor relative to other costs of production, and a progressive tax has been applied on the average remuneration per employee paid by firms, with the tax schedule designed so as to discourage wage rates well in excess of the nationwide average.

The modification of the system of wage determination at the beginning of 1983 did not affect the grid of wage rates within enterprises. For blue collar workers, the matrix of wage rates distinguishes among six categories of skills and four categories of working conditions; for white collar employees among four categories of training and six categories of seniority; and for management among 3-4 classes of enterprises according to their importance and six ranks of seniority. Actual wage rates within the 60-80 percent ranges between minimum and maximum rates in every category of the respective matrix are negotiated by collective bargaining within firms or with the supervisory authorities in the case of senior management. The wage grids are adjusted every 3-4 years. A common practice to permit greater wage differentiation in recent years has been to widen the difference between the lower and upper limits within each category by raising the former less than the latter. At the most recent adjustment of wage brackets with effect from January 1, 1981, the minimum

1/ Remuneration from the sharing fund up to 2 percent of the average wage in the previous year is exempt from the wage tax.

rates were raised by 8 percent and the ceiling rates by 25 percent. The wage matrices currently in effect allow for the maximum basic wage to be six times the lowest wage for blue collar workers and seven times the lowest wage for white collar employees. The maximum basic salary for a manager is about four times the salary of the lowest earning shop floor manager and ten times the lowest wage rate of a blue collar worker.

(2) Income developments

Since 1978, the authorities have placed increased emphasis on incomes policy together with price policy as a means of containing consumer demand. Given a lack of control over the liquidity of enterprises and the absence of a system of household income taxation, the brunt of the effort to curb the growth of nominal disposable income has fallen on the wage regulatory system, whose provisions have been tightened successively. Average real earnings in the socialist sector fell in 1979-80 as a result of a marked acceleration of consumer price increases, but, picked up in 1981 when the rise in consumer prices was kept within the planned range while nominal wage growth continued to exceed the provisions of the plan.

For 1982, the Plan foresaw a deceleration in the rise of average nominal earnings to some 4.5 percent (from 5.7 percent in 1981) and a decline in real terms of 0.5-1.0 percent (1.1 percent rise in 1981), a moderation deemed necessary in the light of a more severe external adjustment need. The slowdown was expected to be helped by measures to curtail enterprise profits, which would curb the growth of performance indicators guiding the development of wages; by a lowering of the wage coefficients, which determined the rate of permissible tax-free wage increases for every percentage point change in the performance indicator; and by reductions in the centrally determined rates of tax-free wage increases. At the same time, the limit on the rise in remuneration from accumulated wage reserves was maintained at 3 percent.

In the event, wage increases picked up in the early part of 1982, exceeding the rise in consumer prices. With real earnings likely to surpass the plan target amid deteriorating external conditions, the authorities constrained the use of wage reserves to permit wage increases of only 1 percent. In addition, they raised the tax on wage increases in agriculture by 50 percent, and decided that tax liabilities on wage increases in excess of resources available in sharing funds could be covered from the compulsory reserve funds only temporarily, with an obligation to reconstitute drawings on reserve funds from the sharing funds of the succeeding two years. Notwithstanding these measures, the rise in average earnings in 1982, at 5.5 percent, exceeded that foreseen in the Plan, as (i) profits in branches subject to the performance-based regulation of the wage rate turned out to be more buoyant than in the rest of the economy; (ii) employment declined more than had been foreseen in branches where the wage bill regulations were applied, thus raising average wages; and (iii) enterprises resorted to a greater extent

than in the past to employing members of their own staff after regular hours under special contractual arrangements not constrained by the wage regulatory system. However, the overshoot in nominal wages was moderately exceeded by a higher-than-planned increase in consumer prices so that average earnings in the socialist sector fell by 1.2 percent in real terms in (Table 3).

As in the preceding two years, total earnings in agricultural cooperatives grew much faster than labor income from the remainder of the socialist sector (Table 9). This mainly reflected higher average earnings and a continued marked increase in employment in the ancillary construction, industrial, and servicing activities of farm cooperatives, where incomes earned increased by 22 percent in 1982. At the same time, labor income from the sale of farm products and from other private activities continued to grow significantly faster (9.8 percent) than wages and salaries in the socialist sector (6.8 percent).

Social benefits to households continued to outpace the rise in labor income in 1982, essentially because of an increase of 2 percent in the number of pension recipients and higher average pensions owing to structural changes as well as a strong growth of benefits in kind due to improved health and education services. Even so, the growth rate of disposable income slackened to 7.8 percent in nominal terms, from 8.5 percent in 1981 (Table 10).

Incomes policy for 1983 was geared to the continued urgency of external adjustment and the decision of the authorities to put greater emphasis on the containment of private consumption in the effort to curtail domestic absorption. Accordingly, the latitude of state and cooperative enterprises and public administration to raise wages and salaries was tightened further. The plan for 1983 foresaw a deceleration in the increase of average nominal wages in the socialist sector to 3.5-3.8 percent, which was expected to entail a real decline of about 3.5 percent. With a view to achieving this objective, the authorities lowered the potential of enterprises to grant tax-free wage increases and introduced a new highly progressive tax schedule on wage increases. In addition, other regulations affecting wage formation were tightened: reserves accumulated under the former scheme of the wage bill regulation for future tax-free wage increases were retroactively cut to one third and their use was entirely revoked for 1983; the rate of social security contributions paid by enterprises on the wage bill was raised by 3 percentage points to 30 percent from January 1, 1983; and drawings by enterprises on their compulsory reserve funds to supplement resources from their sharing funds for tax payments on wage increases had to be reconstituted in one year instead of the two years required formerly. Social benefits, meanwhile, were scheduled to increase by 8-9 percent, mainly reflecting a continued growth of the retirement age population, the structural shift toward higher average pensions, as well as discretionary increases in children's allowances from the middle of the year and in low pensions from September 1, 1983.

In the first eight months of 1983, wages and related incomes in state and cooperative enterprises and the public sector increased by about 3 percent and social benefits in cash by 8.2 percent over a year earlier-- i.e., within the range foreseen under the Plan. However, proceeds from the population's sales of farm products grew by almost 16 percent and other receipts, mainly from various private activities, by about 27 percent. The pick-up in farm sales reflected in part higher prices, a lagged marketing of bumper crops from the previous year, an early harvesting of fruit and vegetables, and a response to a new bonus scheme introduced by the authorities to advance certain farm deliveries to the early part of the year in order to permit a more steady utilization of capacities in the food processing industry. The buoyancy of other nonwage incomes stemmed from the strong underlying growth of private economic units, in particular private partnerships among the staff of socialist enterprises. Although the higher-than-projected incomes earned in the private sector from the beginning of the year were generated by additional supplies of goods and services, the latter were considered necessary to meet enlarged external balance requirements stemming from the weak performance of export prices. Consequently, in addition to absorbing purchasing power through further increases in consumer prices, in May 1983 the authorities decided a virtual freeze on remuneration in the government sector. For the year as a whole, disposable household income is estimated to rise by 6.5-7.0 percent in nominal terms, which implies a moderate decline in real terms.

(3) Wage differentiation

In recent years, increased attention has been given to wage differentiation as a means of increasing labor productivity and mobility. The efforts made have, however, had to contend with deep-rooted social resistance to change, and the heavy reliance of the authorities on tightening the provisions of the wage formation system as a major instrument to curb the rise of household incomes has further narrowed the scope for wage differentiation. As a result, wage differentials have remained narrow; indeed, the full scope for differentiation permitted by existing wage matrices has remained unused. The differential between the earnings of the lowest and highest paid tenths of employees decreased from sixfold in the early 1960s to fourfold in 1982. Available data on the dispersion of earnings in the socialist sector suggest little change over the past five years. Among blue collar employees, the average monthly earnings of skilled workers remained at about 45 percent above that of unskilled workers, and there has been little difference between the salary of a basic white collar employee and that of an unskilled blue collar worker.

The rise in average wages has also borne little relationship to the development in productivity among branches. Enterprises generally endeavor to pay competitive wages, and the discretion of firms in granting wage awards irrespective of performance has been enhanced by possible recourse to resources in the obligatory reserve funds.

The various impediments to income differentiation have, however, contributed to the shift of labor to activities in cooperative and private undertakings and to the ample use by enterprises of the labor of private economic partnerships outside the confines of the official wage system.

3. Prices

a. The price system ^{1/}

The 1979-80 reform of the price system was aimed at establishing a closer linkage between domestic prices and world market prices, allowing greater flexibility in price formation, widening the scope for price setting by enterprises, and creating a better relationship between producer and consumer prices. Substantial supervisory control, however, was maintained, with about one third of producer prices and half of consumer prices remaining subject to regulation by the authorities (Tables 17 and 18). Even in the case of "free" prices, enterprises must notify the Materials and Price Board in advance of price increases, avoid pricing practices that would produce unfair profits, and comply with the rules guiding the alignment of domestic prices to world market prices.

Because the domestic market is not sufficiently competitive to yield genuine market prices, in the 1979-80 reform the authorities introduced simulated "competitive prices," which apply to 65-70 percent of industrial production, and are linked to world market prices. Producer prices in the domestic market for energy and raw materials are linked to import prices from the convertible currency area or to export prices, if imports are negligible. Prices of energy and raw materials imported from the CMEA area or produced domestically are raised to the "competitive" level by differential producer turnover taxes. Domestic prices of raw materials are "free," in the sense that enterprises can determine them on the basis of the above criteria, but energy prices are set by the Government.

Domestic prices of manufacturing enterprises whose convertible currency exports amount to at least 5 percent of domestic sales are generally based on production costs and on profit margins that on average correspond to the firms' average export profit margins. Although some exceptions are allowed, domestic prices on average are not permitted to rise more than, and must decline in line with, export prices. Within the average, an enterprise can set prices of individual products according to the requirements of the market. For enterprises whose export sales are below the 5 percent margin, the adaptation of producer prices to export prices is determined separately by the Materials and Price Board. The rules on competitive pricing were modified in early 1981 and towards the end of 1982 in order to deter enterprises from withholding products

^{1/} The development of the price system and its features after the 1979-80 price reform were described extensively in Appendix IV of Hungarian People's Republic, Recent Economic Developments, SM/82/186, (9/17/82).

with a low profitability from export markets so as to allow a higher profit margin on domestic sales, or from withholding exports so as to avoid reaching the 5 percent margin and thus becoming subject to the competitive pricing scheme. Moreover, with a view to encouraging a substitution of imports from the convertible currency area, since the end of 1982 enterprises have no longer been required to raise the costs of inputs obtained from the nonconvertible currency area or from domestic suppliers to the convertible currency import price.

Producer prices in the construction materials and food processing industries have also been increasingly freed but the competitive pricing scheme is applied only to a minor extent. In the construction sector, the high share of centrally determined prices was reduced in 1982. Since the latter part of 1982 the prices of buildings can be freely negotiated under tenders between the parties concerned. In transport and communications a centrally determined tariff structure and in trade and other services the cost-plus principle are applied.

Agricultural prices are in principle set on the basis of average costs of production. Subsidies are granted to units operating on less fertile land and the differential rent of farms on more fertile land is partly taxed away. The 1980 price reform attempted to adjust the structure of farm prices more closely in line with actual costs, but did not entail a complete overhaul of the price formation process or a linkage to world market prices. Major departures from relative world market prices are common, because of extensive subsidies on inputs and price premia on outputs. Prices on almost two thirds of agricultural output, excluding the consumption of farm products by producers themselves, are subject to government control. Agricultural products, with the exception of wheat and cattle, may be traded in farm markets at free prices.

A major objective of the 1980 price reform was to bring consumer prices closer to their costs, as reflected in producer prices. This aim, however, was qualified by two overriding priorities: goods and services that satisfy basic social, health, and cultural needs would continue to be subsidized, and higher-than-average turnover taxes would continue to be applied to certain luxury items, alcoholic beverages, and tobacco. It was envisaged that the level of consumer prices would rise to about 3-4 percent above that of producer prices from a negative differential of 4-6 percent. In the event, the positive differential obtained in 1980 amounted to only 1.5 percent, largely because the unanticipated sharp rise in energy prices was not fully passed on to consumers. In 1981 the differential fell back to about 0.5 percent, but widened to about 2 percent in 1982 when consumer price subsidies were cut and turnover taxes increased. As a matter of social policy, consumer prices continue to be heavily subsidized for household energy, public transportation, rents, and, to a lesser extent, food.

b. The development of producer prices

It was initially expected that the 1980 reform would produce a fall in producer prices. Due to the sharp increase in world energy prices in 1979, however, producer prices rose by about 11 percent on average in 1980, with industrial producer prices rising by 15 percent (Table 19). After slowing to 6 percent in 1981, the rise in producer prices decelerated further, to 4 percent, in 1982. In industry, the 4.7 percent increase on all sales reflected a rise of 2.2 percent of export prices and 5.3 percent of domestic sales prices. The latter increase mainly stemmed from the carry-over effect of energy price increases in the latter part of 1981 and a further rise in centrally controlled energy prices by 4 percent in 1982, in response to devaluations of the forint.

In agriculture, energy cost increases have to some extent been offset during 1980-82 by partial lump-sum subsidies, so that price increases to consumers could be delayed. Partly as a result, the adjustment of farm prices since the 1980 price reform have fallen well short of the increases that would have been required to eliminate subsidies on agricultural inputs. After increasing at rates broadly matching the overall rise in producer prices in 1980-81, farm prices in 1982 changed little, as procurement prices were not raised and free prices reflected exceptionally good crops.

For 1983, the Plan foresaw a rise of 8 percent in energy prices and of 5.3 percent in domestic industrial producer prices, including carry-over effects from the previous year of 4 percentage points and 2.1 percentage points, respectively. Agricultural procurement prices were to increase by 3.8 percent, providing a partial offset for the effect of higher prices introduced for major farm inputs, in an effort to reduce subsidies on such inputs. The development of industrial producer prices and farm procurement prices in the first eight months of 1983 was in line with the projections of the Plan, and for the year producer prices are tentatively estimated to rise by about 5 percent.

c. The development of consumer prices

In the 1979-80 price reform, consumer prices were increased sharply (Table 20), permitting the elimination of about one third of consumer subsidies. In 1981, the rate of increase in consumer prices fell by a half, to 4.6 percent, in line with the minimum increase foreseen in the Plan, as the higher producer prices of energy and farm products were not fully passed on to households. Correspondingly, consumer price subsidies for most items grew again.

The 1982 Plan foresaw an annual average increase in consumer prices of about 5 percent, due to the carry-over from 1981 (some 1.5 percentage points), increases in centrally controlled prices (1 percentage point), and increases in free consumer prices (about 2.5 percentage points).

In the course of 1982, actual increases in free market prices (2.8 percentage points) slightly exceeded the plan estimates, mainly reflecting the passing on of energy price increases and the freeing of additional consumer prices. Moreover, in a renewed effort to cut consumer subsidies and to curb private consumption, particularly of imported or exportable products, further increases in controlled prices were decided. Gasoline and beer prices were raised in late June by 14 percent and 19 percent, respectively. In July and August prices were increased by 19-30 percent for certain construction materials, by 15-20 percent for some services, by 40 percent for coffee, by 25 percent for some cereal products, and by 100 percent for long distance transportation. At the beginning of December, gasoline prices were raised by another 20 percent, bringing the price of a gallon of premium gasoline at the end of the year to the equivalent of US\$1.92. As a result of these measures, the contribution of administrative consumer price increases rose to 2.6 percentage points, and for the year the overall consumer price index rose by 6.9 percent.

For 1983, the initial plan was for consumer price increases of 7.5 percent; 3 percentage points were expected to stem from the carry-over effect of official price adjustments in the preceding year, 4 percentage points from the effect on market prices of the devaluations of the forint, prior increases in producer prices of energy, and the increase in enterprises' social security contribution rates, and 0.5 percentage points from new administrative price increases. However, in response to a more buoyant development of household incomes than was deemed prudent for the requirements of external adjustment, further administrative consumer price increases and devaluations of the forint ensued. Around the middle of the year, the prices of soft drinks, stoves, small agricultural machinery and some basic building materials were raised and the centrally administered prices of canned and refrigerated food, sweets, enamel ware and catering services were moved to the free price category. The impact of these measures on the consumer price index, however, was offset by the effect of a weaker-than-anticipated development of foreign prices. Further increases in the consumer prices of sugar, vegetable oil, margarine, and bread and bakery products by 12-23 percent were decided in mid-September. As a result, in January-September 1983, consumer prices were 7.9 percent higher than a year earlier.

Table 13. Hungary: The Population, Manpower Resources, and Employment

(In thousands, beginning of period)

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983 ^{1/}
Population by age brackets												
Persons under working age ^{2/}	1,930.3	1,936.4	1,942.1	1,974.2	2,027.7	2,090.7	2,131.5	2,169.0	2,212.0	2,356.4	2,362.7	2,349.8
Working age population ^{3/}	6,320.1	6,339.9	6,369.4	6,374.0	6,369.6	6,358.5	6,353.4	6,359.1	6,302.0	6,142.6	6,115.0	6,103.6
Retirement age population ^{4/}	<u>2,127.4</u>	<u>2,134.1</u>	<u>2,130.1</u>	<u>2,152.7</u>	<u>2,165.4</u>	<u>2,165.5</u>	<u>2,174.7</u>	<u>2,158.9</u>	<u>2,195.5</u>	<u>2,213.8</u>	<u>2,233.2</u>	<u>2,246.8</u>
Total population	10,377.8	10,410.4	10,441.6	10,500.9	10,562.7	10,614.7	10,659.6	10,687.0	10,709.5	10,712.8	10,710.9	10,700.2
Manpower resources												
Manpower of working age ^{3/}	6,320.1	6,339.9	6,369.4	6,374.0	6,369.6	6,358.5	6,353.4	6,359.1	6,302.0	6,142.6	6,115.0	6,103.6
Manpower of retirement age ^{4/}	<u>347.6</u>	<u>337.3</u>	<u>287.1</u>	<u>285.2</u>	<u>277.6</u>	<u>252.1</u>	<u>246.4</u>	<u>233.8</u>	<u>224.6</u>	<u>195.1</u>	<u>164.9</u>	<u>147.8</u>
Total manpower resources	6,667.7	6,677.2	6,656.5	6,659.2	6,647.2	6,610.6	6,599.8	6,592.9	6,526.6	6,337.7	6,279.9	6,251.4
Distribution of manpower resources ^{5/}												
Inactive dependents	1,279.8	1,231.5	1,168.7	1,106.4	1,027.0	969.0	939.8	909.3	847.0	724.2	697.7	705.7
Students	(602.0)	(579.5)	(548.8)	(534.2)	(518.0)	(503.3)	(490.1)	(487.6)	(489.8)	(374.2)	(369.4)	(380.1)
Other dependents	(677.8)	(652.0)	(619.9)	(572.2)	(509.0)	(465.7)	(449.7)	(421.7)	(357.2)	(350.0)	(328.3)	(325.6)
Inactive manpower ^{5/6/}	<u>337.3</u>	<u>372.5</u>	<u>403.2</u>	<u>456.3</u>	<u>517.0</u>	<u>552.4</u>	<u>585.8</u>	<u>597.6</u>	<u>602.0</u>	<u>595.0</u>	<u>576.3</u>	<u>571.6</u>
Total inactive persons and dependents ^{5/}	1,617.1	1,604.0	1,571.9	1,562.7	1,544.0	1,521.4	1,525.6	1,506.9	1,449.0	1,319.2	1,274.0	1,277.3
Active labor force ^{7/}	5,050.6	5,073.2	5,084.6	5,096.5	5,103.2	5,089.2	5,074.2	5,086.0	5,077.6	5,018.5	5,005.9	4,974.1
Persons working abroad under international cooperation agreements	12.0	12.0	11.0	11.0	10.0	8.0	5.4	5.0	4.0	4.0	4.0	4.0
Total domestic employment	5,038.6	5,061.2	5,073.6	5,085.5	5,093.2	5,081.2	5,068.8	5,081.0	5,073.6	5,014.5	5,001.9	4,970.1

Sources: CSO, Statistical Yearbook; and data provided by the Hungarian authorities.^{1/} Preliminary.^{2/} Persons up to 14 years of age.^{3/} Men of 14-59 years and women of 14-54 years.^{4/} Men 60 years and older and women 55 years and older.^{5/} Working age persons.^{6/} Handicapped persons, persons in early retirement, and women on maternity leave, drawing social benefits.^{7/} Manpower resources minus inactive persons and dependents.

Table 14. Hungary: The Structure of Employment by Sectors

	1975	1976	1977	1978	1979	1980	1981	1982	1983
(In thousands; beginning of period)									
Agriculture, forestry, and water economy	1,157	1,130	1,111	1,100	1,105	1,116	1,109	1,130	1,160
Industry	1,816	1,789	1,765	1,752	1,734	1,697	1,654	1,620	1,578
Construction	417	420	417	414	413	404	393	383	373
Transportation and telecommunications	390	402	404	407	409	407	400	395	393
Trade	458	468	476	480	485	488	488	492	498
Services and other	<u>847</u>	<u>844</u>	<u>910</u>	<u>916</u>	<u>935</u>	<u>962</u>	<u>971</u>	<u>983</u>	<u>969</u>
Total employment	5,085	5,093	5,083	5,069	5,081	5,074	5,015	5,002	4,970
(In percent of total)									
Agriculture, forestry, and water economy	22.8	22.2	21.9	21.7	21.7	22.0	22.1	22.6	23.3
Industry	35.7	35.1	34.7	34.6	34.1	33.4	33.0	32.4	31.8
Construction	8.2	8.2	8.2	8.2	8.1	8.0	7.8	7.7	7.5
Transportation and telecommunications	7.7	7.9	7.9	8.0	8.0	8.0	8.0	7.9	7.9
Trade	9.0	9.2	9.4	9.5	9.6	9.6	9.7	9.8	10.0
Services and other	<u>16.6</u>	<u>17.4</u>	<u>17.9</u>	<u>18.0</u>	<u>18.5</u>	<u>19.0</u>	<u>19.6</u>	<u>19.6</u>	<u>19.5</u>
Total employment	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: CSO, Statistical Yearbook, and Statistical Pocketbook; and data provided by the Hungarian authorities.

Table 15. Hungary: The Development of Employment
by Branches in the Socialist Sector

(Period average, year-on-year percentage changes)

	1971-76 <u>1/</u>	1977	1978	1979	1980	1981	1982 <u>2/</u>	1983 <u>2/3/</u>
Agriculture and forestry	-3.7	-1.3	0.3	0.7	-0.6	2.5	2.8	1.3 <u>4/</u>
Industry	0.1	-0.2	-0.1	-1.6	-2.8	-2.1	-2.0	-2.6
Mining	1.9	-1.5	-1.9	-1.2	-0.7	-0.8	-0.6	0.1
Electric energy	1.2	-0.3	-0.4	-1.5	-1.8	-1.3	-1.2	1.5 <u>4/5/</u>
Metallurgy	0.2	--	-0.5	-0.8	-1.4	-2.7	-1.9	-3.5
Engineering	0.3	0.6	0.3	-2.0	-2.9	-2.4	-1.9	-2.9
Construction materials	-0.2	-0.2	0.7	-0.9	-2.0	-2.7	-2.5	-1.8
Chemicals	1.2	-1.6	-0.1	-0.7	-2.0	-0.9	-1.8	-1.8
Light industries	0.6	-1.2	-0.8	-2.7	-3.1	-2.8	-3.3	-4.3
Food processing	1.5	1.4	1.7	-0.5	-1.7	-0.5	-2.8	0.1
Other	1.7	0.7	0.3	0.2	...	-2.2	-1.2	-7.8 <u>5/</u>
Construction	2.0	-0.5	0.3	-1.7	-3.8	-3.7	-4.6	-4.1
Transportation and telecommunications	1.4	1.0	0.7	0.1	-1.5	-1.1	-0.8	-0.4 <u>4/</u>
Trade	2.1	1.7	1.5	1.1	-1.1	0.1	-0.1	-0.9 <u>4/</u>
Water economy	2.5	1.7	2.8	3.5	0.1	0.5	0.3	0.2
Nonmaterial services	3.4	2.1	2.4	2.1	1.5	0.9	1.3	...
Total	0.4	0.4	0.7	--	-1.1	-0.4	-0.4	-0.8 <u>6/</u>
Memorandum item:								
Employment in overall economy <u>7/</u>	0.2	-0.2	0.2	-0.2	-1.2	-0.4	-0.6	...

Sources: CSO, Statistical Yearbook and Monthly Bulletin of Statistics; and data provided by the Hungarian authorities.

1/ Annual average percentage changes.

2/ Preliminary data.

3/ January-August.

4/ First half year.

5/ As of July 1, 1983, the thermal power station of the former CSEPEL Iron and Metal Works Trust has been reclassified from other industry to the electric energy branch.

6/ Excluding nonmaterial services

7/ Percentage changes during period.

Table 16. Hungary: Enterprise Profits

(In billions of forint)

	1979	1980	1981	1982 <u>1/</u>
National income <u>2/</u>	597.4	628.3	683.6	742.1
Gross labor income	295.4	321.9	344.6	368.0
Operating surplus of enterprises	302.0	306.4	339.0	374.1
Production taxes <u>3/</u>	-250.1	-249.8	-271.3	-301.2
Other deductions <u>4/</u>	-15.0	-26.3	-21.9	-28.2
Subsidies	135.7	136.9	150.4	148.1
Enterprise profits before taxes	172.6	167.2	196.2	192.8
Taxes paid out of profits	-99.1	-101.4	-119.8	-121.2
Enterprises profits after taxes	73.5	65.8	76.4	71.6
Profit sharing	9.1	9.7	10.2	10.4
Withheld earnings	64.5	56.1	66.2	61.2
Development funds	...	52.6	52.9	55.4
Reserve funds	...	3.5	13.3	5.8

Sources: CSO, Statistical Yearbook; data provided by Hungarian authorities; and staff estimates.

1/ Preliminary data.

2/ Net domestic product at market prices.

3/ Taxes on production and on factors of production.

4/ Including allocations to welfare and cultural funds and to reserve funds for import prices equalization.

Table 17. Hungary: Distribution of Producer Prices
by Pricing Categories

(In percent)

	<u>Fixed prices</u> ^{1/}		<u>Free prices</u>		<u>Fixed prices</u> ^{1/}		<u>Free prices</u>	
	1979		1980		1983			
Mining	75	25	70	30	80	20		
Electric energy	93	7	93	7	93	7		
Metallurgy	69	31	--	100	1	99		
Engineering	14	86	--	100	--	100		
Construction materials	25	75	20	80	15	85		
Chemicals	51	49	40	60	37	63		
Light industry	9	91	--	100	6	94		
Food industry	<u>13</u>	<u>87</u>	<u>--</u>	<u>100</u>	<u>7</u>	<u>93</u>		
Total industry	29	71	18	82	20	80		
Construction	87	13	87	13	69	31		
Agriculture	63	37	62	38	63	37		
Transportation and Communications	90	10	90	10	77	23		
Trade	<u>35</u>	<u>65</u>	<u>--</u>	<u>100</u>	<u>--</u>	<u>100</u>		
Total	43	57	33	67	30	70		

Source: Data provided by the Hungarian authorities.

^{1/} Includes fixed prices, prices fluctuating between officially set lower and upper limits, and prices subject to a maximum or a minimum limit.

Table 18. Hungary: Distribution of Consumer Prices
by Pricing Categories

(In percent)

		Fixed Prices	Flexible Prices <u>1/</u>	Free Prices
Food, beverages, and tobacco	1979	23	52	25
	1980	23	49	28
	1983	22	46	32
Clothing	1979	--	20	80
	1980	--	1	99
	1983	--	2	98
Ironware, technical, and cultural materials	1979	--	45	55
	1980	--	22	78
	1983	--	13	87
Chemicals and petroleum products	1979	46	25	29
	1980	42	26	32
	1983	42	26	32
Wood and wood products	1979	--	51	49
	1980	--	15	85
	1983	--	32	68
Construction materials	1978	--	72	28
	1980	--	50	50
	1983	...	...	...
Glass and ceramics	1979	--	5	95
	1980	--	--	100
	1983	...	...	...
Fuels	1979	--	100	--
	1980	--	100	--
	1983	--	100	--
Books, periodicals, etc.	1979	50	45	5
	1980	50	40	10
	1983	...	...	...
Total retail trade in state and cooperative shops	1979	15	46	39
	1980	15	35	50
	1983	14	33	53
Services	1979	33	23	44
	1980	33	11	56
	1983	19	15	66
Handicrafts and products from free markets	1979	--	--	100
	1980	--	--	100
	1983	--	--	100
Total private consumption	1979	16	39	45
	1980	16	29	55
	1983	15	28	57

Source: Data provided by the Hungarian authorities.

1/ Within officially set limits.

Table 19. Hungary: Producer Prices 1/
(Average year-on-year percentage changes)

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982 <u>2/</u>	1983 <u>2/3/</u>
Mining	-0.4	-3.8	0.3	30.7	5.8	--	8.3	3.4	60.4	22.8	13.5	9.4
Electric energy	--	--	-0.1	1.7	12.8	--	8.5	0.3	27.3	10.0	13.4	10.6
Metallurgy	4.5	2.1	7.1	7.7	-2.1	--	11.5	3.8	26.8	-1.9	4.2	4.6
Engineering	4.3	2.8	1.8	4.3	0.8	--	4.1	2.1	0.2	3.3	2.2	4.6
Construction materials	5.5	1.5	1.5	6.6	8.5	--	6.2	3.5	10.0	11.1	3.7	6.0
Chemical industry	-1.6	1.1	6.9	24.3	4.2	--	-1.4	2.5	38.3	9.0	7.0	6.7
Light industries	2.0	1.3	2.8	5.7	2.2	1.0	2.5	2.7	1.0	4.7	1.7	2.5
Food processing industry	2.8	9.0	-0.7	1.7	8.1	--	2.4	1.8	12.3	9.3	1.4	5.2
Other industries	<u>4.2</u>	<u>13.3</u>	<u>27.4</u>	<u>13.2</u>	<u>1.4</u>	--	<u>1.3</u>	<u>1.8</u>	<u>1.4</u>	<u>0.2</u>	<u>3.0</u>	<u>...</u>
Total industry	2.5	3.2	2.9	9.6	3.9	--	3.7	2.4	15.3	5.9	4.7	5.6
Construction	5.2	3.6	4.1	2.7	6.0	5.3	5.4	3.1	2.7	5.0	6.6	5.2 <u>4/</u>
Agriculture and forestry	0.6	6.3	1.4	0.9	12.0	0.8	2.4	2.6	10.9	6.7	-0.3	3.8
Transportation and communications	0.7	2.6	0.2	3.9	9.7	3.8	4.4	1.7	11.2	7.1	7.0	...
Trade	3.6	1.0	6.6	-2.0	0.6	5.2	3.3	2.1	-4.3	5.3	...	...
Water economy	<u>2.9</u>	<u>1.4</u>	<u>4.0</u>	<u>3.7</u>	<u>4.9</u>	<u>3.1</u>	<u>4.4</u>	<u>1.9</u>	<u>8.2</u>	<u>8.9</u>	<u>...</u>	<u>...</u>
Total sectors	2.4	3.6	3.0	5.8	5.6	2.4	3.6	2.5	11.3	5.9	4.0	...
Nonmaterial services	<u>2.5</u>	<u>3.0</u>	<u>3.9</u>	<u>4.6</u>	<u>3.4</u>	<u>5.1</u>	<u>4.9</u>	<u>4.7</u>	<u>6.8</u>	<u>9.8</u>	<u>5.7</u>	<u>...</u>
Gross production	2.4	3.6	3.1	5.6	5.3	2.7	3.8	2.7	10.8	6.3	4.2	...

Sources: CSO, Monthly Bulletin of Statistics; and data provided by the Hungarian authorities.

1/ Domestic and foreign sales.

2/ Preliminary data.

3/ January-August. Sales prices in socialist sector, not fully comparable with annual data.

4/ First half year.

Table 20. Hungary: Consumer Prices
(Average year-on-year percentage changes)

	Foodstuffs	Beverages and tobacco	Clothing	Fuel and electricity	Consumer durables	Other industrial articles	Services	Total
1970	0.9	0.5	2.3	-1.8	-0.1	3.3	1.9	1.3
1971	2.0	1.3	2.4	-0.9	1.2	1.7	4.5	2.0
1972	1.1	7.0	4.0	-2.1	2.4	2.3	3.5	2.9
1973	4.7	7.7	1.8	-2.0	1.8	0.8	2.2	3.3
1974	0.5	2.3	2.0	5.6	2.4	2.1	1.8	1.8
1975	1.2	3.6	4.7	7.8	4.6	9.0	2.2	3.8
1976	10.2	0.5	5.2	-0.9	2.9	6.7	2.4	5.0
1977	5.5	5.0	4.5	-0.7	2.4	2.2	3.2	3.9
1978	3.6	9.2	5.0	0.3	3.1	3.3	3.9	4.6
1979	10.2	12.4	9.0	8.8	8.3	8.0	3.4	8.9
1980	13.4	1.7	5.0	21.4	13.2	9.5	7.0	9.1
1981	3.4	2.6	6.0	-0.2	1.1	9.0	6.5	4.6
1982 <u>1/</u>	4.8	13.1	5.5	10.0	2.1	6.4	7.2	6.9
1983 <u>1/2/</u>	4.6	10.2	5.7	9.1	7.6	9.8	11.3	8.2

Sources: CSO, Monthly Bulletin of Statistics; and data provided by the Hungarian authorities.

1/ Preliminary data.

2/ January-July.

III. The State Budget

1. Introduction

The critical focus of budgetary policy in Hungary has traditionally concerned income distribution on the one hand, and resource allocation on the other, the latter reflecting the need to channel resources toward enterprises and sectors where greater production and investment was desired than would be warranted or could be financed on the basis of profitability considerations alone. With the successive steps in the reform movement that began in 1968, however, the frequency and importance of ad hoc budgetary interventions into enterprise financial affairs have lessened, with budgetary policy being increasingly preoccupied by the burdens imposed by the social security system and the network of different subsidy payments. Nevertheless, the budget remains a key instrument of economic and financial policy in Hungary--determining, for example, the relative proportions of the economy's savings that can be at the direct disposal of enterprises via after-tax profits rather than in the form of a budget surplus to be intermediated back to enterprises through the National Bank.

The state budget comprises the expenditures and revenues of the Central Government and the social security system plus all current and part of the capital expenditures of the local authorities. The deficit of the state budget was very low up to 1980, generally less than 1 percent of GDP, and was financed by borrowing from the National Bank of Hungary. The deficit grew in 1981 and 1982, rising to 1.5 percent of GDP in the latter year, but is expected to recede to about 0.3 percent of GDP in 1983. These deficits, however, are lower than the borrowing requirement of the Central Government as the proceeds from intergovernmental credits from the nonconvertible currency area are included above the line as revenues (with the corresponding repayments included as expenditures).

After allowing for changes in accounting practices, the overall size of the state budget has shown relatively little change in recent years. ^{1/} A rapid growth in transfers to and for households--mostly social security payments and consumer price subsidies--has been largely offset by a declining share of expenditures on producer subsidies and budget-financed investment. The latter trend reflects the major price reform undertaken in 1979-80 and renewed efforts to reduce the scope of direct state intervention in the economy, to increase the autonomy of enterprises, and to rely more on indirect control through financial policies. This has changed significantly the nature of fiscal policy in Hungary. Although a large proportion of investment is still centrally determined or otherwise influenced by the authorities, the role of the budget in actually financing investment by the enterprise sector has been reduced markedly, as the importance of both self-financing through enterprise development funds and bank credits has been extended.

^{1/} On a comparable basis, the ratio of budgetary expenditures to GDP was 63 percent in 1980, 59 percent in 1982, and it is expected to be 61 percent in 1983.

2. Developments, 1982-1983

a. The 1982 outturn

The state budget deficit in 1982 was Ft 12.2 billion (Table 21), compared with Ft 9.5 billion in 1981. While the outturn was close to earlier official forecasts, the 1982 budget was considerably more restrictive of domestic economic activity than had been projected, as the forecast deficit was achieved despite a large shortfall in inter-governmental credits from the nonconvertible area. Under present budgetary practice in Hungary, such credits are treated as a source of nontax revenues rather than a financing item. Nontax revenues of the state budget were Ft 10.0 billion lower than in 1981 and Ft 8.6 billion below forecast. Half of the decline, and much of the deviation from plan, was due to the decline in foreign credits. The bulk of the remaining decrease reflected the termination in 1981 of payments to the budget of certain enterprise funds that had been generated in earlier years under the previous price and exchange system. The shortfall was offset roughly equally by smaller expenditures and larger tax revenues than planned. These reflected both policy responses designed to restrain budgetary outlays for investment and modernization grants to enterprises and also increased consumer turnover (i.e., sales) tax receipts.

During 1982, state budgetary expenditures rose by Ft 15.9 billion or 3.3 percent--compared with a 5.7 percent rise in the GDP deflator--while total revenues rose by Ft 13.2 billion or 2.8 percent. The growth in nominal expenditures largely reflected increases in the provision of government and social services--social security (Ft 8.1 billion); health, education, and culture (Ft 5.4 billion); defense and internal security (Ft 2.1 billion). Expenditures more directly associated with budgetary intervention in the domestic economy were restrained: price subsidies increased by Ft 2.0 billion and investment grants fell by Ft 6.4 billion.

The rise in revenues was due to increases in wages and social security taxes (Ft 11.6 billion); producer and consumer turnover taxes (Ft 15.7 billion); and production taxes (Ft 4.6 billion). Profit tax revenues were sharply down in 1982--by Ft 8.6 billion--as a result of Ft 6.0 billion in refunds of 1981 taxes paid to enterprises in the first quarter and a drop in payments of estimated profit taxes. In the event, profits--and tax liabilities thereon--declined by considerably less than expected (Ft 4 billion versus Ft 9 billion), shifting about Ft 2 billion in actual tax payments and budgetary receipts from the fourth quarter of 1982 to the first quarter of 1983. Despite higher duty rates and the 20 percent surcharge on imports of spare parts and components that was introduced in September 1982, tariff revenues were slightly lower than in 1981 because of the cutback in imports. In other nontax revenues, nonconvertible currency credits fell by about Ft 5 billion.

In contrast to 1981, when the deficit was financed primarily by recourse to the National Bank, in 1982 net credit from the National Bank fell back to about its average level in 1978-80 and the enlarged deficit was covered principally from bond sales to specialized banks (Table 22).

b. The projected 1983 outturn

For 1983, the state budget as approved by Parliament in December 1982 envisaged a deficit of some Ft 10.2 billion. It is now officially estimated at Ft 7.0 billion, although changes in classification mean that the present estimate is not comparable with the outturn in 1982 or with the 1983 approved budget. The underlying improvement from the Ft 12.2 billion deficit recorded in 1982 has been much stronger than the official estimates would suggest, since debt repayments of Ft 4.4 billion to the National Bank (NBH) have been included as expenditure items in the 1983 budget. In terms of the original classification, the present estimate implies a deficit of just Ft 2.6 billion (0.3 percent of GDP), an improvement of Ft 9.6 billion (1.1 percent of GDP) compared with 1982. As regards the impact of budgetary expenditure and taxation on the Hungarian economy, a further relevant influence was the fall, of about Ft 3 billion, in net receipts of nonconvertible currency inter-governmental credits. If account is taken of these essentially financing items within the budget, the effective improvement in terms of the budget's withdrawal of purchasing power from the domestic economy in 1983 was substantially greater than the figures for the reduction in the budget deficit, whether on the new or the old basis, would suggest.

Excluding repayments of NBH credit, expenditures are estimated to increase by 8.8 percent (Ft 43.8 billion) in 1983. The bulk of this increase is due to increases in price subsidies (Ft 13.1 billion) and social security outlays (Ft 8.5 billion) and to contributions totaling Ft 10.8 billion to the newly created State Lending Fund, which it is intended should remain on deposit at the National Bank. The estimated rise in price subsidies (Table 24 and Section 4, below) derives almost entirely from an increase of Ft 9.8 billion in modernization grants, which, in addition to certain ad hoc grants to enterprises, includes subsidies to exporters to CMEA countries. Of the projected 8.6 percent increase in social security expenditures, 3.0 percentage points represent cost of living adjustments; 3.9 percentage points are due to increases in the average level of pensions associated with changes in the demographic composition of beneficiaries; and the remaining 1.7 percentage points represent an extension of services of small social programs.

On the revenue side, the principal sources of the projected increase in total revenues of Ft 53.4 billion (11 percent) are profits taxes (Ft 17.0 billion), consumer turnover taxes (Ft 12.5 billion), wage and social security taxes (Ft 11.1 billion), and receipts of Ft 10.8 billion accruing to the budget for the first time from the confiscation of enterprise funds and the proceeds from IBRD-related credits (Table 25). A large part of the increase in profit taxes is due to the payment in 1983 of Ft 2 billion in taxes on profits earned in 1982 compared with the previously mentioned refund to enterprises in the first quarter of 1982 of excess profits taxes paid in 1981; the projected increase in 1983 relative to 1982 explained by this purely technical factor totals over Ft 8 billion. Additionally, profits--and tax liabilities thereon--

are expected to be higher this year (by Ft 12 billion) both because of greater output and higher prices that are not fully reflected in wages and because of modifications of rules concerning enterprise contributions to the amortization and other funds that are treated as production costs which are exempt from profit taxes. The projected rise in revenue from consumer turnover taxes (of 16.8 percent) reflects higher nominal consumer sales and higher tax rates, 1/ while the forecast rise in wage and social security taxes (14.7 percent) stems from a 3 percentage point increase in the rate of wage tax paid by employers and an increase in the progressivity of the schedule of rates for individual contributions. Of the remaining sources of revenue increases, production taxes are to rise by Ft 4.2 billion, reflecting, inter alia, higher prices received for certain exports to the CMEA area, 2/ higher taxes on agricultural cooperatives, and a new tax on trucks and vans. As noted above, nonconvertible credits are estimated to fall significantly in 1983 from the level recorded in 1982; this is partially offset in other nontax revenues by a projected increase in revenues of the budgetary institutions and payments to the budget associated with the upward valuation of inventories resulting from centrally administered price increases.

3. Subsidies

a. Consumer subsidies

The main component of budgetary expenditures for subsidies--over 40 percent--is for consumer goods (Table 24). Such subsidies are typically paid at the wholesale level, with the rate set annually as a percentage of the consumer price. Consumer subsidies are levied largely for distributional reasons; indeed consumer turnover taxes in the aggregate exceed the amount of such subsidies. Consumer subsidies grew by about 3 percent in 1982, and, abstracting from changes in classification, are expected to grow by 9 percent in 1983.

Subsidies for food and public catering, household energy, and pharmaceuticals are the three largest categories of consumer subsidy, and in each case the average subsidy rate declined slightly in 1983. The average rate of food and public catering consumer subsidies decreased from 13.6 percent to 12.9 percent in 1983, although their cost to the state budget increased from Ft 17.7 billion to Ft 20.4 billion. For household energy, the average subsidy rate declined from 139 percent to 133 percent with the corresponding budget expenditure down from Ft 12.8 billion in

1/ The latter include, inter alia: petrol (from 33 percent to 46 percent); coffee (from 26 percent to 47 percent); chocolate (from 13 percent to 35 percent); and rice (from 7 percent to 13 percent).

2/ When prices of exports to CMEA countries exceed those in convertible trade, the excess is taxed under "production taxes." When prices of exports to CMEA countries are lower than their domestic counterparts, producers receive subsidies under "modernization grants" (see Section 3.c.).

1982 to Ft 12.0 billion in 1983. For pharmaceuticals, the average rate of subsidy fell from 237 percent to 220 percent but at a cost to the budget of Ft 7.8 billion in 1983, up from Ft 7.2 billion in 1982.

b. Producer price subsidies

These are subsidies paid to producers and designed, inter alia, to keep consumer prices low. Excluding subsidies to agricultural enterprises (discussed below), producer price supports have increased relatively slowly in recent years. The main recipients of this type of subsidy are the food processing industry and agriculture (of the Ft 19.8 billion approved for 1983--excluding subsidies to agricultural enterprises-- Ft 7 billion is for fertilizer production, Ft 2 billion for pesticides, and Ft 1 billion for wool production). Energy-intensive products such as building materials are another major recipient of producer subsidies; for example, in cement production, 60-70 percent of recent energy price increases have been offset by subsidies. Producer price subsidies also include Hungary's contribution to the CMEA transportation system.

Producer price subsidies take one of two forms: (a) direct price subsidies, which are very similar to the consumer price subsidies; and (b) structural subsidies, which support infant industries or maintain the structure of production in line with given political or economic goals. With direct price subsidies, the wholesaler claims the subsidy from the budget after the product is sold. For structural subsidies, the producer claims the subsidy.

c. Modernization grants

These are principally capital grants to exporting enterprises for "structural adjustments" and are provided in declining annual allotments over a five-year period to enterprises for which there are insufficient development funds to undertake the particular investments. In general, since prices in CMEA trade differ from domestic prices, which are set in conformance with prices on Western markets, special taxes and subsidies are necessary to prevent the accumulation of windfall profits, on the one hand, and to encourage enterprises to export, on the other hand. Modernization grants exist in lieu of direct export subsidies and are disbursed for investments to maintain the profitability largely of enterprises exporting to the CMEA market. ^{1/} Typically enterprises in light industry are the recipients of such grants, although in 1982 fertilizer production and metallurgy were also subsidized. In 1983, modernization grants are expected to total Ft 36.5 billion, representing an increase over 1982. The increase is partly attributable to the constancy of CMEA prices in the face of rising domestic production costs.

^{1/} In 1982, more Western-oriented enterprises received such grants than before, although the size of these grants was smaller than those going to enterprises trading with the CMEA area.

d. Tax rebates to exporters

A 6 percent tax rebate is given for exports as an offset for domestic turnover taxes, actual rates of which vary widely. The rate had been 10 percent, but was changed to 6 percent in 1982 to offset somewhat the higher profits accruing to exporters from the devaluation of the forint.

e. Import subsidies

These are primarily for agricultural and energy products, viz., soyabeans, fish meal, pesticides, wood, benzine, and coke. These subsidies have fallen in recent years because of declining volumes of such imports.

f. Subsidies to agricultural enterprises

Subsidies in this category are to agricultural cooperatives, while those to state farms are generally included as producer subsidies. These subsidies are primarily intended to assist the cooperatives in their purchases of fertilizer, raw materials, and other inputs.

g. Other subsidies

These are typically subsidies to enterprises. The largest category (Ft 7 billion of the forecast Ft 16.6 billion in 1983) is for special enterprises that renovate houses for local councils. This category also includes budgetary contributions: to the sharing funds of coal mining enterprises; to buffer stocks for the food industry; and to various decentralized funds for tourism. In addition, miscellaneous irregular items are covered here, such as the payments in 1982 of claims to exporters under export insurance policies written before the revaluations of 1980 and 1981, and in 1983 the drought-related emergency aid to agricultural cooperatives and enterprises.

4. Local governments

Local budgets have two principal components: development funds and operational budgets. The operational expenditures and revenues are fully covered in the state budget. Capital expenditures by the local authorities on roads, hospitals, housing, and other infrastructure are conducted through development funds and are included in the state budget only to the extent that their financing constitutes a transfer from the state budget (Table 26). In this connection, Ft 15.2 billion of the Ft 38.2 billion disbursed by local development funds in 1982 was not included in the state budget, although almost one third of this represented debt amortization. Correspondingly, the local development funds had off-budget revenues of Ft 10.6 billion in 1982. These included municipal contributions of the population and enterprises, local property taxes, water and sewage payments, local fees for land use, and revenues from sales of

flats. Expenditures and revenues of the local development funds have declined slightly since 1979 in line with the Central Government's policy of reducing overall investment.

In Table 26, the national convention is followed of categorizing loan repayments by local governments as expenditures and presenting the borrowing requirement of the local development funds on a gross basis. The borrowing requirement is financed primarily by the National Savings Bank which makes three types of advances to local councils' development funds: so-called general loans for capital investments; loans for housing investment; and loans from the local councils' county loan fund. ^{1/} Excluding loan repayments, between 1979 and 1981, local development funds recorded small net surpluses; these were followed in 1982 by a net deficit of Ft 1 billion. The pattern for the first half of 1983 suggests that another small net deficit may be recorded for this year.

The operational expenditures of the local councils are shown in Table 27. Local expenditures account for about 70 percent of budgetary outlays for health, education, and culture and about 15 percent of budgetary outlays for defense and internal security. Local expenditures under "other"--about 20-25 percent of the total--are for communal services, infrastructure maintenance (especially roads), and local economic institutions. Such expenditures are crucially dependent on the flow of revenues. Current revenues accruing to local authorities derive from local taxes and fees assessed by local councils and revenues transferred from the Central Government under revenue-sharing arrangements, such as 50 percent of profit taxes on enterprises controlled by local councils.

5. Social security

Hungary has an extensive social security system encompassing pensions, sickness benefits, maternity and family allowances, and child-care

^{1/} The housing loans are mostly to finance the renovation of houses for resale to the population. This program, which is financed by budgetary grants as well as NSB credits, is being phased out over the next two to three years. Advances from the county loan fund, which are quantitatively the smallest of the three types of credit, are financed from voluntary medium-term deposits at the NSB made by municipalities with surplus funds. These can be lent to other municipalities within a given county, at the discretion of the county council concerned. In addition to borrowing from the NSB, local development funds may also issue bonds and borrow from the development funds of local enterprises (for example, to finance local infrastructure of direct benefit to an enterprise); however, neither of the latter is a major source of such finance. Since 1982, local councils have been permitted to offer bonds to the population. Up to end-September 1983, such issues totaled Ft 60 million and have attracted only Ft 34 million in subscriptions. Typically these bond issues have been organized on a local basis, being tied to specific projects which the local population might want to support.

benefits. In 1983, social security expenditures are forecast to total Ft 107 billion, or almost one fifth of the state budget outlays and some 12 percent of estimated GDP. Expenditures consist almost exclusively of cash payments to households, and as a proportion of personal disposable income, these payments have grown from 11.3 percent in 1970 to an estimated 19.3 percent in 1983. Much of this increase can be attributed to demographic and institutional factors which are increasing the burden imposed on the social security system by pensions.

Tax revenues accruing to the system are channeled through the state budget, and comprise social security taxes paid by enterprises, cooperatives, and the self-employed and employees' pension contributions. In the socialist sector, excluding agriculture, enterprises pay a social security contribution equivalent to 30 percent of wage costs. In addition, employees pay a progressive earnings-related pension contribution ranging in 1983 from 3 percent on monthly salaries below Ft 1,800 to 15 percent on monthly salaries above Ft 14,000. In the socialist sector this is the only form of taxation at present levied directly on employees' incomes. For full-time employees of enterprises who, outside normal work hours, are members of workers' associations using enterprise fixed capital, the only additional social security burden is a Ft 250 monthly social insurance premium which provides 100 percent coverage against loss of part-time income. In agriculture, social security contributions are lower than in industry, at 19-23 percent of the wages of employees of state farms and of agricultural cooperatives. Contributions--and also benefits--are also somewhat lower in the private sector than in socialist industry.

In recent years, the social security system has relied to an increasing extent on transfers from the state budget to cover its operating deficit. Between 1978 and 1981, the growth of expenditures outstripped that of tax revenue by a wide margin mainly as a result of increased pension payments. In 1982, however, the social security deficit decreased both in nominal terms and relative to GDP (from 3.3 percent to 2.7 percent), and a further decline is expected in 1983 (Table 28), with the increase in revenues following the rise in the social security wage tax rate from 27 percent in 1982 to 30 percent in 1983 more than offsetting the 8.6 percent projected rise in expenditures resulting from the cost of living increases and the demographically related increase in the average level of benefits. For 1984 a further increase in the social security wage tax rate (from 30 percent to 40 percent in the nonagricultural socialist sector) has been announced that is expected to permit a more marked narrowing in the social security deficit.

Table 21. Hungary: The State Budget 1/

(In billions of forint)

	1978	1979	1980 2/	1981 2/	1982 3/	Estimate 1983
Expenditures						
Investment	77.3	81.9	69.6	59.7	53.3	57.2
Price subsidies	126.5	135.4	131.8	144.5	146.5	159.6
Social security	53.6	62.2	77.7	90.4	98.5	107.0
Health, education, culture	46.1	49.6	56.0	67.6	73.0	75.8
Defense, internal security	24.2	25.5	27.8	30.9	33.0	32.8
Contributions to State Lending Fund	--	--	--	--	--	10.8
Other	<u>58.7</u>	<u>60.6</u>	<u>64.6</u>	<u>89.0</u>	<u>93.7</u>	<u>98.6</u>
Total expenditures	386.4	415.2	427.5	482.1	498.0	541.8
Revenue						
Direct taxes						
Wage taxes and social security contributions	59.4	60.8	53.7	63.7	75.3	86.4
Profit taxes	97.0	99.2	102.6	121.1	112.5	129.5
Production taxes	57.3	60.7	21.9	20.6	25.2	29.4
Taxes on capital	<u>28.8</u>	<u>30.9</u>	<u>2.4</u>	<u>1.1</u>	<u>0.6</u>	<u>1.0</u>
Total direct taxes	242.5	251.6	180.6	206.5	213.6	246.3
Indirect taxes						
Turnover taxes	30.6	52.0	131.9	152.7	168.4	181.0
Tariffs and import taxes	<u>32.8</u>	<u>31.3</u>	<u>22.0</u>	<u>23.7</u>	<u>23.1</u>	<u>22.0</u>
Total indirect taxes	63.4	83.3	153.9	176.4	191.5	203.0
Other revenues						
Confiscated working capital funds	--	--	--	--	--	1.4
Confiscated development funds	--	--	--	--	--	8.5
IBRD credits	--	--	--	--	--	0.9
Other revenues	<u>77.0</u>	<u>76.7</u>	<u>88.5</u>	<u>89.7</u>	<u>80.7</u>	<u>79.1</u>
Total revenues	382.9	411.6	423.0	472.6	485.8	539.2
Budget deficit	3.5	3.6	4.5	9.5	12.2	2.6
Memorandum items (incorporated in official outturn for 1983):						
Classified as expenditures:						
Repayment of NBH credits	--	--	--	--	--	4.4
Official budget deficit	3.5	3.6	4.5	9.5	12.2	7.0

Sources: Ministry of Finance; and staff estimates.

1/ Fiscal year is same as calendar year.

2/ Due to change of coverage in 1981, 1980 and 1981 are not on comparable basis.

3/ In the structure of the approved budget for 1983.

Table 22. Hungary: Financing the State Budget Deficit ^{1/}

(In billions of forint)

	1978	1979	1980	1981	1982	<u>Estimate</u> 1983
Budget deficit	3.5	3.6	4.5	9.5	12.2	2.6
Financing:						
National Bank of Hungary	1.6	2.8	1.8	8.9	2.9	
Of which:						
Claims on government	1.5	2.5	3.5	2.7	5.6	
Government deposits						
(increase = -)	0.2	0.3	-1.7	6.2	-2.8	
Specialized banks	--	--	--	--	7.2	
Of which:						
Bond holdings					7.2	
Other domestic financing	1.9	0.8	2.7	0.6	2.1	
Of which:						
Bond holdings	--	--	--	--	0.8	
Other	1.9	0.8	2.7	0.6	1.3	

Source: IMF, International Financial Statistics; and data provided by the Hungarian authorities.

^{1/} Components may not seem to total due to rounding. External financing is recorded "above the line."

Table 23. Hungary: State Budget Expenditures
(Economic Classification)

(In billions of forint)

	1978	1979	1980 <u>1/</u>	1981	1982 <u>2/</u>	<u>Estimate</u> 1983
Current expenditures						
Wages and salaries	26.5	30.0	41.1	43.7	46.2	51.0
Other purchases of goods and services	74.7	77.2	78.4	106.4	117.0	122.0
Social security	53.6	62.2	77.7	90.4	98.5	107.0
Interest payments <u>3/</u>	3.8	4.3	5.1	5.7	6.4	8.5
Subsidies	126.5	135.4	131.8	144.5	146.5	159.6
Other current transfers	<u>24.0</u>	<u>24.2</u>	<u>23.8</u>	<u>31.7</u>	<u>30.1</u>	<u>36.5</u>
Total current expendi- tures	309.1	333.3	357.9	422.4	444.7	484.6
Capital expenditures						
Acquisition of fixed capital assets	41.1	42.2	33.2	33.1	25.0	26.8
Capital transfers	<u>36.2</u>	<u>39.7</u>	<u>36.4</u>	<u>26.6</u>	<u>28.3</u>	<u>30.4</u>
Total capital expendi- tures	77.3	81.9	69.6	59.7	53.3	57.2
Total expenditures	386.4	415.2	427.5	482.1	498.0	541.8

Source: Data provided by the Hungarian authorities.

1/ Due to change of coverage in 1981, 1980 and 1981 are not on a comparable basis.

2/ In the structure of the budget approved for 1983.

3/ Includes interest subsidies on housing.

Table 24. Hungary: Budgetary Expenditures for Subsidies

(In billions of forint)

	1981	1982 <u>1/</u>	1982 <u>2/</u>	<u>Estimate</u> 1983
Consumer price supports	62.1	64.2	60.0	65.4
Modernization grants	25.4	26.7	26.7	36.5
Producer price supports	17.9	18.3	29.5 <u>3/</u>	28.2 <u>3/</u>
Tax rebate to exporters	16.5	14.4	14.4	12.0
Import subsidies	2.4	0.9	0.9	0.9
Subsidies to agricultural enterprises	9.2	9.0	...	...
Other	<u>11.0</u>	<u>13.0</u>	<u>13.0</u>	<u>16.6</u>
Total	144.5	146.5	144.5	159.6
Memorandum item:				
Consumer turnover taxes	66.4	74.2	74.2	86.8
Producer turnover taxes	<u>86.3</u>	<u>94.1</u>	<u>94.1</u>	<u>94.2</u>
Total	152.7	168.3	168.3	181.0

Source: Data provided by Hungarian authorities.

1/ Reported outturn.

2/ Outturn revised to be comparable with 1983's revised classification. The Ft 2.0 billion change in total subsidies due to reclassifications has its counterpart in lower production taxes.

3/ Including subsidies to agricultural enterprises.

Table 25. Hungary: State Budget Revenues

(In billions of forint)

	1978	1979	1980 <u>1/</u>	1981 <u>1/</u>	1982	Estimate 1983
Direct tax revenue						
Taxes on wages	14.5	12.7	1.8	...	...	...
Profit taxes	97.0	99.2	102.6	121.1	112.5	129.5
Production taxes	57.3	60.7	21.9	20.6	25.2	29.4
Social security contributions	44.9	48.1	51.9	63.7	75.3	86.4
Other direct taxes	<u>28.8</u>	<u>30.9</u>	<u>2.4</u>	<u>1.1</u>	<u>0.6</u>	<u>1.0</u>
Total direct taxes	242.5	251.6	180.6	206.5	213.6	246.3
Indirect tax revenue						
Turnover taxes	30.6	52.0	131.9	152.7	168.4	181.0
Of which:						
Producer's differential turnover tax	...	...	71.0	86.3	94.1	94.2
Consumer turnover tax	30.6	52.0	60.5	66.4	74.3	86.8
Import duties	<u>32.8</u>	<u>31.3</u>	<u>22.0</u>	<u>23.7</u>	<u>23.1</u>	<u>22.0</u>
Total indirect taxes	63.4	83.3	153.9	176.4	191.5	203.0
Total tax revenues	305.9	334.9	334.5	382.9	405.1	449.3
Nontax revenue						
Property income of non-financial public enterprises and public financial institutions	8.7	10.0	10.9	33.6	36.0	38.6
Other property income	1.7	1.8	1.9	0.8	1.1	0.7
Administrative fees and charges, etc.	4.0	4.5	4.7	4.8	4.9	5.0
Confiscated working capital funds	--	--	--	--	--	1.4
Confiscated development funds	--	--	--	--	--	8.5
IBRD credits	--	--	--	--	--	0.9
Other nontax revenue	53.6	50.3	59.1	36.7	25.2	21.0
Other capital revenue	<u>9.0</u>	<u>10.1</u>	<u>11.9</u>	<u>13.8</u>	<u>13.5</u>	<u>13.8</u>
Total nontax revenue	77.0	76.7	88.5	89.7	80.7	89.9
Total revenue	382.9	411.6	423.0	472.6	485.8	539.2

Source: Data provided by Hungarian authorities.

1/ Due to change of coverage in 1981, 1980 and 1981 are not on comparable basis.

Table 26. Hungary: Local Government Development Funds

(In billions of forint)

	1978	1979	1980	1981	1982	<u>Estimate</u> 1983
Tax revenue	7.7	7.7	11.5	12.5	12.6	12.0
Of which:						
Own sources	--	--	--	3.6	3.9	2.6
Other revenue	4.6	5.0	4.6	4.8	4.4	3.4
State budget investment grants	<u>21.6</u>	<u>24.3</u>	<u>19.7</u>	<u>15.5</u>	<u>16.7</u>	<u>15.4</u>
Total revenues	33.9	37.0	35.8	32.8	33.7	30.8
Expenditures <u>1/</u>	<u>36.8</u>	<u>40.3</u>	<u>39.6</u>	<u>36.9</u>	<u>38.2</u>	<u>34.5</u>
Gross borrowing requirement	-2.9	-3.3	-3.8	-4.1	-4.5	-3.7

Source: Data provided by the Hungarian authorities.

1/ Includes gross capital repayments to National Savings Bank.

Table 27. Hungary: Local Government Operating Expenses 1/
(In billions of forint)

	Outcome		Approved budget
	1981	1982	1983
Health and welfare	)	)	22.7
Education and culture	) 44.2	) 48.1	32.8
Defense, internal security administration	4.5	4.9)	17.9
Other	<u>16.6</u>	<u>20.1</u>)	_____
Total operating expenditures	65.3	73.0	73.4

Source: Data provided by the Hungarian authorities.

1/ Included in state budget.

Table 28. Hungary: Social Security Fund

(In billions of forint)

	1981	1982	<u>Estimate</u> 1983
Receipts			
Tax revenue	63.8	74.6	85.6
Nontax revenue	0.7	0.7	0.8
Grants	==	==	==
Total receipts	64.5	75.3	86.4
Expenditures			
Pensions	61.2	68.5	74.9
Sick pay	9.1	9.7	10.7
Maternity pay, family allowances, other	<u>20.1</u>	<u>20.3</u>	<u>21.4</u>
Total expenditures	90.4	98.5	107.0
Balance	-25.9	-23.2	-20.6
(As percent of GDP)	(-3.3)	(-2.7)	(-2.3)

Sources: Statistical Yearbook; and data provided by the Hungarian authorities.

IV. Money and Credit

As indicated in preceding chapters, the Hungarian economic reforms have entailed a shift in the mode of managing the economy from reliance on direct instructions to enterprises to greater use of indirect regulators designed to establish an economic environment conducive to enterprises' themselves making appropriate decisions. As part of this shift, the role of budgetary policy has declined relative to monetary and credit policy, both in the financing of fixed investment and in the provision of working capital. Nevertheless, so far the authorities have not been successful in achieving either the appropriate level of financial intermediation among enterprises or the desired degree of control over investment spending through credit policy. The failure to achieve the latter is due to an "overhang" of enterprise financial resources that can be tapped to finance investments for which neither credit nor budgetary grants are forthcoming, and that has led the authorities to limit the use of--and in some cases confiscate--certain enterprise deposits. These measures, while immediately limiting spending, do so at the expense of increasing the velocity of subsequent enterprise receipts and of diminishing thereby the inclination of enterprises to maintain deposits that could be intermediated back to other enterprises.

1. The institutional setting

The financial structure of the Hungarian economy is relatively less complex than that of a developed market economy, resembling more closely the financial structure of many developing countries. Enterprise financial assets consist principally of demand and time deposits at the National Bank of Hungary (NBH), but enterprises can also hold bonds issued by local councils, cooperatives, and other enterprises. Transactions both between enterprises and between the Government and enterprises are conducted entirely with demand deposits; by contrast, transactions between enterprises and households and within the household and private sectors are conducted mostly in currency.

The National Bank plays the dual role of central bank and commercial bank. Fully owned by the Government, it is the sole bank of issue and has responsibility for establishing and administering credit policy. The volume and direction of credits to be granted by the banking system to Hungarian enterprises and cooperatives for working capital and investment purposes, and the credit and interest rate policies to be followed, are determined by the credit policy guidelines which are approved by the Government in close coordination with the annual national economic plan. Since the NBH exercises its control over credit directly, it does not engage in operations such as open market sales and purchases and is not concerned with controlling the liquidity or reserves of banks.

In addition to the NBH, the Hungarian financial system consists of the following institutions 1/: (a) the State Development Bank, whose principal task is the preparation, financing, and control of state investments except those under the supervision of local councils, and

1/ For further details, see SM/82/186 (9/17/82), pp. 69-71.

whose sources of funds are refinancing credits from the NBH, transfers from the state budget, enterprise contributions to project financing, and project loans from the International Investment Bank of the CMEA; (b) the National Savings Bank, which keeps accounts for and grants credits to councils, provides a wide range of banking services to individuals, and makes loans to private industry; (c) the Hungarian Foreign Trade Bank, which specializes in import and export trade and in foreign exchange transactions; (d) the Central Bank of Exchange and Credit Limited, which engages in all types of commercial banking and foreign exchange transactions; (e) the Central Corporation of Banking Companies, which conducts special banking activities related to international or, in certain cases, domestic real estate transactions; (f) the Central European International Bank Limited, which is an "offshore" bank, established as a joint venture between the NBH and six foreign banks, and authorized to conduct commercial banking business in convertible currencies; (g) the General Banking and Trust Company, which represents and handles the claims of Hungarian citizens or institutions abroad; (h) The Insurance Enterprise of the State; and (i) The Interinvest Company for the Development of Foreign Trade.

In addition to the foregoing, beginning in 1983 several new experimental financial institutions are being set up to provide funds for research and development and venture capital for risky projects. In due course they may issue bonds to increase their resources. Four are to be part owned by the State Development Bank and part by government bodies drawing on resources previously received as budget investment allocations. Two were established in 1983: the Financing Association for Technical Development and the Innovations Association of Building Industry. They have both been established as unlimited liability partnerships with initial capital of Ft 620 million and Ft 300 million, respectively. They are intended to promote research and development in state enterprises and cooperatives and also to provide investment finance to implement new technical advances. At present their advances to finance research and development carry a 7 percent interest charge, while their investment loans are subject to the same rate as those extended by the NBH (currently 14 percent). In 1984 the State Development Bank plans to establish two further experimental financial institutions, in collaboration with government bodies. These are the Development Association of Industrial Cooperatives and the Agrarian Innovation Association. Unlike the two institutions established in 1983, these are both to be profit-oriented limited liability companies, with initial capital of Ft 300 million and Ft 520 million, respectively. They are to provide investment finance for high risk projects introducing new technology and for increasing net exports.

It is expected that the funds provided by these institutions will have a revolving character, although if the authorized capital is fully lent out, the associations may issue bonds. At present they may not take deposits from enterprises, and loans made by the associations cannot be refinanced at the NBH.

In addition, the National Savings Bank plans to establish in 1984 a fund called Takarekinvest, with a capital of Ft 300-500 million, to develop innovations in small ventures and to encourage joint ventures both in industry and agriculture. The fund's resources are to be provided by a proportion of the annual profit of the NSB, supplemented by the proceeds of bond issues.

2. Credit

Credit policy since 1979 has generally reflected the shift in economic policy that occurred at that time toward greater emphasis on the balance of payments. After increasing by 16 percent over the year to end-1978, the rate of growth of total credit was reduced to about 10 percent in 1979, 8-9 percent in 1980-81, and 6 percent in 1982. In the year to September 1983, domestic credit expanded by 6.4 percent (Table 29).

Of the Ft 40.0 billion increase in total credit in 1982, Ft 10.1 billion represented government borrowing from the banking system (Table 30). Of this, Ft 2.9 billion consisted of net credits from the NBH and Ft 7.2 billion was accounted for by the purchase of government bonds by the Central Exchange and Credit Bank (Table 31). Credit to government had been expected to grow more rapidly, but Ft 1.2 billion in other financing was provided indirectly by the specialized banks, in particular the State Development Bank; such financing is reflected indirectly in the monetary survey in other items net. During the first three quarters of 1983, the claims of the banking system on the state budget increased only moderately further, mirroring the marked reduction in the budget deficit, which for the year is expected to decline to only Ft 2.6 billion (see Chapter III). As in 1982, it is expected that part of this deficit will be financed through a sale of bonds to the State Insurance Company (and thus does not appear in the monetary survey).

Credit to enterprises grew by Ft 19.2 billion or 4.6 percent in 1982 (Table 32). Within this, working capital credits extended by the NBH grew by Ft 8.8 billion; NBH investment credits extended fell by Ft 2.1 billion; and loans extended by the State Development Bank increased by Ft 12.5 billion. Working capital credit policy was stricter than in previous years. The outstanding stock of working capital credits grew by 5.2 percent compared with 5.5 percent in 1981, and there was a rise in the proportion of refused applications, from 8 percent of the outstanding stock of working capital credits in 1981 to 13 percent in 1982. A further sign of tightened financial conditions was the increase in the number of enterprises with overdue working capital credits from 27 in 1981 to 85 in 1982. About half the total short-term working capital credits extended in 1982 were granted to enterprises with liquidity problems. These liquidity problems were concentrated in the machine building, metallurgy, and construction sectors. The obligation of the NBH to provide working capital credits to weak enterprises to ensure their ability to pay wages constrains the extent to which these credit extensions can be restricted.

Investment credit policy was also tighter than in previous years. The number of investment credit applications was only one quarter the number of such applications in 1981, reflecting both the surge in credit requests in 1981, the first year of the Five-Year Plan, and the awareness by enterprises that for much of the year, credit applications were not being processed. Two thirds of the new requests were for credits in the so-called preferred areas, and, of Ft 23 billion in gross disbursements, Ft 10 billion were for promotion of convertible currency exports, Ft 1 billion for energy conservation, and Ft 2 billion under the Austro-Hungarian hotel construction scheme. Although gross disbursements of state loans were only somewhat above those for investment credits (by Ft 2.6 billion), the outstanding net stock of State Development Bank loans grew by Ft 12.5 billion in 1982, whereas the stock of outstanding investment credits extended by the NBH declined by Ft 2.1 billion. This reflects the shift in the composition of SDB financing in recent years, with the growing importance of state loans mirroring the decline in disbursements of budget investment grants.

During the first nine months of 1983 net credit extensions to enterprises increased slightly faster than in the corresponding period of 1982 (Ft 18.4 billion against Ft 16.4 billion). Most of the increase was accounted for by working capital credits, which followed their normal seasonal pattern but were amplified by special factors. Part of the growth in the early months of 1983 was due to early shipments of oil and chemicals from the U.S.S.R., and for the twelve months to end-September credits for the food processing industry increased by more than overall working capital, reflecting the financing of the food industry's enlarged stocks following the bumper harvest of 1982. During 1983 there has been some further increase in the number of enterprises with overdue working capital credit obligations to the NBH, particularly in engineering and light industry. Despite this, there has been no apparent tendency for working capital credits to these sectors to increase. In line with the program to make enterprises more efficient and financially responsible, the NBH is scrutinizing applications for working capital credits more closely than in the past with respect to enterprise financial and economic management and inventory control and has been authorized to confiscate working capital from inefficient enterprises; in 1983, this is expected to draw off Ft 1.5 billion in such funds from 40 to 50 enterprises.

The stock of outstanding NBH investment credits, meanwhile, declined further in the first three quarters of 1983 while state loans extended by the State Development Bank continued to grow rapidly. Despite the decline in the stock of NBH investment credits, gross disbursements of such credits are expected to total some Ft 20 billion in 1983. Of this, almost Ft 2 billion is for IBRD-related projects to improve energy conservation and grain storage. Otherwise, priority for investment credit applications is being given to low-cost, quick-payoff projects that serve the goals of improving the employment situation and the foreign balance, modernizing plant and equipment, and promoting energy and raw material conservation. In contrast to the development of NBH credit, the growth in SDB loans has been more rapid than expected. In part,

this is explained by the considerably earlier-than-expected delivery of equipment for the PAKS nuclear power station, investment expenditures on which in 1983 are now forecast to be Ft 3.7 billion above the level specified in the 1983 Plan.

Credit extended to individuals by the National Savings Bank increased by Ft 13.7 billion or 11.4 percent in 1982. While there was a noticeable increase in the number of credit applications, their average value fell, reflecting a shift from house construction to renovation and improvement of existing structures. From the beginning of 1983 there was a substantial increase in the ceilings on individual housing loans offered by the National Savings Bank, and after a surprisingly quiet start to the year, both applications from and loans to households picked up dramatically. In the nine months to end-September 1983, NSB credits to households grew by Ft 16.7 billion, or 15.3 percent on an annual basis and accounted for fully half of the increase in total credit over this period.

3. Domestic liabilities of the monetary sector

The broad money supply grew by 6.2 percent in 1982 and by 6.4 percent in the year to September 1983, despite measures designed to drain away excess enterprise liquidity and the tighter credit policy outlined above. Within broad money, the growth of narrow money has significantly exceeded that for quasi-money in both 1982 and 1983.

a. Money

In Hungary, money is defined to include currency in circulation, demand deposits of households, current accounts of enterprises, and unfinished settlements. By far the largest components are currency and enterprise accounts, although the latter category includes enterprise import cover deposits, 1/ only a part of which is freely usable.

In the year to end-1982 and again over the twelve months to end-September 1983, the narrow money supply increased by 9.6 percent. By component, the growth of demand deposits was relatively rapid during 1982 (reaching 11.7 percent, against 7.4 percent for currency in circulation) but in 1983 the growth of currency has picked up noticeably, spurting to 10.3 percent in the year to September (against 9.0 percent for deposits). Among the factors contributing to the upsurge in currency have been the continuing growth of the private sector (where transactions are carried out almost entirely in cash); the increase in loans by the National Savings Bank for house construction in rural areas (where disbursements are largely in cash); a growing tendency for enterprises to demand payment in cash from enterprises with known liquidity problems; and an increase in the NSB's holdings of vault cash (which are included in money). These factors have combined to bring about a further decline in the velocity of currency circulation in the last two years (see below). At

1/ The forint cover scheme is described in Chapter VI.

the same time, individuals' checking accounts have been growing rapidly from a small base; whereas in 1980 households' cash holdings were equivalent to fifteen times their demand deposits, by the first nine months of 1983 the ratio had fallen to around eight. While this trend cut into the growth of currency held by the population, it has also been responsible for the aforementioned rise in vault cash held by the NSB, where the maturity structure of liabilities has correspondingly shortened.

In contrast to the development of household demand deposits, enterprise demand deposits grew by 10.4 percent in 1982 but fell by 2.7 percent in the 12 months to September 1983. With enterprise current accounts showing little change in either period (growing by 2.7 percent in 1982 and declining by 1.4 percent in the year to September 1983), import cover deposits--the other component of enterprise demand deposits--has shown considerable variation, expanding by 24.3 percent in 1982 and then falling by 4.1 percent in the year to end-September 1983 (Table 34).

b. Quasi-money

Approximately 75 percent of quasi-money consists of savings deposits of households, with the remainder being enterprise deposits. Household savings deposits have been expanding at a rate of 7-8 percent in recent years. In 1983, household saving deposits at the NSB have grown significantly faster both than in 1982 (9.6 percent in the year to September against 7.7 percent for 1982) and than earlier expected. Several factors help to explain this, including the buoyancy of private incomes; the tendency of the population in rural areas to place a large part of its income from sales of farm products into savings deposits; a change in regulations increasing downpayments on apartments; and a change in the timing of interest payments on deposits.

Enterprise time deposits comprise (i) voluntary interest-bearing time deposits, (ii) investment target deposits, which are funds set aside from development funds to cover anticipated expenses for investment projects under construction, and (iii) other deposits from development funds. During 1982 and 1983 the voluntary deposits have grown significantly--albeit from a low base--while development fund and investment target deposits have declined markedly, particularly in 1983. In the year to September 1983, these two categories of enterprise fixed deposits fell from Ft 43.7 billion to Ft 33.9 billion. This reduction reflects a number of influences, including the financing out of own resources of higher-than-expected enterprise investment outlays; increased enterprise contributions to state investments undertaken by local authorities; payments of the investment tax introduced in May; and confiscations of 6-9 percent of enterprise contributions to development funds stemming from 1982 profits and 1983 depreciation allowances. By end-September these confiscations totaled Ft 4.6 billion, and are expected to exceed Ft 7.0 billion by end-1983.

c. Enterprise reserve funds

Enterprises have long been obliged to place a specified proportion--20 percent in 1983--of after-tax profits in a compulsory reserve fund until a certain minimum level is attained. The use of the compulsory reserve is limited by statutory conditions and carries an obligation of reconstitution. Additional voluntary contributions to reserve funds are treated as a cost item in figuring the enterprise's profit tax liability. After rising only moderately in 1980 and 1981, reserve funds increased sharply (by more than Ft 15 billion, or some 38 percent) in 1982. For 1983, it was originally forecast that reserve funds would increase by about Ft 5.8 billion, reckoned on the basis of 1982 profits on which the obligatory contributions for 1983 would be based. Subsequently, the forecast was changed to a decrease of Ft 13.2 billion, incorporating a retroactive (to the beginning of the year) Ft 19.1 billion absorption by the NBH of enterprise reserve funds amassed prior to 1980. This cancellation of domestic liabilities of the NBH was an offset to the increase in the forint value of foreign liabilities that resulted from the devaluations of the forint in 1982 and 1983.

The decision has been announced to eliminate compulsory contributions to reserve funds beginning in 1984, although tax-deductible voluntary contributions can continue. In part this reflects the authorities' increasing dissatisfaction with the role that reserve funds have played in disrupting the authorities' plans for financial and economic balance. Indeed the authorities have come to view the reserve funds as a kind of insulation for enterprises against the policies the authorities were trying to implement, rather than the protective shield against market and real shocks for which they were created. In addition, the large increase in enterprise labor costs accompanying the increase in the social security tax and the decreases in consumer subsidies planned for 1984 made it an opportune time to release enterprises from their compulsory reserve fund contributions.

In calendar year 1984 such contributions will still be obligatory on the basis of profits earned in 1983 and for replenishing drawings made in 1983 and previous years, but, starting with profits earned in 1984, compulsory contributions will no longer be required. Existing reserve funds accumulated under the compulsory standard are to be disposed of in the following way: enterprises may put into voluntary reserves 80 percent of the level of their existing holdings of voluntary reserves; of the remainder, 30 percent can be used for the purchase of bonds issued by the CECB and the rest is to be confiscated.

d. Velocity

Except for 1980, when velocity fell, partly as a result of institutional changes, the velocity of both the narrow and broad monetary aggregates has been very stable in recent years, hovering, respectively, at about 4.6 and 2.2 revolutions per year (Chart B). The comparative stability of narrow money in terms of GDP has reflected an increase in

velocity of demand deposits (which resumed in 1983) and an offsetting rapid secular decline in the velocity of currency (averaging about 13 percent per year) 1/ which reflects the continuing expansion of private sector activity and increased monetization of the rural economy. Nevertheless, a somewhat smaller decline in the velocity of currency than that of the recent past had initially been envisaged for 1983, since it was thought that the higher expected rate of inflation as well as recent increases in interest rates (see below) would offset the increase in the demand for money stemming from the continuing growth of the private sector and the expanding role of the so-called "second economy." In the event, the latter factors, together with others mentioned above, have led to a stronger growth of currency and a seemingly sharper fall in velocity than expected earlier.

4. Interest rate policy

Following six years of unchanged rates on enterprise credits and deposits, in 1981 the authorities began to implement a more active interest rate policy. During the course of that year, rates on investment and working capital credits from the NBH were raised twice, by 1 percentage point each time. This was followed in 1982 by three further adjustments resulting in an increase for most credits of 3 percentage points over 1981 levels. More recently, on January 1, 1983, enterprise credit and deposit contracts were put on a "variable rate" basis, as part of the National Bank's program of interest rate unification. Under this program, as of July 1, rates are 14 percent on medium-term credits and 13 percent on short-term credits. At the beginning of 1984, the existing system of preferential interest rates and rebates for certain kinds of investments is to cease, being replaced--where appropriate--with tax rebates. Similarly motivated by the desirability of streamlining the structure of interest rates, at the end of 1982 interest rates on credits for small private businesses were raised from 6-10 percent to 11-12 percent.

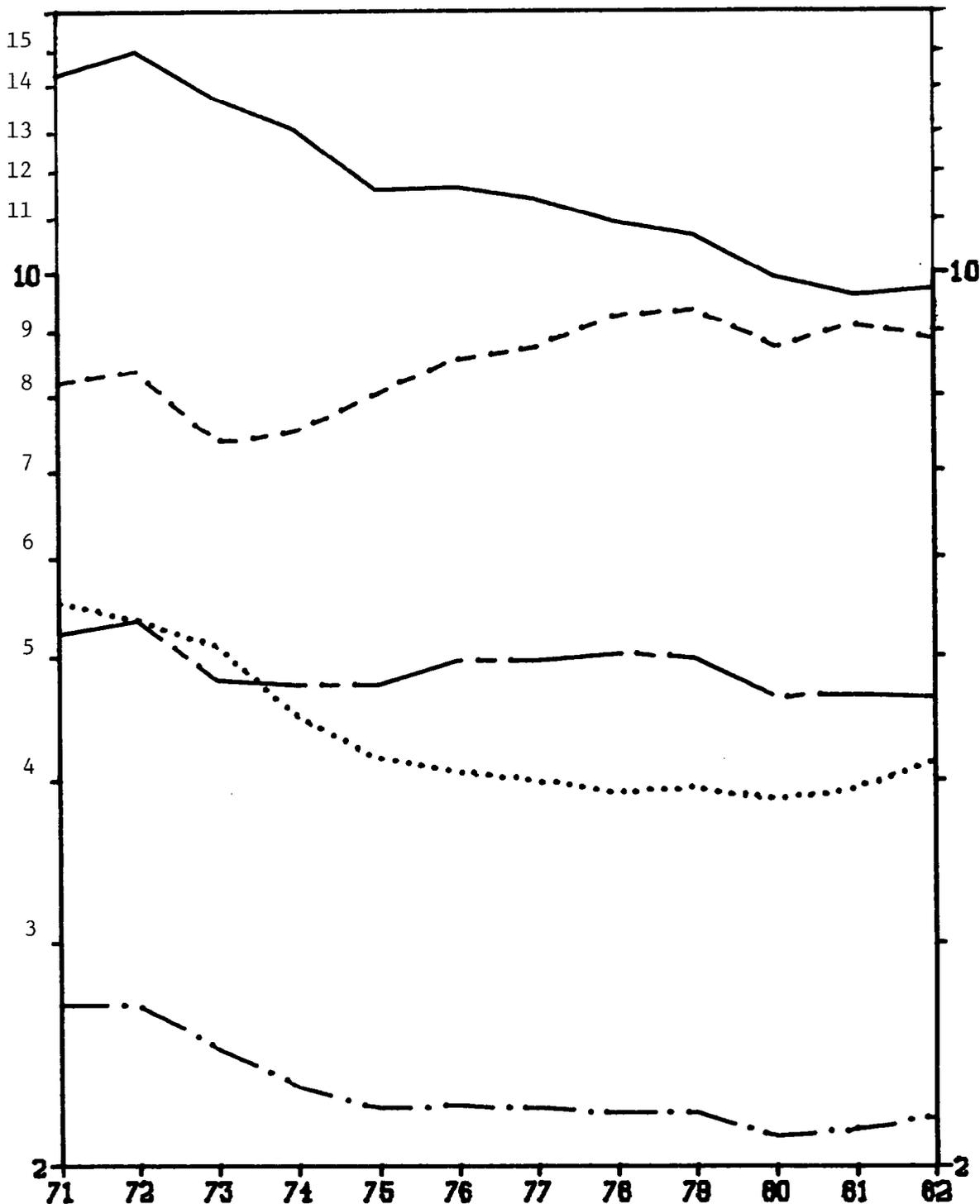
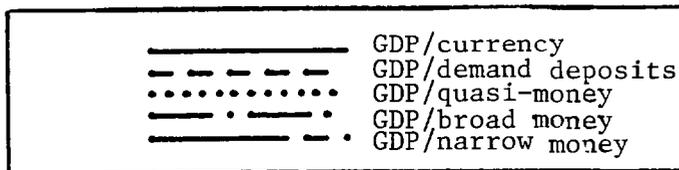
In contrast to rates applicable to enterprises, the basic rate schedule for household deposits and loans has remained unchanged since 1982 (Table 37). There have, however, been increases in the bonuses that deposits earn in respect to longevity. In addition, a new savings instrument for housing was established in 1983, carrying an interest rate of 6 percent for five-year deposits and 7 percent for ten-year deposits. On housing loans--accounting for 99 percent of credits to households--there has been some rearrangement of the applicable rates; the typical rate paid on most primary housing loans is now 3 percent, with shorter-term supplementary loans being available at 6-8 percent.

1/ Within this there are, of course, year-to-year variations reflecting, inter alia, the calendar and the effect on the spacing of paydays for employees. Such a calendar-induced phenomenon caused velocity to rise in 1982.

Chart B

HUNGARY

The Velocity of Circulation



Source: IMF, International Financial Statistics.



5. New financial instruments

While the authorities have relied heavily in the recent past on short run expedients to control investment expenditures, they have also sought to begin developing financial instruments which would strengthen monetary control and improve financial intermediation. Early in 1983, for example, the authorities took first steps toward establishing a bond market by issuing a decree empowering state enterprises and cooperatives to issue bonds. The Hungarian Oil and Gas Trust in conjunction with the State Development Bank sold Ft 400 million in bonds to Hungarian enterprises and cooperatives; this was double the initially intended amount, the issue having been enlarged to meet the demand for the bonds. By contrast, a second bond issue, by a different enterprise, was poorly received and the offering was subsequently withdrawn. Apparently the oil and gas bond issue had been a special case, drawing as its purchasers would-be customers for the gas to be pumped through the pipeline network being financed.

The difficulty confronting the authorities is a basic one. In an economy where power derives from control over resources and not ownership thereof, an enterprise cannot readily be expected to surrender its control over part of its resources to another enterprise for five or ten years, even if the expected profitability of such a surrender exceeds that likely to be attained by a direct investment undertaken by the enterprise itself. This, basic reluctance of an enterprise to transfer even temporarily its purchasing power to another enterprise has been exacerbated in the present situation by certain policy measures--viz., confiscations of enterprise development funds and working capital and compulsory early repayments of investment credits--that have made enterprises less inclined to publicize their possession of "excess" liquid resources.

Against this background, and in order to make interenterprise bonds more attractive, the authorities are considering measures to enhance their liquidity by fostering the development of a resale market. At the same time, regulations governing direct interenterprise loans and the rate of interest thereon are being amended to make the flow of such credits more attractive to enterprises with funds at their disposal. While enterprises can now entrust their free development funds to other enterprises, as of the beginning of 1984 they will be able to grant trade credits to their customers and obtain credits from the National Bank of Hungary, with the bills of exchange so created used as collateral. The authorities expect these instruments to be more readily attractive to enterprises since they are short term, can be rediscounted, and may provide the crediting enterprise with customers it might otherwise not have.

Table 29. Hungary: Summary Monetary Survey

(In billions of forint; end of period)

	1977	1978	1979	1980	1981	1st	2nd	3rd	4th	1st	2nd	3rd
						qtr.	qtr.	qtr.	qtr.	qtr.	qtr.	qtr.
						1982			1983			
Domestic credit	436.8	508.0	557.8	603.5	657.0	660.8	677.9	685.7	697.0	708.4	715.8	729.7
Reserve funds (-)	27.7	31.2	36.2	38.3	40.0	45.8	51.7	53.7	55.2	35.1	35.5	33.8
Frozen develop- ment funds (-)	--	--	--	--	--	--	--	--	--	3.1	3.1	4.6
Other items net (-)	<u>10.5</u>	<u>4.8</u>	<u>5.7</u>	<u>13.2</u>	<u>28.0</u>	<u>23.9</u>	<u>32.7</u>	<u>22.8</u>	<u>13.3</u>	<u>32.3</u>	<u>25.7</u>	<u>25.6</u>
Net domestic credit	398.6	472.0	515.9	552.0	589.0	591.1	593.5	609.2	628.5	637.9	651.5	665.7
Net convertible foreign liabilities	130.9	176.3	197.3	196.1	217.2	219.6	214.8	231.1	234.4	241.4	246.1	255.0
Net nonconvertible foreign liabili- ties	<u>5.7</u>	<u>10.3</u>	<u>9.6</u>	<u>13.8</u>	<u>6.7</u>	<u>8.2</u>	<u>12.1</u>	<u>13.1</u>	<u>6.5</u>	<u>17.5</u>	<u>20.2</u>	<u>22.2</u>
Net foreign liabilities	136.6	186.6	206.9	209.9	223.9	227.8	226.9	244.2	240.9	258.9	266.3	277.2
Narrow money	117.0	125.1	136.5	155.3	167.0	156.9	158.3	160.1	183.0	166.9	170.1	175.6
Quasi money	<u>145.0</u>	<u>160.3</u>	<u>172.5</u>	<u>186.8</u>	<u>198.1</u>	<u>206.4</u>	<u>208.3</u>	<u>204.9</u>	<u>204.6</u>	<u>212.1</u>	<u>215.1</u>	<u>212.9</u>
Broad money	262.0	285.4	309.0	342.1	365.1	363.3	366.6	365.0	387.6	379.0	385.2	388.5

Source: National Bank of Hungary.

Table 30. Hungary: Consolidated Monetary Survey

(In billions of forint; end of period)

	4th qtr. 1980	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
		1981				1982				1983		
Domestic credit	603.5	611.9	630.8	645.4	657.0	660.8	677.9	685.7	697.0	708.4	715.8	729.7
Claims on state bud- get (net) 1/	10.3	6.7	11.0	13.3	19.2	10.8	23.6	22.5	29.3	23.9	28.3	30.6
Claims on enter- prises, etc. 2/	486.0	497.3	509.1	514.8	517.9	528.8	530.5	532.8	534.1	548.3	547.0	548.8
Claims on households	107.2	107.9	110.7	117.3	119.9	121.2	123.8	130.4	133.6	136.2	140.5	150.3
Money	155.3	154.3	154.7	152.3	167.0	156.9	158.3	160.1	183.0	166.9	170.1	175.6
Currency in circula- tion	72.8	74.8	74.3	73.6	81.3	80.0	82.8	85.4	87.3	87.6	95.6	94.2
Demand deposits of households	4.5	4.9	5.1	5.5	5.8	6.3	6.7	7.1	8.2	8.4	9.3	10.1
Current accounts of enterprises 3/	67.4	67.2	64.7	62.6	69.4	60.6	59.1	62.0	76.6	60.2	56.9	60.3
Unfinished settle- ments	10.6	7.4	10.6	10.6	10.5	10.0	9.7	5.6	10.9	10.7	8.3	11.0
Quasi-money	186.8	193.6	192.8	192.2	198.1	206.4	208.3	204.9	204.6	212.1	215.1	212.9
Households	136.6	140.7	141.1	141.7	147.9	152.5	153.4	154.1	159.4	165.7	167.5	168.9
Enterprises	50.2	52.9	51.7	50.5	50.2	53.9	54.9	50.8	45.2	46.4	47.6	44.0
Savings bonds	4.2	5.2	5.6	5.9	6.4	7.3	7.6	7.9	8.2	9.0	9.4	9.6
Enterprise reserve funds 4/	38.3	39.0	40.7	40.5	40.0	45.8	51.7	53.7	55.2	35.1	35.5	33.8
Frozen development funds	--	--	--	--	--	--	--	--	--	3.1	3.1	4.6
Net foreign liabili- ties	209.9	192.5	209.9	219.9	223.9	227.8	226.9	244.2	240.9	258.9	266.3	277.2
Other items (net) (by difference)	9.0	27.3	27.1	34.6	21.6	16.6	25.1	14.9	5.1	23.3	16.3	16.0

Sources: National Bank of Hungary and staff estimates.

1/ Claims of the National Bank of Hungary and the Central Exchange and Credit Bank.

2/ Includes real estate investment and a small and relatively stable amount of credit extended by the Foreign Trade Bank, in addition to the claims of the National Bank of Hungary (direct claims plus refinancing credits extended to the State Development Bank).

3/ Including forint cover deposits against imports; see Table M8.

4/ Figures for 1983 reflect transfers of Ft 19.1 billion of enterprise reserve funds to the National Bank in connection with the settlements of currency valuation changes.

Table 31. Hungary: Monetary Survey Disaggregated

(In billions of forint; end of period)

	1977	1978	1979	1980	1981	1st	2nd	3rd	4th	1st	2nd	3rd
						qtr.	qtr.	qtr.	qtr.	qtr.	qtr.	qtr.
						1982			1983			
National Bank												
Claims on state budget net	4.1	5.7	8.5	10.3	19.2	10.8	23.6	22.5	22.1	16.7	21.1	23.4
Claims on enterprises	209.4	240.6	261.2	280.7	293.3	305.5	306.1	304.5	300.0	314.4	311.9	308.9
Claims specialized banks	102.7	34.3	144.6	161.1	178.1	178.8	177.3	180.8	187.0	184.8	184.0	185.2
Total domestic claims	316.2	380.6	414.3	452.1	490.6	495.1	507.0	507.8	509.1	515.9	517.0	517.5
Currency in circulation	50.7	57.2	63.5	72.8	81.3	80.0	82.8	85.4	87.3	87.6	95.6	94.2
Deposits of specialized banks	19.1	39.9	47.8	55.5	66.1	72.5	122.6	119.3	121.0	105.0	101.1	99.1
Enterprise demand deposits	54.2	54.6	60.5	67.4	69.4	60.6	59.1	62.0	76.6	60.1	56.9	60.3
Clearing items	9.5	10.1	8.5	10.6	10.5	10.0	9.7	5.6	10.9	10.7	8.3	11.0
Reserve money	133.5	161.8	180.3	206.3	227.3	223.1	274.2	272.3	295.8	263.4	261.9	264.6
Enterprise fixed deposits	41.9	41.3	44.0	50.2	50.2	53.9	54.9	50.8	45.2	46.4	47.6	44.0
Enterprise reserve funds	27.7	31.2	36.2	38.3	40.0	45.8	—	—	—	—	—	—
Net foreign liabilities	111.0	145.7	156.0	158.0	171.1	180.1	177.9	194.4	189.0	206.1	212.6	219.9
Other items net	2.1	0.6	-2.2	-0.7	2.0	-7.8	0.0	-9.7	-20.9	—	-5.1	-11.0
Specialized banks												
Deposits at National Bank	19.2	40.1	48.1	55.5	65.4	68.8	118.5	115.4	119.0	103.0	98.0	93.6
Claims on enterprises, public sectors, and state budget	148.9	175.7	187.6	199.4	217.0	215.5	216.3	219.5	233.1	233.9	232.8	236.3
Of which:												
State loans	73.0	89.2	99.1	109.0	120.4	119.4	122.5	125.6	132.9	134.1	137.5	142.5
Non-specified	75.9	86.5	88.5	90.4	96.6	96.1	93.8	93.9	93.0	92.6	88.1	86.6
State budget	—	—	—	—	—	—	—	—	7.2	7.2	7.2	7.2
Claims on households	71.4	81.6	94.1	107.2	119.9	121.1	123.8	130.4	133.6	136.2	140.5	150.3
Real estate investments	3.1	4.4	6.4	5.9	7.6	7.8	8.1	8.8	8.2	7.2	10.0	10.9
Total domestic claims	242.6	301.8	336.2	368.0	409.9	413.3	466.7	474.1	493.9	480.3	481.3	491.1
Demand deposits	2.7	3.2	3.9	4.5	5.8	6.3	6.7	7.1	8.2	8.4	9.3	10.1
Savings deposits	103.1	119.0	128.5	136.6	147.9	152.5	153.4	154.1	159.4	165.8	167.5	168.9
Savings notes	1.7	2.7	3.4	4.2	6.4	7.3	7.6	7.9	8.2	9.0	9.3	9.6
Enterprise reserve funds	—	—	—	—	—	—	51.7	53.7	55.2	35.1	35.5	33.8
Credit from National Bank	102.7	134.3	144.6	161.1	178.1	178.8	177.3	180.8	187.0	184.8	184.0	185.2
Net foreign liabilities	25.6	40.9	50.9	51.9	52.8	47.7	49.0	49.8	51.9	52.8	53.7	57.3
Other items net	6.8	1.7	4.9	9.7	18.9	20.7	21.0	20.7	24.0	24.4	22.0	26.2
Monetary survey												
Domestic credit	436.8	508.0	557.8	603.5	657.0	660.8	677.9	685.7	697.0	708.4	715.8	729.7
Claims on state budget net	4.1	5.7	8.5	10.3	19.2	10.8	23.6	22.5	29.3	23.9	28.3	30.6
NBH	4.1	5.7	8.5	10.3	19.2	10.8	23.6	22.5	22.1	16.7	21.1	23.4
CECB	—	—	—	—	—	—	—	—	7.2	7.2	7.2	7.2
Enterprises and public sector	358.2	416.3	451.5	480.1	510.3	521.0	522.4	524.0	525.9	541.1	537.0	537.9
NBH, direct	209.4	240.6	261.2	280.7	293.3	305.5	306.1	304.5	300.0	314.4	311.9	308.9
NBH via SDB	102.7	134.3	144.6	161.1	178.1	178.8	177.3	180.8	187.0	184.8	184.0	185.2
Other	46.1	41.4	45.7	38.3	38.9	36.7	39.0	38.7	38.9	41.9	41.1	43.8
Claims on households	71.4	81.6	91.4	107.2	119.9	121.2	123.8	130.4	133.6	136.2	140.5	150.3
Real estate investments	3.1	4.4	6.4	5.9	7.6	7.8	8.1	8.8	8.2	7.2	10.0	10.9
Money	117.0	125.1	136.5	155.3	167.0	156.9	158.3	160.1	183.0	166.8	170.1	175.6
Quasi-money	145.0	160.3	192.5	186.8	198.1	206.4	208.3	204.9	204.6	212.2	215.1	212.9
Net foreign liabilities	136.6	186.6	206.9	209.9	223.9	227.8	226.9	244.2	240.9	258.9	266.3	277.2
Enterprise reserve funds	27.7	31.2	36.2	38.3	40.0	45.8	51.7	53.7	55.2	35.1	35.5	33.8
Other items net	10.5	4.8	5.7	13.2	28.0	23.9	32.7	22.8	13.3	35.4	28.8	30.2

Source: National Bank of Hungary.

Table 32. Hungary: Summary Credits Outstanding

(In billions of forint; end of period)

	1977	1978	1979	1980	1981	1st	2nd	3rd	4th	1st	2nd	3rd
						qtr.	qtr.	qtr.	qtr.	qtr.	qtr.	qtr.
						1982			1983			
Net credit to government	4.1	5.7	8.5	10.3	19.2	10.8	23.6	22.5	29.3	23.9	28.3	30.6
Credit to enterprises	282.4	329.8	360.3	389.7	413.7	424.9	428.6	430.1	432.9	448.5	449.4	451.3
Of which:												
Working capital	(127.1)	(143.3)	(148.7)	(161.7)	(170.6)	(191.2)	(190.9)	(188.3)	(179.4)	(202.0)	(198.4)	(194.6)
Investment credits	(82.2)	(97.3)	(112.5)	(119.0)	(122.7)	(114.3)	(115.2)	(116.2)	(120.6)	(112.4)	(113.5)	(114.2)
State loans	(73.1)	(89.2)	(99.1)	(109.0)	(120.4)	(119.4)	(122.5)	(125.6)	(132.9)	(134.1)	(137.5)	(142.5)
Credit to individuals	71.4	81.6	94.1	107.2	119.9	121.2	123.8	130.4	133.6	136.2	140.5	150.3
Nonspecified	<u>78.9</u>	<u>90.9</u>	<u>94.9</u>	<u>96.4</u>	<u>104.2</u>	<u>103.9</u>	<u>101.9</u>	<u>102.7</u>	<u>101.2</u>	<u>99.8</u>	<u>97.6</u>	<u>97.6</u>
Total	436.8	508.0	557.8	603.5	657.0	660.8	677.9	685.7	697.0	708.4	715.8	729.7

Source: National Bank of Hungary.

Table 33. Hungary: Liabilities of the Monetary Sector

(In billions of forint)

	1977	1978	1979	1980	1981	1st	2nd	3rd	4th	1st	2nd	3rd
						qtr.	qtr.	qtr.	qtr.	qtr.	qtr.	qtr.
						1982			1983			
Money	<u>117.1</u>	<u>125.1</u>	<u>136.4</u>	<u>155.3</u>	<u>167.0</u>	<u>156.9</u>	<u>158.3</u>	<u>160.1</u>	<u>183.0</u>	<u>166.9</u>	<u>170.1</u>	<u>175.6</u>
Banknotes and coins	50.7	57.2	63.5	72.8	81.3	80.0	82.8	85.4	87.3	87.6	95.6	94.2
Enterprises and cooperatives	(2.7)	(3.1)	(3.8)	(3.5)	(3.8)	(3.2)	(3.7)	(3.9)	(4.9)	(2.2)	(4.5)	(4.7)
Individuals	(46.5)	(52.4)	(58.0)	(67.9)	(75.9)	(74.7)	(77.0)	(79.6)	(80.0)	(85.3)	(88.7)	(87.2)
Other	(1.5)	(1.7)	(1.7)	(1.4)	(1.6)	(2.1)	(2.1)	(1.9)	(2.4)	(0.1)	(2.4)	(2.3)
Demand deposits	66.4	67.9	72.9	82.5	85.7	76.9	75.5	74.7	95.7	79.2	74.5	81.4
Enterprises and cooperatives	(54.2)	(54.6)	(60.5)	(67.4)	(69.4)	(60.6)	(59.1)	(62.0)	(76.6)	(60.1)	(56.9)	(60.3)
Individuals	(2.7)	(3.2)	(3.9)	(4.5)	(5.8)	(6.3)	(6.7)	(7.1)	(8.2)	(8.4)	(9.3)	(10.1)
Other	(9.5)	(10.1)	(8.5)	(10.6)	(10.5)	(10.0)	(9.7)	(5.6)	(10.9)	(10.7)	(8.3)	(11.0)
Quasi-money	<u>145.0</u>	<u>160.3</u>	<u>172.5</u>	<u>186.8</u>	<u>198.1</u>	<u>206.4</u>	<u>208.3</u>	<u>204.9</u>	<u>204.6</u>	<u>212.1</u>	<u>215.1</u>	<u>212.9</u>
Enterprise fixed deposits	41.9	41.3	44.0	50.2	50.2	53.9	54.9	50.8	45.2	46.4	47.6	44.0
Savings deposits	103.1	119.0	128.5	136.6	147.9	152.5	153.4	154.1	159.4	165.7	167.5	168.9
Broad money	262.1	285.4	308.9	342.1	365.1	363.3	366.6	365.0	387.6	378.9	385.2	388.5

Source: National Bank of Hungary.

Table 34. Hungary: Deposits of Enterprises and Cooperatives

(In billions of forint; end of period)

	1977	1978	1979	1980	1981	1982				1983		
						1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.	3rd qtr.
Demand deposits	54.2	54.6	60.5	67.4	69.4	60.6	59.1	62.0	76.6	60.1	56.9	60.3
Current accounts	(28.2)	(32.3)	(38.4)	(42.3)	(44.7)	(33.1)	(25.8)	(30.2)	(45.9)	(33.5)	(27.2)	(29.8)
Import cover	(26.0)	(22.3)	(22.1)	(25.1)	(24.7)	(27.5)	(33.3)	(31.8)	(30.7)	(26.6)	(29.7)	(30.5)
Fixed deposits	41.9	41.3	44.0	50.2	50.2	53.9	54.9	50.8	45.2	46.3	47.6	44.0
Voluntary interest bear- ing	(5.6)	(6.3)	(6.4)	(5.0)	(5.8)	(6.5)	(7.1)	(7.1)	(7.4)	(7.4)	(9.3)	(10.1)
Deposits from development funds	(15.7)	(14.0)	(13.8)	(17.3)	(19.5)	(22.3)	(21.9)	(20.5)	(18.2)	(19.4)	(19.7)	(18.1)
Investment target deposits	(20.6)	(21.0)	(23.8)	(27.9)	(24.9)	(25.1)	(25.9)	(23.2)	(19.6)	(19.5)	(18.6)	(15.8)
Total	96.1	95.9	104.5	117.6	119.6	114.5	114.0	112.8	121.8	106.5	104.5	104.3

Source: National Bank of Hungary.

Table 35. Hungary: Development Fund, Sources and Uses

(In billions of forint)

	1981	1982
Sources		
Profits	51.4	53.9
Depreciation	62.3	66.3
Subsidies of local councils	4.2	4.6
Other <u>1/</u>	46.2	38.2
Sources, total	164.1	163.0
Uses		
Investment outlays	105.1	107.5
Contribution to state investment	4.5	6.1
Credit repayment		
State loans	12.9	13.7
Bank investment credit	21.9	25.8
Allocation to working capital <u>2/</u>	19.3	20.1
Tax and charges	--	--
Uses, total	163.7	173.2
Stock of development funds, end of period <u>3/</u>	44.4	37.8

Source: National Bank of Hungary.

1/ Includes other own sources net of uses; investment credit disbursements; state loans; and capital allocations from the SDB.

2/ Includes direct supplementing of working funds; and medium-term working fund credits.

3/ Stock of enterprise development fund and investment target deposits.

Table 36. Hungary: Interest Rates on Credits to and Deposits from Enterprises

(In percent per annum)

	Basic interest rates							
	From Dec. 1, 1970	From Feb. 1, 1975	From Jan. 1, 1981	From Sept. 1, 1981	From Jan. 1, 1982	From July 1, 1982	From Oct. 1, 1982	From July 1, 1983
Interest rates on credits								
State development loans	7	7- 8.5	8	9	10	11	13	13
Investment credits								
Long-term credits	8	8- 9.5	9	10	11	12	14	14
Medium-term credits	9	9-10.5	10	11	12	13	14	14
Short-term credits (granted in anticipation of amortization)	9	9	10	11	12	12	14	13
Working capital credits								
Medium-term working fund credits	9	9	10-11	11-12	12-13	13-14	15-16	14
Working fund supplementary credits	5-8	9	9	9	9	12	12	13
Short-term capital credits	8	9	10	11	12	12	14	13
Other credits								
Credits for innovation purposes			9	10	11	11	14	14
Medium- and long-term export credits	6	6	7.25	7.25	8.25	8.25	8.25	8.25
Reorganization credits	6	6	6	7	8	8	11	14
Credits for advancing the technical development fund medium term	7	8	9	10	11	11	14	13-14
	From Dec. 1, 1970	From Sept. 1, 1981	From Jan. 1, 1982	From Oct. 1, 1982	From July 1, 1983			
	For coun- cils	For enter- prises	For coun- cils	For enter- prises	For coun- cils	For enter- prises	For coun- cils	For enter- prises
Interest rates on deposits ^{1/}								
For time deposits fixed for at least:								
Six months	2	3	2	3	3	3	4	5
One year	3	5	3	6	4	6	6	8
Eighteen months	4	6	4	7	5	7	7	9
Two years	6	8	6	9	7	9	9	11

Source: National Bank of Hungary.

^{1/} Voluntary deposits in the case of enterprises.

Table 37. Hungary: Interest Rates on Credits to and
Deposits from Households

(In percent per annum)

	1975	1978	1981	1982	1983
Deposits					
Time and savings deposits	2-5	2-5	2-5	2-5	2-5
Premium deposits	3.8	4	4-4.7	4-4.7	4-4.7
Savings notes	--	6	6-7	5-7	5.5-8
Checking accounts	0-3	0-5	0-5	0-5	0-5
Savings deposits for housing	--	--	--	--	6-7
"Flat application" deposits	--	--	--	--	2-5
Loans					
Housing loans	0-6	0-6	0-6	0-6	0-3
"Bank loans" for housing	--	--	--	--	8
Hire purchase loans	6-8	6-8	6-8	6-8	6-8
Agricultural loans	6-8	6-8	6-8	6-8	6-8
Loans to small private businesses	6-10	6-10	7-10	6-10	11-12
Personal loans	8	8	8-10	8-10	8-10

Source: National Bank of Hungary.

V. External Sector

1. Overview

Two distinct phases have characterized the evolution of the balance of payments since the mid-1970s. From 1975 until 1978, the external current deficit widened rapidly, to more than US\$1.4 billion in 1978 (Table 38), equivalent to 8.7 percent of GDP. Financing these deficits caused a rapid expansion of foreign borrowing, and gross external debt trebled from the end of 1973 until the end of 1978.

The trend of rapidly widening external current deficits was reversed after 1978, although progress in reducing the deficit was uneven. Following two years of rapid reduction, the current deficit again widened in 1981, reflecting a large increase in the deficit in respect of current services and transfers. However, the trend of the two preceding years was subsequently resumed as the current deficit was reduced to less than US\$0.3 billion in 1982 and is estimated to be balanced in 1983.

The improvement in the external current balance since 1978 was achieved despite a continued widening of the deficit in respect of current services and transfers and reflected a substantial improvement of the trade balance. Mostly, the better trade performance was achieved in

respect of transactions settled in convertible currencies, the balance of which was reversed gradually from a deficit of US\$0.8 billion in 1978 to an estimated surplus of US\$0.8 billion in 1982, and US\$0.6 billion during the first nine months of 1983 (Table 39).

Developments in the capital account have also played a significant, at times dominant, role in recent years. In particular, Hungary's access to foreign sources of medium- and long-term capital has been sharply curtailed since mid-1981. Smaller inflows of medium- and long-term capital and large-scale withdrawals of short-term deposits held at the National Bank were primarily responsible for the substantial loss of foreign exchange reserves in early 1982 and the subsequent tight liquidity situation. Gross international reserves in convertible currencies at the end of September 1983 amounted to US\$0.7 billion, ^{1/} equivalent to 2.3 months of imports from the convertible currency area, compared to holdings equivalent to 4.5 months of imports, on average, during the period 1979-81.

Several institutional changes have been introduced in recent years which are intended to increase the openness of the economy and the response of domestic producers and consumers to developments in foreign markets. In particular, exchange rates for the forint relative to convertible currencies were unified and, concurrently, a more active exchange rate policy was pursued in support of the required strong

^{1/} Gold valued at SDR 35 per ounce.

expansion of exports. Controls have been eased on a wide range of producer prices, allowing such prices to be adjusted to reflect changes in foreign prices and the previous trend of expanding authorizations for domestic producers to export directly rather than through foreign trading enterprises was accelerated.

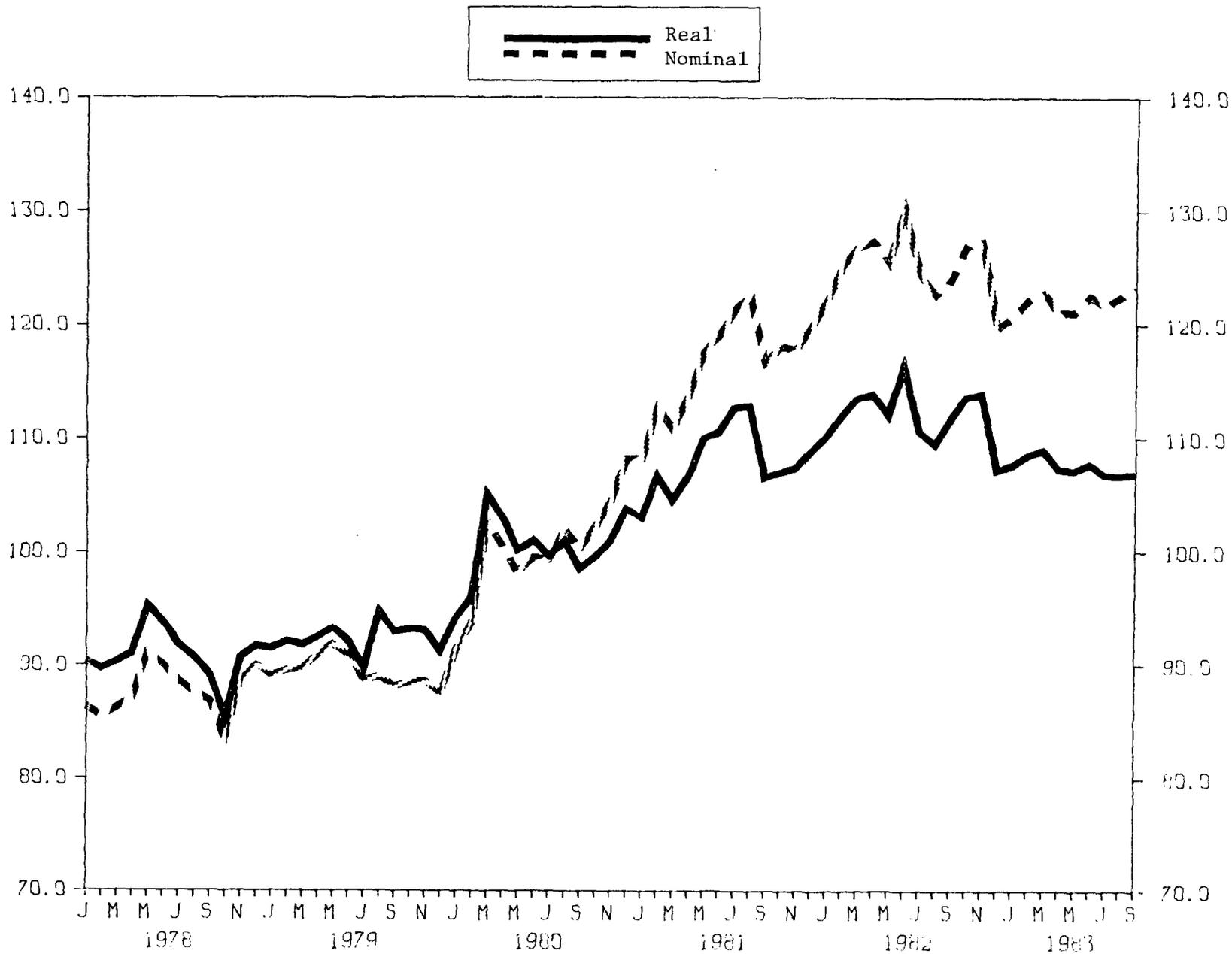
Remaining institutional and structural rigidities, however likely, have limited the impact of such changes on the efficiency of domestic resource use and on the response of domestic agents to changes in foreign markets. In particular, since a significant portion of consumer and producer prices remain controlled, changes in relative prices in foreign markets or changes in the exchange rate are not automatically reflected in domestic markets for these commodities, thus limiting or at least delaying the response of domestic demand. On the supply side, responses have been impeded by domestic rigidities which hinder the reallocation of capital and labor from less profitable to more profitable enterprises or sectors, including the weakness of mechanisms and incentives for intersectoral transfers of capital, limited wage differentiation, profile limitations on enterprise activities, and other administrative restraints. The full benefits of the institutional changes introduced in recent years are thus likely to take longer to realize than in other cases where no such restraints hinder responses.

2. Exchange rate developments and changes in competitiveness

The basic principle of exchange rate policy during the period since 1968 has been to adjust the exchange rate to limit the transmission of foreign inflation to domestic prices. Other factors, including the need to maintain adequate levels of profit in the production of exportables, are also taken into account. This latter concern has been given particular emphasis since mid-1982. Thus, during the second half of 1982, the forint was depreciated by some 11 percent against the basket of convertible currencies to which it is pegged. Further depreciations, totaling 7 percent, were introduced during the first nine months of 1983.

Indices of nominal and real effective exchange rates for the forint relative to the currencies of major trade partners and competitors are shown in Chart C. Salient features of the evolution of the real effective rate index in recent years are the sharp increase of the index from early 1980 through mid-1981, followed by a period of relative stability and, more recently, a partial reversal of the earlier trend of real appreciation. By September 1983, the exchange rate for the forint had depreciated by 8 percent in real effective terms relative to its earlier high in June 1982. Although the depreciation since June 1982 reversed only about half of the increase of the real effective rate index during the previous two years, this latter increase probably overstated significantly the actual loss of competitiveness in 1980-81. In particular, the 1979-80 price reforms, which involved the elimination of one third of then existing consumer price subsidies in July 1979 and

Chart C
 HUNGARY
 NOMINAL AND REAL EFFECTIVE EXCHANGE RATES



Source: Staff estimates.



from January 1980 the linkage of producer prices to world market prices for a broad range of commodities, raised domestic prices. The resulting higher rate of domestic inflation, however, overstated the loss of competitiveness since domestic incomes were compensated for only about two thirds of the effect on consumer prices of the cut in subsidies, resulting in a reduction of real incomes of 3 percent, while the impact of the reform of producer prices on the profitability of enterprises was offset in part by the reduction of taxes on capital and wages. ^{1/}

Another important development in gauging the evolution of competitiveness in recent years has been the gradual narrowing of the spread between the commercial and noncommercial rates of exchange from early 1979 and the eventual unification of the two rates in October 1981. As a result, the noncommercial exchange rate was depreciated by 40 percent, on a cumulative basis, during the three-year period 1979-81, substantially improving the competitiveness of the domestic tourist industry.

3. Developments in the current account

a. Trade balance

The trend of widening trade surpluses of recent years was further accelerated in 1982-83, with surpluses in respect of trade settled in convertible currencies of US\$0.8 billion in 1982 and US\$0.6 billion during the first nine months of 1983. This improved performance was achieved despite weakening terms of trade (Table 46) and--excluding re-export trade--reflected both a strong growth in the volume of exports and lower real imports. The traditional deficit on trade in nonconvertible currencies, meanwhile, was reduced in 1982 but was slightly higher in January-September 1983 than in the corresponding period of 1982 (Table 40).

The evolution of nonruble export and import volumes and prices is shown in Tables 41 and 42. Movements in these indices, however, must be interpreted with care. Since published trade statistics include re-exports and associated imports, the behavior of the indices may be significantly distorted at times of sharp fluctuations in the value of re-export trade. This has been the case in particular since the last quarter of 1982 for trade in energy products settled in currencies other than rubles. Exports and imports of energy products settled in currencies other than rubles both have increased sharply to more than US\$200 million per quarter since September 1982, compared to US\$70-80 million per quarter previously. Such re-export activities, although they do not affect the trade balance, which in fact has deteriorated in respect of nonruble trade in energy products since 1981 (Table 45), overstate the volume of both exports and imports.

^{1/} Thus, the reform of producer prices, by lowering enterprise taxes and subsidies to enterprises, reduced the intermediation role of the budget.

Excluding trade in energy products, the volume of exports settled in currencies other than rubles increased 6.7 percent in 1982 while the volume of imports fell by 8.3 percent. Similar trends were recorded in early 1983 as nonenergy exports and imports in the first six months were, respectively, 9.5 percent higher and 8.3 percent lower than in the corresponding period of the preceding year.

Except for consumer durables, all categories of trade in nonenergy products contributed to the improvement of the nonruble trade balance, reflecting the broadly based reduction of imports and the strong growth of exports of capital goods and transportation equipment and of food products. On the import side, both the increase in the relative price of imports and the restraint of domestic demand contributed, although restrictions introduced in 1982 also played a significant role. ^{1/} Excluding imports of food products which increased in early 1983 from a relatively low base in the previous year, nonenergy import volumes were about 12 percent lower in the first half of 1983 than in the corresponding period of the preceding year.

Developments in the balance of trade settled in ruble have been dominated in recent years by the large increase in the deficit in respect of trade in energy products, from US\$0.6 billion in 1978 to US\$1.3 billion in 1982 (Table 45), as prices for intra-CMEA trade were adjusted with a lag to developments in world market prices. Accordingly, Hungary's terms of trade for transactions settled in ruble deteriorated by 10 percent, on a cumulative basis, from 1978 to 1982. The wider deficit on energy products, however, was offset by larger surpluses in respect of nonenergy trade, reflecting in particular weak demand for imports of capital goods and transportation equipment as domestic investment spending was reduced and relatively strong growth of exports of consumer durables and food products. In 1982 and early 1983, imports of raw materials and capital goods settled in rubles increased strongly, probably reflecting in part the impact of weak demand in western markets on the availability of exportable supplies in CMEA partners and, in early 1983, advance deliveries for the construction of the PAKS nuclear plant.

b. Services and transfers

The key feature of developments in respect of nontrade current transactions in recent years has been the sharp increase in the deficit on investment income account, from US\$0.4 billion in 1979-1980 to US\$1.0-1.1 billion in the two following years. This development reflected both the rapid increase in preceding years in external debt in convertible currencies and high rates of interest on foreign capital markets. In addition, the tight liquidity situation and restricted access to loans

^{1/} These restrictions, which include quotas on imports of certain raw materials and a surcharge on imports of component parts as well as a tighter implementation of the licensing system are described in more detail in Chapter VI.

on favorable terms added significantly to borrowing costs, thus reversing in part the favorable compositional effects which had contributed to keeping debt service payments low in the early stage of the period of high rates of interest on foreign capital markets.

Partly offsetting the bigger deficit in investment income, the balance on both travel and other current services settled in convertible currencies improved strongly in recent years. Increases in hotel capacity, easier visa regulations, and the depreciation of the exchange rate applied to tourist spending have resulted in annual increases in travel receipts in convertible currencies in excess of 20 percent in 1981 and 1982. In contrast, spending by Hungarian travelers abroad, which had been increasing rapidly in previous years, leveled off after 1980 reflecting primarily reduced tourist spending in response to weaker income growth and the increase in the relative cost of foreign exchange due to the depreciation of the forint. However, the trend toward rapidly widening travel surpluses was halted in early 1983 as travel expenditures during the first six months increased by more than 10 percent compared to the same period of the previous year (Table 49), while receipts stagnated, reflecting in particular sharply reduced tourist arrivals from Yugoslavia.

Significant improvements were also recorded in recent years in respect of other current services in convertible currencies, the balance of which shifted from a deficit of US\$180 million in 1979 to a surplus of US\$175 million in 1982. In part, this improved performance reflected larger receipts from transit trade, fees and earnings from professional and technical services. However, a significant part of the improvement reflects settlement in convertible currencies of previously accumulated balances in nonconvertible currencies other than ruble under bilateral payments agreements.

4. Nonmonetary capital movements

In contrast with previous years when the financing of widening external current deficits had resulted in a rapid accumulation of external debt, net capital inflows slowed down sharply after 1981. In particular, reflecting the difficulties in raising medium- and long-term loans in eurocurrency markets, net long-term capital inflows in convertible currencies fell to US\$260 million in 1982 from, respectively, US\$0.9 billion and US\$0.8 billion in 1979 and 1980. Between mid-1981 and mid-1983, only two large loans were contracted on eurocurrency markets, a loan for US\$260 million in August 1982 and a loan for US\$200 million in April 1983. More recently, three loans, amounting to US\$270 million, were raised for cofinancing of IBRD projects.

Another factor which has influenced significantly the net flow of medium- and long-term capital has been the sharp increase in 1982 of outflows for export credit. In part, this has reflected the need to meet, at least partially, credit terms extended by other suppliers and

also increasing delays in receipts from certain buyers. 1/ Net outflows in the form of export credits, however, were significantly smaller in the first nine months of 1983 than during the corresponding period of 1982. 2/

Similar developments also occurred in the case of short-term non-monetary capital. In particular, reflecting factors similar to those which limited Hungary's access to sources of medium- and long-term capital, maturing short-term deposits held at the National Bank were sharply reduced in early 1982, resulting in a net outflow of short-term capital other than for export financing of US\$1.3 billion in the first quarter of 1982. Such outflows continued, albeit on a smaller scale, during the remainder of 1982. Despite short-term BIS credits amounting to US\$400 million on a net basis and short-term inflows to bolster reserves in late 1982, short-term capital outflows in convertible currencies, excluding export credit, amounted to US\$1 billion 3/ for 1982 as a whole. Although short-term outflows continued into early 1983, the situation has since improved significantly. Despite the repayments of the BIS credits and the seasonal reversal of short-term inflows to bolster end-1982 reserves, the net outflow of short-term capital during the first nine months of 1983 was sharply reduced to US\$0.5 billion, compared to US\$1 billion during the corresponding period of the preceding year.

Significant, although substantially smaller, fluctuations have also occurred in recent years in the case of capital flows in nonconvertible currencies. These fluctuations have reflected the conclusion of loan agreements with CMEA trade partners, including loans to ease the process of adjustment to the change in the relative price of energy in intra-CMEA trade and the conversion of short-term loans into longer maturities as part of bilateral agreements. In 1982, transport bottlenecks and disruptions in some CMEA trade partners contributed to a widening of the external current deficit in nonconvertible currencies, financed through the accumulation of short-term liabilities. Similarly, in early 1983, advance deliveries of oil and of capital goods for the PAKS nuclear plant were financed by larger-than-planned short-term capital inflows.

5. External debt and debt service

Reflecting the above developments on capital account, external debt outstanding which had increased rapidly through the mid- and late-1970s

1/ Receipts that the Hungarian authorities consider have been delayed beyond reasonable commercial practices, increased from US\$205 million in September 1982 to US\$245 million in March 1983. Such delays affect both short- and long-term export credits.

2/ Most of the recorded (net) outflows in the form of medium- and long-term assets during the first nine months of 1983 reflects a large medium-term deposit abroad, as security for certain capital inflows. The transaction which gave rise to the deposit was reversed in the fourth quarter.

3/ Includes errors and omissions.

was reduced by US\$1 billion in 1982 (Table 50). The reduction was more than accounted for by the decline in convertible currency debt of original maturity of less than one year, as medium- and long-term debt in convertible currencies continued to increase, albeit at a slower pace than in preceding years, while external debt in nonconvertible currencies fell slightly. Over the first nine months of 1983, despite the increase in short-term liabilities in nonconvertible currencies, total debt outstanding declined marginally further, reflecting the continued rundown in short-term debt in convertible currencies. At the end of September 1983, external debt with original maturities of one year or less accounted for 17 percent of total debt in convertible currencies, compared to 37 percent at the end of 1980. Reflecting the more difficult access to traditional sources of financing, there was also a significant change in the composition of external debt in convertible currencies as the share of trade-related credits, mostly suppliers' credits, more than doubled during the last two years.

The terms on which new loans were contracted also were significantly less favorable during the last two years. The maturity of new loans contracted in convertible currencies was sharply reduced from 6.1 years in 1981 to 4.7 years in 1982 (Table 51). As a result, and also reflecting a bunching of maturities in respect of loans contracted earlier, amortization payments will increase sharply in the next few years. Amortization payments on medium- and long-term debt in convertible currencies outstanding at end-June 1983 are scheduled to increase to US\$1.5 billion in 1984 from US\$1.2 billion in 1983. ^{1/} Accordingly, the ratio of debt service payments to current receipts for goods and services in convertible currencies, which increased to 35 percent in 1983, is expected to rise further in 1984 but to decline subsequently.

6. External reserves and other foreign assets

The large payments deficits of recent years resulted in a sharp reduction in holdings of gross external reserves in convertible currencies. Including gold, ^{2/} such holdings amounted to US\$1.1 billion at the end of 1982 (Table 53), equivalent to 3.2 months of convertible currency imports, compared to US\$2.1 billion at the end of 1980. Reflecting normal seasonal fluctuations and the unwinding of short-term borrowing to bolster end-year reserves, holdings of reserves in convertible currencies fell by US\$0.5 billion during the first quarter of 1983, and subsequently remained in the US\$0.7-0.8 billion range.

In contrast with official reserves, holdings of other foreign assets in convertible currencies increased by US\$0.3 billion in 1982, and further by US\$150 million during the first nine months of 1983.

^{1/} Including early repayment of a loan originally maturing in 1985.

^{2/} Valued at SDR 35/ounce.

Table 38. Hungary: Balance of Payments, 1978-1983

(In millions of U.S. dollars)

	1978	1979	1980	1981	1982	Jan.-Sept.	
						1982	1983
Exports	6,565	7,949	8,877	8,894	9,083	6,345	6,245
Imports	<u>-7,752</u>	<u>-8,509</u>	<u>-9,020</u>	<u>-8,855</u>	<u>-8,575</u>	<u>-6,346</u>	<u>-6,204</u>
Trade balance	-1,187	-560	-143	39	508	-1	41
Freight and insurance (net)	-263	-264	-332	-326	-311	-214	-191
Travel (net)	117	179	191	250	257	185	177
Investment income (net)	-264	-381	-389	-1,119	-962	-834	-486
Government expenditure (net)	-33	-39	-40	-44	-42	-28	-23
Other current receipts (net)	94	80	87	255	203	91	202
Unrequited transfers (net)	<u>99</u>	<u>42</u>	<u>48</u>	<u>48</u>	<u>63</u>	<u>39</u>	<u>38</u>
Current balance	-1,437	-943	-578	-897	-284	-762	-242
Medium- and long-term capital							
Assets <u>1/</u>	-80	-106	-168	-130	-180	-192	-196
Liabilities	1,225	1,037	948	1,119	347	325	172
Inflows	(...)	(...)	(...)	(2,025)	(1,287)	(1,079)	(903)
Outflows	(...)	(...)	(...)	(-906)	(-940)	(-754)	(-731)
Short-term capital							
Assets <u>1/</u>	-136	12	-71	-87	-33	172	-66
Liabilities <u>2/</u>	<u>987</u>	<u>-122</u>	<u>309</u>	<u>-622</u>	<u>-966</u>	<u>-802</u>	<u>-82</u>
Overall balance	559	-122	440	-616	-1,116	-1,259	-414
Monetary movements							
Monetary gold (increase -)	-134	62	-177	177	383	347	-193
Foreign exchange (increase -)	-425	60	-263	439	498	912	342
Use of Fund resources <u>3/</u>	--	--	--	--	235	--	265

Sources: National Bank of Hungary; and staff estimates.

1/ Nonreserve assets; mostly export financing.

2/ Includes errors and omissions.

3/ Includes drawing of SDR 72 million under CFF in December 1982.

Table 39. Hungary: Balance of Payments in Convertible Currencies, 1978-1983

(In millions of U.S. dollars)

	1978	1979	1980	1981	1982	Jan.-Sept.	
						1982	1983
Exports	3,177	4,063	4,863	4,877	4,876	3,464	3,472
Imports	<u>-3,979</u>	<u>-4,230</u>	<u>-4,587</u>	<u>-4,432</u>	<u>-4,110</u>	<u>-2,984</u>	<u>-2,854</u>
Trade balance	-782	-167	276	445	766	480	618
Freight and insurance (net)	-180	-187	-237	-216	-220	-139	-136
Travel (net)	34	72	84	133	176	124	105
Investment income (net)	-251	-366	-409	-1,100	-976	-849	-484
Government expenditure (net)	-32	-37	-43	-47	-45	-29	-30
Other current receipts (net)	-56	-181	-87	11	175	51	60
Unrequited transfers (net)	<u>25</u>	<u>40</u>	<u>46</u>	<u>47</u>	<u>61</u>	<u>37</u>	<u>36</u>
Current balance	-1,242	-826	-370	-727	-63	-325	169
Medium- and long-term capital							
Assets <u>1/</u>	-57	-111	-124	-104	-192	-205	-187
Liabilities	1,124	901	794	617	260	271	125
Inflows	(...)	(...)	(1,605)	(1,443)	(1,154)	(984)	(821)
Outflows	(...)	(...)	(-811)	(-826)	(-894)	(-713)	(-696)
Short-term capital							
Assets <u>1/</u>	-87	39	-15	31	-161	-16	-50
Liabilities <u>2/</u>	<u>724</u>	<u>-144</u>	<u>145</u>	<u>-348</u>	<u>-998</u>	<u>-979</u>	<u>-511</u>
Overall balance	462	-141	430	-531	-1,154	-1,254	-454
Monetary movements							
Monetary gold (increase -)	-134	62	-177	177	383	347	-193
Foreign exchange (increase -)	-328	79	-253	354	536	907	382
Use of Fund resources <u>3/</u>	--	--	--	--	235	--	265

Sources: National Bank of Hungary; and staff estimates.

1/ Nonreserve assets; mostly export financing.

2/ Includes errors and omissions.

3/ Includes drawing of SDR 72 million under CFF in December 1982.

Table 40. Hungary: Balance of Payments in Nonconvertible Currencies, 1978-1983

(In millions of U.S. dollars)

	1978	1979	1980	1981	1982	Jan.-Sept.	
						1982	1983
Exports	3,387	3,886	4,015	4,017	4,207	2,881	2,773
Imports	<u>-3,792</u>	<u>-4,279</u>	<u>-4,434</u>	<u>-4,423</u>	<u>-4,465</u>	<u>-3,362</u>	<u>-3,350</u>
Trade balance	-405	-393	-419	-406	-258	-481	-577
Freight and insurance (net)	-83	-77	-95	-110	-91	-75	-55
Travel (net)	84	107	107	117	81	61	72
Investment income (net)	-13	-15	20	-20	14	15	-2
Government expenditure (net)	-1	-2	3	3	3	1	7
Other current receipts (net)	149	261	174	245	28	40	142
Unrequited transfers (net)	<u>74</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>
Current balance	-195	-117	-208	-169	-221	-437	-411
Medium- and long-term capital							
Assets <u>1/</u>	-23	4	-44	-26	12	13	-9
Liabilities	101	136	154	502	87	54	47
Inflows	(...)	(...)	(...)	(582)	(133)	(95)	(82)
Outflows	(...)	(...)	(...)	(-80)	(-46)	(-41)	(-35)
Short-term capital							
Assets <u>1/</u>	-49	-27	-56	-118	128	188	-16
Liabilities <u>2/</u>	<u>263</u>	<u>22</u>	<u>164</u>	<u>-274</u>	<u>32</u>	<u>177</u>	<u>429</u>
Overall balance	97	19	10	-85	38	-5	40
Monetary movements							
Monetary gold (increase -)	--	--	--	--	--	--	--
Foreign exchange (increase -)	-97	-19	-10	85	-38	5	-40
Use of Fund resources <u>3/</u>	--	--	--	--	--	--	--

Sources: National Bank of Hungary; and staff estimates.

1/ Nonreserve assets; mostly export financing.

2/ Includes errors and omissions.

3/ Includes drawing of SDR 72 million under CFF in December 1982.

Table 41. Hungary: Value, Volume, and Price: Nonruble Exports

(Percent change)

	1978	1979	1980	1981	1982	1983 ^{1/}
Value ^{2/}						
Energy products	37.5	56.5	23.3	-3.8	51.1	147.8
Raw materials and semifinished products	7.8	45.6	13.6	-11.8	-7.0	7.5
Capital goods and transportation equipment	14.7	39.1	7.2	7.7	25.4	-14.1
Consumer durables	15.3	19.8	10.8	-5.9	-12.4	-5.4
Food products	<u>1.8</u>	<u>24.5</u>	<u>23.8</u>	<u>14.1</u>	<u>-0.3</u>	<u>-9.0</u>
Total	9.3	34.7	15.7	-0.7	2.2	7.1
Volume						
Energy products	19.9	9.3	-8.9	-14.8	70.9	186.1
Raw materials and semifinished products	-1.1	15.2	0.8	-5.1	-0.1	21.6
Capital goods and transportation equipment	5.4	27.4	-2.0	10.6	30.1	-6.6
Consumer durables	5.1	8.8	-1.8	-2.7	-6.3	4.7
Food products	<u>-2.3</u>	<u>12.1</u>	<u>8.4</u>	<u>11.8</u>	<u>10.7</u>	<u>7.2</u>
Total	1.6	15.6	2.2	1.7	10.7	22.1
Price ^{2/}						
Energy products	14.7	43.4	35.2	12.9	-11.6	-13.4
Raw materials and semifinished products	9.0	26.4	12.8	-7.1	-7.0	-11.6
Capital goods and transportation equipment	8.8	9.2	9.4	-2.6	-3.6	-8.1
Consumer durables	9.7	10.1	12.8	-3.2	-6.5	-9.6
Food products	<u>4.2</u>	<u>11.1</u>	<u>14.1</u>	<u>2.2</u>	<u>-10.0</u>	<u>-15.1</u>
Total	7.6	16.5	13.3	-2.3	-7.6	-12.3

Source: CSO, Monthly Bulletin of Statistics.

^{1/} First six months only, relative to first six months of 1982.

^{2/} U.S. dollar.

Table 42. Hungary: Value, Volume, and Price: Nonruble Imports

(Percent change)

	1978	1979	1980	1981	1982	1983 <u>1/</u>
Value <u>2/</u>						
Energy products	55.5	24.2	-28.5	-25.4	110.5	196.9
Raw materials and semifinished products	23.9	8.5	17.2	-2.7	-13.2	-20.2
Capital goods and transportation equipment	42.5	-1.8	-7.7	4.3	-5.9	-19.3
Consumer durables	44.9	3.5	17.1	21.3	-11.0	-22.9
Food products	<u>-7.8</u>	<u>0.1</u>	<u>11.6</u>	<u>1.4</u>	<u>-30.0</u>	<u>-0.5</u>
Total	23.7	6.6	8.6	-1.0	-8.8	-5.3
Volume						
Energy products	53.4	-20.3	-43.0	-39.0	126.9	204.8
Raw materials and semifinished products	15.4	-10.6	4.2	2.7	-8.0	-12.3
Capital goods and transportation equipment	29.6	-10.8	-15.7	8.0	-1.5	-9.9
Consumer durables	32.5	-5.3	6.4	27.2	-6.6	-12.9
Food products	<u>-9.7</u>	<u>-5.3</u>	<u>3.6</u>	<u>6.8</u>	<u>-17.2</u>	<u>19.1</u>
Total	15.9	-9.6	-2.6	3.6	-2.4	5.7
Price <u>2/</u>						
Energy products	1.3	55.9	25.3	22.4	-7.3	-2.6
Raw materials and semifinished products	7.4	21.4	12.4	-5.3	-5.6	-9.0
Capital goods and transportation equipment	10.0	10.1	9.5	-3.5	-4.4	-10.5
Consumer durables	9.3	9.3	10.0	-4.6	-4.7	-11.5
Food products	<u>2.1</u>	<u>5.7</u>	<u>7.7</u>	<u>-5.0</u>	<u>-15.4</u>	<u>-16.5</u>
Total	6.7	17.9	11.6	-4.4	-6.6	-10.4

Source: CSO, Monthly Bulletin of Statistics.

1/ First six months only, relative to first six months of 1982.

2/ U.S. dollar.

Table 43. Hungary: Value, Volume, and Price: Ruble Exports

(Percent change)

	1978	1979	1980	1981	1982	1983 <u>1/</u>
Value <u>2/</u>						
Energy products	26.8	38.7	-19.6	40.7	8.2	-30.4
Raw materials and semifinished products	6.5	9.8	1.4	11.2	-4.9	-2.2
Capital goods and transportation equipment	11.4	22.1	1.8	-5.5	1.4	-6.9
Consumer durables	9.3	6.8	-0.5	7.6	5.9	-10.6
Food products	<u>3.4</u>	<u>13.7</u>	<u>0.9</u>	<u>12.6</u>	<u>1.2</u>	<u>2.8</u>
Total	8.7	15.2	1.1	3.2	0.6	-5.4
Volume						
Energy products	3.6	26.0	-31.9	22.6	-0.6	-30.1
Raw materials and semifinished products	1.2	4.9	-3.7	9.2	-3.7	8.7
Capital goods and transportation equipment	2.4	15.2	-0.1	-2.6	4.1	3.7
Consumer durables	2.3	1.2	-2.7	7.9	9.9	1.4
Food products	<u>-2.5</u>	<u>4.7</u>	<u>3.2</u>	<u>11.2</u>	<u>4.4</u>	<u>15.5</u>
Total	1.4	8.8	-1.2	3.9	3.3	5.8
Price <u>2/</u>						
Energy products	22.4	10.1	18.0	14.7	8.9	-0.5
Raw materials and semifinished products	5.2	4.6	5.3	1.8	-1.3	-10.1
Capital goods and transportation equipment	8.8	6.0	1.9	-2.9	-2.7	-10.2
Consumer durables	6.9	5.5	2.3	-0.3	-3.7	-11.8
Food products	<u>6.1</u>	<u>8.6</u>	<u>-2.2</u>	<u>1.3</u>	<u>-3.1</u>	<u>-11.0</u>
Total	7.2	5.9	2.3	-0.6	-2.6	-10.6

Source: CSO, Monthly Bulletin of Statistics.

1/ First six months only, relative to first six months of 1982.

2/ U.S. dollar.

Table 44. Hungary: Value, Volume, and Price: Ruble Imports

(Percent change)

	1978	1979	1980	1981	1982	1983 ^{1/}
Value ^{2/}						
Energy products	28.7	31.4	22.7	8.9	11.7	0.7
Raw materials and semifinished products	15.1	2.7	1.6	2.1	0.7	-0.5
Capital goods and transportation equipment	18.7	16.4	-6.5	-17.4	0.9	-7.2
Consumer durables	19.2	7.4	1.5	3.4	-0.5	-12.4
Food products	<u>25.3</u>	<u>15.7</u>	<u>-8.9</u>	<u>48.8</u>	<u>-5.2</u>	<u>-36.6</u>
Total	19.2	12.8	3.3	-0.2	3.4	-3.8
Volume						
Energy products	5.6	14.8	14.6	-4.3	0.1	1.8
Raw materials and semifinished products	6.5	-3.6	0.3	0.4	3.7	11.5
Capital goods and transportation equipment	11.9	9.7	-9.2	-14.3	6.1	5.0
Consumer durables	12.1	1.2	-1.2	4.7	4.2	-1.0
Food products	<u>14.6</u>	<u>8.1</u>	<u>-13.2</u>	<u>30.5</u>	<u>-6.9</u>	<u>-32.2</u>
Total	8.7	4.6	--	-3.4	2.8	4.7
Price ^{2/}						
Energy products	21.9	14.4	7.1	13.8	11.6	-1.0
Raw materials and semifinished products	8.0	6.6	1.3	1.7	-2.9	-10.8
Capital goods and transportation equipment	6.1	6.0	3.0	-3.7	-4.9	-11.6
Consumer durables	6.3	6.1	2.7	-1.2	-4.5	-11.6
Food products	<u>9.3</u>	<u>7.1</u>	<u>5.0</u>	<u>14.0</u>	<u>1.8</u>	<u>-6.4</u>
Total	9.7	7.8	3.3	3.3	0.6	-8.1

Source: CSO, Monthly Bulletin of Statistics.

^{1/} First six months only, relative to first six months of 1982.

^{2/} U.S. dollar.

Table 45. Hungary: Balance of Trade, Performance
by Categories of Exports and Imports

(In millions of U.S. dollars)

	1978	1979	1980	1981	1982	1983 <u>1/</u>
Total Trade						
Energy products	-804.0	-986.7	-1,007.1	-1,031.6	-1,243.5	-865.9
Raw materials and semi- finished products	-1,942.6	-1,598.4	-1,840.5	-1,913.4	-1,690.2	-1,013.0
Capital goods and trans- portation equipment	-10.3	279.3	480.6	599.9	804.6	546.3
Consumer durables	493.0	606.8	623.1	542.5	538.8	337.1
Food products	<u>675.2</u>	<u>946.4</u>	<u>1,163.4</u>	<u>1,369.1</u>	<u>1,581.1</u>	<u>976.7</u>
Total	-1,588.6	-752.6	-580.5	-433.6	-9.1	-18.8
Nonruble Trade						
Energy products	-158.3	-140.0	42.1	104.6	26.5	49.4
Raw materials and semi- finished products	-1,305.6	-997.5	-1,228.1	-1,364.7	-1,084.8	-592.7
Capital goods and trans- portation equipment	-340.9	-184.0	-93.3	-78.0	112.3	60.8
Consumer durables	301.9	405.3	431.4	318.0	272.7	185.4
Food products	<u>319.7</u>	<u>544.3</u>	<u>746.4</u>	<u>937.1</u>	<u>1,134.4</u>	<u>642.3</u>
Total	-1,183.3	-371.9	-101.4	-83.0	461.1	345.1
Ruble Trade						
Energy products	-645.7	-846.7	-1,049.2	-1,136.2	-1,270.0	-915.3
Raw materials and semi- finished products	-636.9	-600.8	-612.5	-548.7	-605.4	-420.3
Capital goods and trans- portation equipment	330.7	463.3	573.8	677.9	692.3	485.5
Consumer durables	191.1	201.5	191.7	224.5	266.1	151.7
Food products	<u>355.5</u>	<u>402.0</u>	<u>417.0</u>	<u>432.0</u>	<u>446.8</u>	<u>334.4</u>
Total	-405.3	-380.7	-479.1	-350.6	-470.2	-364.0

Source: CSO, Monthly Bulletin of Statistics.

1/ First nine months only.

Table 46. Hungary: Trade Indices and Terms of Trade, 1978-83
(Change from preceding year; in percent)

	1978	1979	1980	1981	1982	1983 <u>1/</u>
Trade settled in rubles						
Exports						
Value	8.7	15.2	1.1	3.2	0.6	-5.4
Volume	1.4	8.8	-1.2	3.9	3.3	5.8
Price	7.2	5.9	2.3	-0.6	-2.6	-10.6
Imports						
Value	19.2	12.8	3.3	-0.2	3.4	-3.8
Volume	8.7	4.6	--	-3.4	3.8	4.7
Price	9.7	7.8	3.3	3.3	0.6	-8.1
Terms of trade	-2.3	-1.8	-1.1	-3.9	-3.2	-2.7
Trade settled in currencies other than rubles						
Exports						
Value	9.3	34.7	15.7	-0.7	2.2	7.1
Volume	1.6	15.6	2.2	1.7	10.7	-22.1
Price	7.6	16.5	13.3	-2.3	-7.6	-12.3
Imports						
Value	23.7	6.6	8.6	-1.0	-8.8	-5.3
Volume	15.9	-9.6	-2.6	3.6	-2.4	-5.7
Price	6.7	17.9	11.6	-4.4	-6.6	-10.4
Terms of trade	0.8	-1.2	1.6	2.2	-1.1	-2.1
Total						
Exports						
Value	9.0	24.9	8.9	1.0	1.5	1.4
Volume	1.5	12.5	0.9	2.6	7.2	14.5
Price	7.4	11.0	7.9	-1.6	-5.3	-11.4
Imports						
Value	21.7	9.3	6.2	-0.6	-3.1	-4.5
Volume	12.6	-3.3	-1.2	0.2	--	5.0
Price	8.0	13.1	7.5	-0.8	-3.1	-9.1
Terms of trade	-0.6	-1.8	0.4	-0.8	-2.2	-2.5

Source: CSO, Monthly Bulletin of Statistics.

1/ First six months only, relative to first six months of 1982.

Table 47. Hungary: Trade Balance with Socialist and Nonsocialist Countries, According to Currency of Settlement, 1978-1983

(In millions of U.S. dollars)

	1978	1979	1980	1981	1982	Jan.-August	
						1982	1983
Trade with socialist countries settled in rubles							
Exports, f.o.b.	3,189.2	3,675.2	3,714.3	3,835.8	3,860.8	2,309.7	2,183.8
Imports, c.i.f.	<u>-3,594.5</u>	<u>-4,055.9</u>	<u>-4,193.5</u>	<u>-4,186.4</u>	<u>-4,331.0</u>	<u>-2,743.5</u>	<u>-2,579.3</u>
Trade balance	-405.3	-380.7	-479.1	-350.6	-470.2	-433.8	-395.5
Trade with socialist countries settled in currencies other than rubles							
Exports, f.o.b.	679.5	894.7	1,046.0	1,237.5	1,196.5	700.8	680.8
Imports, c.i.f.	<u>-511.9</u>	<u>-584.7</u>	<u>-471.3</u>	<u>-530.4</u>	<u>392.7</u>	<u>-223.2</u>	<u>-235.5</u>
Trade balance	167.6	309.9	574.7	707.1	803.8	477.6	445.3
Trade with nonsocialist countries							
Exports, f.o.b.	2,480.6	3,360.0	3,877.7	3,652.2	3,800.9	2,083.1	2,201.7
Imports, c.i.f.	<u>-3,831.5</u>	<u>-4,041.9</u>	<u>-4,533.8</u>	<u>-4,442.3</u>	<u>-4,143.6</u>	<u>-2,517.7</u>	<u>-2,360.9</u>
Trade balance	-1,350.9	-681.9	-676.1	-790.1	-342.7	-434.6	-159.2
Trade balance, total							
Exports, f.o.b.	6,349.7	7,929.9	8,638.0	8,725.5	8,858.2	5,093.6	5,066.3
Imports, c.i.f.	<u>-7,937.9</u>	<u>-8,682.5</u>	<u>-9,218.6</u>	<u>-9,159.1</u>	<u>-8,867.3</u>	<u>-5,484.4</u>	<u>-5,175.7</u>
Trade balance	-1,588.5	-752.6	-580.5	-433.6	-9.1	-390.8	-109.4

Source: CSO, Monthly Bulletin of Statistics.

Table 48. Hungary: Direction of Trade, 1978-1983

(In percent)

	1978	1979	1980	1981	1982	Jan.-June	
						1982	1983
Exports	<u>100.0</u>	100.0	100.0	100.0	100.0	100.0	100.0
Settled in rubles ^{1/}	50.2	46.3	43.0	44.0	43.6	45.5	42.5
Settled in convertible currencies	49.8	53.7	57.0	56.0	56.4	54.5	57.5
Of which:							
Germany, Fed. Rep. of	8.4	9.4	9.7	8.7	7.2	6.9	6.6
Italy	4.2	5.0	4.5	3.3	3.4	4.0	3.3
Austria	3.3	3.4	4.4	4.4	5.0	4.0	3.7
Switzerland	1.3	1.2	1.6	1.5	1.3	1.5	1.3
United Kingdom	1.5	1.5	1.1	1.0	0.9	0.8	0.8
France	1.6	1.6	1.7	1.6	1.5	1.5	1.4
United States	1.2	1.3	1.3	1.6	1.6	1.5	1.9
Japan	0.2	0.3	0.1	0.2	0.3	0.2	0.2
Imports	<u>100.0</u>	100.0	100.0	100.0	100.0	100.0	100.0
Settled in rubles ^{1/}	45.3	46.7	45.5	45.7	48.8	49.2	49.6
Settled in convertible currencies	54.7	53.3	54.5	54.3	51.2	50.8	50.4
Of which:							
Germany, Fed. Rep. of	12.3	12.1	11.7	11.9	11.1	11.4	9.4
Italy	3.4	3.0	3.1	3.0	2.7	3.1	2.1
Austria	5.1	5.2	5.4	5.0	3.8	5.2	4.3
Switzerland	2.7	2.5	2.8	2.4	2.2	2.2	1.7
United Kingdom	1.9	1.9	2.0	2.3	2.0	2.0	2.0
France	2.4	2.2	2.2	2.5	2.2	2.3	1.8
United States	2.2	1.9	2.7	2.5	2.1	2.3	2.6
Japan	1.1	0.9	1.5	1.4	1.3	1.3	1.2

Source: Statistical Yearbook of Foreign Trade.

^{1/} The actual share of socialist countries in Hungary's foreign trade is higher than reflected in these figures, since part of foreign trade with socialist countries is settled in convertible currencies.

Table 49. Hungary: Travel to and from Hungary 1/

	1978	1979	1980	1981	1982	January-June	
						1982	1983
Settled in rubles							
Travelers to Hungary	11,995	10,421	10,414	11,012	5,939	1,125	1,582
of which: tourists	(7,348)	(7,392)	(7,480)	(8,380)	(4,377)	(753)	(1,111)
Revenues	309	298	281	231	153	38	46
Travelers from Hungary	4,107	3,995	4,164	4,621	2,993	960	1,224
of which: tourists	(3,943)	(3,902)	(4,049)	(4,496)	(2,721)	(852)	(984)
Expenditures	119	105	96	81	59	22	24
Settled in currencies other than rubles							
Travel from/to Yugoslavia							
Travelers to Hungary	3,281	2,622	1,638	1,513	1,186	459	296
of which: tourists	(1,440)	(1,124)	(709)	(751)	(619)	(234)	(122)
Revenue	4	16	16	23	17	7	4
Travelers from Hungary	969	650	530	449	418	123	144
of which: tourists	(911)	(612)	(500)	(417)	(355)	(103)	(96)
Expenditures	25	27	28	20	14	4	4
Other travel settled in currencies other than rubles							
Travelers to Hungary	1,684	2,080	1,944	2,316	2,707	1,032	1,114
of which: tourists	(1,162)	(1,331)	(1,224)	(1,319)	(1,477)	(515)	(533)
Revenues	102	145	167	201	249	87	87
Travelers from Hungary	355	407	470	477	482	196	216
of which: tourists	(340)	(387)	(426)	(425)	(412)	(162)	(176)
Expenditures	46	61	69	66	71	28	32

Source: CSO, Monthly Bulletin of Statistics.

1/ Travelers in thousands. Revenues and expenditures in millions of U.S. dollars (converted from forint at noncommercial rate of exchange).

Table 50. Hungary: Foreign Debt, 1980-83
(In millions of U.S. dollars; end of period)

	1980	1981	1982	1983		
				March	June	Sept.
Total foreign debt	<u>10,314</u>	<u>10,026</u>	<u>8,989</u>	<u>8,864</u>	<u>9,002</u>	<u>8,944</u>
In convertible currencies	<u>9,090</u>	<u>8,699</u>	<u>7,715</u>	<u>7,329</u>	<u>7,397</u>	<u>7,367</u>
By original maturity:						
Short-term	3,347	2,849	1,764	1,410	1,221	1,282
Long-term	5,743	5,850	5,951	5,919	6,176	6,085
By type:						
Financial loans <u>1/</u>	8,616	8,050	6,653	6,146	6,150	5,964
Trade-related credits <u>2/</u>	293	402	661	797	888	1,032
Intergovernmental credit	6	6	5	4	4	4
Other <u>3/</u>	175	241	396	382	355	367
In nonconvertible currencies	<u>1,224</u>	<u>1,327</u>	<u>1,274</u>	<u>1,535</u>	<u>1,605</u>	<u>1,577</u>
By original maturity:						
Short-term	558	243	249	525	608	624
Long-term	666	1,084	1,025	1,010	997	953
By type:						
Financial loans	532	260	225	503	585	599
Trade-related credits	23	15	39	38	35	33
Intergovernmental credit	635	1,038	974	959	951	910
Other	34	14	36	35	34	35

Source: National Bank of Hungary.

1/ Syndicated loans, bonds and notes, bank to bank credit and deposits and balances of nonresident banks. Includes Fund credit.

2/ Including bankers' acceptances.

3/ Mainly downpayment for Hungarian exports; and import documents in the process of settlement.

Table 51. Hungary: Interest Rate and Maturity
Characteristics of Foreign Indebtedness, 1978-82

	1978	1979	1980	1981	1982
Debt denominated in convertible currencies					
Interest rates (percent)					
Average rate of interest on stock of debt outstanding <u>1/</u>	4.91	5.87	9.71	14.04	12.84
Average rate of interest in loans contracted in year indicated <u>2/</u>	6.78	8.74	8.57	13.07	9.54
Maturity (number of years)					
Average maturity of loans contracted in year indicated <u>2/</u>	5.7	6.5	6.0	6.1	4.7
Debt denominated in rubles					
Interest rates (percent)					
Average rate of interest on stock of debt outstanding <u>1/</u>	2.73	2.52	2.52	2.71	2.64
Average rate of interest on loans contracted in year indicated <u>2/</u>	2.02	2.01	2.07	2.38	3.51
Maturity (number of years)					
Average maturity of loans contracted in year indicated <u>2/</u>	9.4	10.4	9.9	9.9	8.7

Source: National Bank of Hungary.

1/ Includes short-term debt.

2/ Medium- and long-term debt only.

Table 52. Hungary: Debt Service Payments in Convertible Currencies

(In millions of U.S. dollars)

	Amortization	Interest <u>1/</u>	Total Debt Service	Debt Service Ratio <u>2/</u>
1979	905	463	1,368	32.3
1980	811	856	1,667	29.7
1981	904	1,014	1,918	33.7
1982	894	1,016	1,910	32.7
1983	1,213 <u>3/</u>	753	1,966	35.1
1984 <u>4/</u>	1,481	600	2,081	...
1985 <u>4/</u>	1,342	450	1,792	...
1986 <u>4/</u>	1,152	320	1,472	...
1987 <u>4/</u>	709	260	969	...
1988 <u>4/</u>	412	210	622	...
After 1988	296	...	...	...

Sources: National Bank of Hungary; and staff estimates.

1/ Includes interest on short-term debt.

2/ In percent.

3/ Includes early repayment of a loan originally maturing in 1985.

4/ Only on debt outstanding at end-June 1983.

Table 53. Hungary: International Reserves and Other Foreign Assets, 1980-1983

(In millions of U.S. dollars)

	1980	1981	1982	1983		
				March	June	Sept.
International reserves						
Convertible currencies						
Gold ^{1/}	92	69	25	38	26	40
Foreign exchange	1,978	1,624	1,087	600	784	705
Official reserves	(1,853)	(1,482)	(771)	(331)	(555)	(542)
Other readily market- able assets ^{2/}	(125)	(142)	(316)	(269)	(229)	(163)
Total	2,070	1,693	1,112	638	810	745
Nonconvertible currencies	<u>113</u>	<u>28</u>	<u>66</u>	<u>84</u>	<u>117</u>	<u>105</u>
Total	2,183	1,721	1,178	722	927	850
Other foreign assets						
Convertible currencies	1,256	1,219	1,539	1,561	1,635	1,687
Short-term ^{3/}	(685)	(595)	(773)	(788)	(725)	(786)
Long-term	(571)	(624)	(766)	(773)	(910)	(901)
Nonconvertible currencies	413	510	318	327	311	305
Short-term	(139)	(238)	(89)	(101)	(94)	(93)
Long-term	(274)	(272)	(229)	(226)	(217)	(212)
Total	1,669	1,729	1,857	1,888	1,946	1,992
Total international reserves and other foreign assets	3,852	3,450	3,035	2,610	2,873	2,842

Source: National Bank of Hungary.

^{1/} Valued at SDR 35 per ounce. Gold is valued at \$42.22 per ounce prior to 1978, \$126 per ounce in 1978 and \$226 per ounce thereafter in official reserve statistics.

^{2/} Excluded from the official Hungarian definition of reserves.

^{3/} This item includes working balances of the specialized banks and claims of enterprises in the form of export bills and suppliers' credits. Prime export bills are discountable at the National Bank, with recourse. The National Bank regards this facility as a means of providing domestic liquidity to the enterprises and normally holds the bills to maturity rather than rediscounting them on foreign markets.

VI. Exchange and Trade System

A detailed description of Hungary's exchange and trade system is contained in the 1983 Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER). Only jurisdictional issues and recent developments are reviewed in this section.

Hungary's exchange and trade system currently involves a number of exchange restrictions, some of which give rise to multiple currency practices.

1. Import licensing

The import license authorizes the holder to enter and perform a foreign trade contract, to purchase the foreign currency needed for the performance of the contract, and to carry out all legal acts required for the implementation of the contract. No additional authorization or license is required to purchase foreign currency or effect payment. The import license is subject to Fund jurisdiction as a joint exchange and trade license.

Before September 1982, apart from the import of consumer goods from the convertible currency area, the licensing of imports was automatic and was used essentially for the purpose of ensuring that only authorized enterprises engaged in international trade. Since then, however, the regime for imports from the convertible currency area has been applied more restrictively. From September until December 1982, all licenses were subject to individual approval. However, some easing of the obligation for individual approval was introduced from January 1983: quarterly limits relative to 1981 imports were introduced for all large and frequent importers, below which individual licenses are automatically granted. This simplification did not apply to imports of capital goods, for which licenses remained subject to individual approval.

Company-specific limits for 1983 range from 80 percent to 120 percent of 1981 imports (in forint), averaging 98.3 percent for all qualifying importers. ^{1/}

Company-specific limits are set by an interministerial committee, taking into account various criteria:

- a. Criteria which could raise a company's reference ceiling,
 - needs for exports to the convertible currency area or energy savings;

^{1/} Corresponding averages for the same companies in 1980 and 1982 amounted to, respectively, 94.5 percent and 101.6 percent of 1981 imports. The overall price index (in forint) for nonruble imports is estimated to have increased 7.4 percent from 1981 until 1983.

- basic needs of the population (foodstuffs, detergent, etc.);
 - needs to meet export commitments under intergovernmental agreements;
- b. Criteria which could lower a company's reference ceiling,
- imports for the production of luxuries;
 - imports of investment goods not used to expand capacity for exports to the convertible currency area.

Quarterly ceilings for the application of the company-specific annual reference limits were set at 20 percent each for the first two quarters of 1983, 32 percent for the third quarter and 28 percent for the fourth quarter. Of total licenses for imports from the convertible currency area granted during the first eight months of 1983, 75 percent were for imports effected under the reference limit system.

Imports outside the reference limit system remain subject to individual approval. The same criteria followed in setting company-specific limits under the reference limit system are used, in addition to external liquidity considerations, in approving applications for licenses. It is expected that such imports in 1983 will amount to about 95 percent of similar imports in 1981 (in forint).

2. Import payments

a. Advance import deposit

An advance import deposit scheme was formally introduced in Hungary in 1967 for all imports. The legislation related to this scheme remains in force; however, the rate has been set to zero percent since 1971.

b. Forint cover

The forint cover relating to imports was legally introduced in a resolution of the Economic Committee of 1967 and requires that all domestic units that wish to import have the required financing means. Implementation of the forint cover is regulated by the President of the National Bank (NBH). In the case of imports against letter of credit domestic importing units are required to deposit a forint cover equivalent to the value of the letter of credit in a blocked noninterest-bearing account with the NBH. The forint cover may be either in cash available in the current account of the importing domestic units or both in cash and in the form of a short-term credit from the NBH. In the latter case, prevailing rates of interest on working capital credit (at present 13-14 percent) are charged by the NBH on the borrowed portion of the forint cover.

In the case of imports on behalf of other end-users, foreign trade organizations must obtain payment from the end-user 15 days before the

due date for payment. The due date for the payment can relate to the date when a letter of credit is to be opened or to the date of payment of the purchase price in the case of imports against documents or acceptance.

Regulations pertaining to the forint cover make it possible for the NBH to exempt domestic importing units from the forint cover requirement. Such exemptions were granted liberally until early 1982. However, since April 1, 1982, such waivers are no longer granted. Moreover, the NBH would no longer grant a short-term credit to finance the borrowed portion of the forint cover if (1) the domestic importing units have limited or no cash in their respective current accounts and are deemed not to be creditworthy, or (2) have excessive stocks with respect to normal production requirements.

c. Payments arrears

Payments arrears were incurred in mid-1982, but had been eliminated before the end of the year.

3. Import quotas and surcharge

Since September 1982, imports against convertible currencies of several primary products have been subject to quota restrictions while imports against convertible currencies of component parts have been subject to a 20 percent surcharge (Table 54). These restrictions were eased partially effective January 1, 1983 as the proportion of imports subject to quotas in 1983 was reduced by about 20 percent compared to 1982. Imports currently subject to quotas, other than imports of consumer goods, or to the surcharge amounted to US\$1,346 million in 1981, equivalent to 30 percent of total imports settled in convertible currencies in 1981. The import quotas, being implemented through the licensing system, are considered part of the licensing system and thus represent an intensification of a restriction subject to Fund jurisdiction.

The quota for imports of consumer goods from the convertible currency area was set at US\$95 million for 1983, compared to US\$106 million in 1982. Licenses amounting to US\$92 million had been granted under the quota by early September.

4. Broken cross rates

Exchange rates are quoted by the National Bank of Hungary for 19 convertible currencies and the National Bank stands ready to effect transactions in any of these currencies. Buying and selling rates are set with a spread of 1/10 of 1 percent around the middle rate for each currency. New rates are quoted once a week (on Tuesday) and, in the case of currencies included in the basket to which the forint is pegged, 1/

1/ Austrian schillings, deutsche mark, French francs, Italian lire, Netherlands guilders, pounds sterling, Swedish kronor, Swiss francs and U.S. dollars.

are based on the average exchange rates between the currencies in international markets during the previous five working days. Rates for other currencies are based on the quoted rate for the U.S. dollar and the dollar rates for the currencies concerned in international markets. The exchange rate of the forint against individual currencies need not be changed if the adjustment relative to the previous quotation would be less than one half of 1 percent and if cumulative changes in the value of the forint relative to the basket would not exceed 1 percent during the calendar year.

Although exchange rates relative to convertible currencies are adjusted once a week, two aspects of the Hungarian practice in adjusting the exchange rates for the forint against these currencies have resulted and may continue to result in broken cross rates. These two aspects are: (1) exchange rates for various currencies are quoted on the basis of average rates in international markets during the preceding five working days, and (2) the rate for the forint relative to each individual currency is not changed from the previous week whenever the change is less than one half of 1 percent. Staff calculations indicate that broken rates have at times occurred for more than one week.

5. Exchange rates for nontrade transactions
with other Fund members

On October 1, 1981, the commercial and noncommercial exchange rates which were previously quoted for convertible currencies were unified. In principle, a single rate of exchange is now quoted for each currency. Problems arise, however, in relation to the currencies of countries with which trade and related transactions are settled in transferable (or clearing) rubles, including Romania and Viet Nam, which are both Fund members. Since both partners to the transaction quote an exchange rate for their own currencies relative to the transferable ruble, there also exists an implied cross exchange rate between national currencies which applies to trade transactions between these countries. 1/ At the same time, since there is an explicit exchange rate 2/ between the leu and the forint agreed bilaterally between Hungary and Romania and quoted in both countries, and since exchange rates for the national currencies of CMEA members and for the transferable ruble are adjusted independently, a difference in excess of 2 percent could arise 3/ and, thus, give rise to multiple currency practices.

1/ For example, using end-July 1983 exchange rates for the Romanian leu and the Hungarian forint relative to the transferable ruble of lei 17.5 = TR 1 and Ft 26 = TR 1, an effective exchange rate between the leu and the forint of Ft 1.49 = lei 1 can be calculated.

2/ This rate of Ft 1.7 = lei 1, which was last changed in July 1976, applies to certain noncommercial transactions, e.g., international travel, expenses of diplomatic representation, and scholarships.

3/ Based on end-July 1983 exchange rates, the difference amounted to 14 percent.

Another aspect of the exchange rate policies of member countries of the CMEA, which may give rise to multiple currency practices, is that the exchange rates they quote for each other's currencies bear no relationship to the rates they each quote for their own currency relative to convertible currencies. 1/

6. Bilateral payments agreements

Hungary has bilateral payments agreements with Albania, Brazil, the People's Republic of China, Colombia, Ecuador, Finland, Islamic Republic of Iran, Democratic People's Republic of Korea, the Lao People's Democratic Republic, Mali, and Viet Nam. Hungary also has trade agreements with bilateral payments features for certain commodities with Afghanistan, Bangladesh, and Pakistan. Except for Albania, the People's Republic of China, Democratic Republic of Korea, the Lao People's Democratic Republic, and Viet Nam, settlements under bilateral agreements were in clearing U.S. dollars. Settlements with the People's Republic of China were in clearing Swiss francs, and with Albania, Democratic People's Republic of Korea, the Lao People's Democratic Republic and Viet Nam in clearing rubles. The agreement with Mali has been inoperative. The Hungarian authorities have also reported that a trade and payments agreement was signed with the People's Republic of Kampuchea on February 20, 1981. The agreement has not yet been activated.

7. Other discriminatory restrictions

Hungary maintains a number of discriminatory restrictions, including two restrictions that relate to Fund members, i.e., a minimum spending/conversion requirement applied to Yugoslav tourists; and the application to Romania and Viet Nam of the different travel regulations in effect for travel to the ruble area. By intergovernmental agreement, special regulations apply to travel between Hungary and Poland and between Hungary and Czechoslovakia requiring tourists to have in their possession specified minimum amounts of the currency of their country of destination.

Yugoslavia was exempted in 1978 from the minimum spending/conversion requirement, along with other countries with which settlements are effected in convertible currencies. As a result, many Yugoslavs entered Hungary for the purpose of arbitraging manufactured products for food. The obligatory conversion requirement for Yugoslav tourists was reintroduced in 1980 for the purpose of halting the arbitrage. Since then, a minimum daily spending/conversion requirement of Ft 760, which cannot be bought back, has been applied to Yugoslav tourists; however, the unspent portion can be deposited in ordinary interest-bearing accounts with banks in Hungary and used subsequently for travel expenses in Hungary.

1/ For example, the rates quoted, respectively, at end-July 1983 by Hungary (Ft 44.178 = US\$1) and Romania (lei 17.62 = US\$1 commercial; lei 13.54 noncommercial) imply cross rates between the forint and the leu of Ft 2.5 = lei 1 and Ft 3.3 = lei 1, compared to the official rate of Ft 1.7 = lei 1.

8. Foreign trading rights

Foreign trade is a state monopoly. In practice, this means that commercial exports and imports may be effected only by economic enterprises authorized for this purpose. Authorization to enter foreign trade may be either general or specific, referring in the latter case to the import and/or export activities of a producing enterprise for own account or to a single transaction or contract.

The number of enterprises with permanent trading rights has increased rapidly in recent years. For example, 27 additional enterprises were granted such trading rights in 1982, raising the total number of enterprises with permanent trading rights to 190, of which 32 are foreign trade organizations; the rest consisted of industrial enterprises, state farms, cooperatives, and domestic trading concerns. In addition, approvals for ad hoc foreign trade activities (e.g., one-time activity) were granted in 500 cases in 1982, compared to 400 in 1981.

The increase in the number of enterprises with foreign trading rights reflects efforts by the authorities to expand direct access by domestic producers to foreign markets. In addition, since 1980, seven foreign trade organizations have been authorized to trade in any product, thus abrogating the earlier monopoly position of specialized foreign trading organizations and widening the range of possible intermediaries for smaller domestic producers. For the most part, however, these changes have been introduced on the export rather than on the import side.

9. Changes during 1982 and 1983

a. Exchange arrangements

1982. The forint was depreciated against the basket of currencies to which it is pegged on three occasions: by 7 percent on July 13, 3 percent on November 30, and 1 percent on December 7.

1983. The forint was depreciated against the basket of currencies to which it is pegged on three occasions: by 3 percent on April 8, 1 percent on June 7, and 3 percent on July 12.

b. Imports and exports

April 1, 1982. Waivers ceased to be granted in respect of the forint cover on imports. (Such waivers had previously been liberally granted.) The extension of short-term credit by the National Bank to finance the borrowed portion of the forint cover was also made more restrictive.

September 1, 1982. Imports of several primary products were made subject to quantitative restrictions, while imports of component parts became subject to a 20 percent surcharge. Imports subject to these restrictions amounted to US\$1.5 billion in 1981, equivalent to 30 percent of imports from outside the ruble area. In addition, all import licenses were made subject to individual approval.

December 10, 1982. The amount of foreign currency exempted from the surrender requirement was raised from Ft 400 a person to Ft 2,000 (in banknotes).

January 1, 1983. Large and frequent importers were exempted, up to specified quarterly limits, from the requirement for approval of licenses. The exemption did not apply to imports of capital goods.

c. Nonresident accounts

January 1, 1983. Interest rates on deposits of more than one year maturity in residents' accounts in foreign currencies or in forint convertible into foreign currencies were raised to rates prevailing on international markets.

d. Payments for invisibles

January 1, 1982. Travel allowances were raised to Ft 15,000 a person for travel to CMEA countries and to Ft 12,000 a passport holder and Ft 1,800 for a child of less than 14 years of age traveling under a parent's passport for "tourists" traveling to countries outside the CMEA area. At the same time, residents became automatically entitled to "tourist" allowances every third year for travel outside the CMEA area. Travel allowances for "visitors" to countries outside the CMEA area were raised to Ft 1,600 a person.

April 20, 1982. Regulations pertaining to the amounts which non-residents could take out of the country were changed to apply the limit of Ft 3,000 (up to Ft 1,000 an article) to articles either bought or received as gifts. Within the same overall limits, additional limits were introduced for nonresidents from countries with which an agreement was in force for the reciprocal exchange of currencies (CMEA countries, except Cuba and Viet Nam): gifts up to Ft 300 a person; and purchased articles up to 50 percent of the amount brought into Hungary under the certification of the nonresident's foreign exchange authority. (Decree No. 11/982 of the Minister of Finance.)

May 15, 1982. By intergovernmental agreement, special regulations became effective in respect of travel between Hungary and Czechoslovakia requiring tourists to have in their possession specified minimum amounts of the currency of their country of destination. The amounts set for

Hungarian travelers to Czechoslovakia were Kcs 150 for the first day of their visit and Kcs 90 for each additional day (reduced to, respectively, Kcs 75 and Kcs 45 for children of 10 to 15 years of age, with no allowance for younger children).

July 13, 1982. Following a depreciation of the forint, the basic travel allowance was raised from Ft 12,000 to Ft 12,800 a person for travel to countries outside the CMEA area.

December 1, 1982. Travel allowances for travel to countries outside the CMEA area were raised by 3 percent, to Ft 13,200 for "tourists" and by 6 percent, to Ft 1,800 for "visitors."

April 8, 1983. Travel allowances for travel to countries outside the CMEA area were raised to Ft 13,600 a passport holder and Ft 2,100 a child.

e. Capital

November 16, 1982. Regulations pertaining to foreign investment were modified to allow participation by foreign companies in joint ventures in duty-free zones. Such joint ventures would remain Hungarian companies but would benefit from preferential treatment as regards, inter alia, customs clearance and duties, and wage, foreign exchange, and trade regulations (Joint Decree No. 62/1982 of the Minister of Finance and Minister of Foreign Trade).

Table 54. Hungary: Import Restrictions Introduced September 1982

	Imports		Quota 1/	Imports		Quota 2/
	1981	1982		1981	1982	
	Volume (tons)			Value (millions of forint)		
<u>Imports subject to quotas</u>						
1982 quotas						
Iron ore	339,600	228,000	290,000	623.8	...	...
Asbestos, long fibred	2,627	4,500	4,500	78.0	...	...
Caustic soda, solid	4,443	7,000	5,000	54.0	...	...
Organic chemical basic material	...	...	...	1,654.5	1,594.0	1,680.0
Aliphatic ketones, aldehydes acids	...	...	...	1,091.8	944.0	1,050.0
Aniline colors, auxiliary chemical materials for the textile, leather and fur industries	...	...	...	1,719.2	1,608.0	2,000.0
Natural rubber	14,238	12,000	13,000	715.3	...	...
PVC	9,397	8,000	8,000	321.4	...	...
Plastic basic materials 3/	...	...	...	2,587.0	2,611.0	2,300.0
Zinc oxide, titanium dioxide and lithopone	18,163	17,000	13,000	640.9	...	...
Cellulose based silk Fibrous semifinished product for the paper industry	6,845	6,000	6,700	1,023.0	...	...
Paper and cardboard	88,939	96,000	95,000	2,239.0	...	...
Raw cotton	25,167	14,000	16,700	1,722.0	...	...
Rawhide	24,565	28,000	25,000	1,369.9	...	...
Protein fodder of the vegetable oil industry/soya meal	597,913	565,000	600,000	6,871.9	...	...
Husked rice	19,223	13,000	11,000	342.5	...	...
Total	...	...	...	24,685.6	...	...
1983 quotas						
Office equipment requisites	...	...	...	200.0	150.0	120.0
Aniline colors, auxiliary chemical materials for the textile, leather and fur industries	...	...	...	1,719.0	1,603.8	2,000.0
Motor vehicle tires (thousand units)	263	174	75	392.0	...	...
PVC powder and hard granules	9,400	8,000	8,000	321.0	...	...
Polystyrene and styrene capoliners	16,500	18,000	16,000	686.0	...	...
Fertilizers--nitrogene phosphore calcium	88,300	138,000	140,000	1,716.0	...	...
Plant protection chemicals	6,800	6,000	8,000	...	...	...
Paper and cardboard	88,939	74,100	98,000	2,232.0	...	...
Protein fodder of animal and vegetable origin	644,500	239,000	670,000	7,737.0	...	...
Fodder concentrate	6,200	7,000	5,000	156.0	...	...
Animal feed phosphate	72,400	73,000	75,000	901.0	...	...
Chemicals for feed	...	...	...	1,300.0	1,392.8	1,500.0
Total	...	...	...	19,460.0	...	...
<u>Imports subject to surcharge</u>	...	...	...	26,729.0	25,700.0	...

Source: Data provided by the Hungarian authorities.

1/ If quota specified in volume.

2/ If quota specified in value.

3/ Except PE, PP, PS, PTFE, PVC, and moulding powders.

Table 55. Hungary: Balance of Bilateral Accounts
with IMF Member Countries, 1978-1982

(In millions of SDRs)

	1978	1979	1980	1981	1982
Bangladesh	-0.8	-2.4	-2.7	-0.4	-3.1
Brazil	-12.2	-55.2	-9.5	-42.9	-12.8
Colombia	-0.1	-5.6	-18.7	-26.6	-8.3
Ecuador	-14.8	-21.8	-21.9	-12.9	-10.5
Finland	-22.4	-15.3	-24.0	-12.1	-7.8
Iran	8.1	-9.5	34.9	27.2	14.1
Pakistan	-2.3	--	-1.8	-5.9	-3.6
Peoples' Republic of China	-15.7	-9.6	1.7	-5.7	-0.6
Total	-60.2	-119.4	-111.8	-79.3	-32.6

Source: National Bank of Hungary.



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