IMMEDIATE ATTENTION

EB/CGATT/83/1

February 28, 1983

To : Members of the Committee on Liaison with the CONTRACTING PARTIES to the GATT

From : The Committee Secretary

Subject: Consultations with the CONTRACTING PARTIES to the GATT - Hungary

The attached memorandum from the staff concerning preparation for forthcoming consultations with the CONTRACTING PARTIES on their consultation with Hungary is herewith submitted for consideration by the Committee.

In the absence of objection from a member of the Committee by noon on Wednesday, March 2, 1983, the memorandum will be deemed approved by the Committee for submission to the Executive Board for consideration on a lapse-of-time basis.

Att: (1)

Other Distribution:
Members of the Executive Board

February 28, 1983

To : The Chairman of the Committee on Liaison with the CONTRACTING PARTIES to the GATT

From : The Director
Exchange and Trade Relations Department

Subject: Consultations with the CONTRACTING PARTIES to the GATT

The Fund has been invited to consult with the CONTRACTING PARTIES in connection with their consultations with Hungary. The Managing Director has recommended that this invitation be accepted and that Mr. Shailendra J. Anjaria, Chief, Trade and Payments Division, be designated to represent the Fund during the consultations to be held in Geneva during March 7-11, 1983. This recommendation was approved by the Executive Board on February 24, 1983 (EBD/83/50).

In accordance with procedures set out in EBD/56/102 (8/29/56), the latest Recent Economic Developments papers on Hungary have been transmitted to the CONTRACTING PARTIES. It is expected that the CONTRACTING PARTIES will request the Fund's view with respect to Hungary. It is recommended that, in reply to such request, the Fund representative should be guided by the statement set forth below.

Hungary

The progress made by Hungary in 1979 and 1980 toward restoring a sustainable balance of payments position faltered in 1981 and the early part of 1982, as external economic conditions became more difficult and domestic demand policies were less effective than intended. The sharp increase in the external current account deficit that ensued was particularly unfortunate as it coincided with a drying-up of medium-term foreign loans and with withdrawals of short-term funds by some foreign lenders. Together, these developments produced massive losses in reserves in the first quarter of 1982.

In the light of the liquidity crisis, corrective measures decided on by the authorities in the latter part of 1981 were reinforced considerably in the course of 1982. Financial policies were tightened, the latitude of enterprises to raise wages and to utilize their investible resources was constrained, and various increases were announced in consumer prices. In the allocation of investment funds, priority was given more strictly to projects designed to strengthen exports to the convertible currency area and to lead to savings in imports of energy and raw materials. In a further effort to bolster the balance of payments, temporary import restrictions were introduced and the forint was depreciated twice during the second half of 1982.

Reflecting the tightening of demand policies, the deficit of the state budget in 1982 was kept below the level foreseen in the initial budget plan and the stock of outstanding investment credits to

enterprises declined, while that of working capital credits grew by about one half of the amount envisaged in the Plan. All told, domestic absorption in real terms is estimated to have fallen by 2 per cent in 1982 (on a net material product basis), with the volume of fixed investment in the socialist sector declining, the rate of stockbuilding slowing down markedly, and real private consumption rising only moderately. The curtailment of domestic demand, together with other measures to improve the external accounts, and exceptionally favorable crops, led to an important strengthening in the trade balance in 1982, notwithstanding the continued weakness of export markets and a further deterioration in the terms of trade. Thus, the surplus on total trade (convertible and nonconvertible) rose from SDR 33 million in 1981 to SDR 460 million in 1982, with the trade surplus in convertible currencies increasing from SDR 377 million to SDR 694 million. The current account in convertible currencies, meanwhile, moved into surplus in the second half of 1982 and the deficit for the year as a whole is estimated to have been reduced to the order of SDR 150 million from SDR 618 million in 1981. With the improvement in the real foreign balance, economic growth is estimated to have remained positive in 1982, at 1 1/2-2 per cent. At the same time, the strengthening of the current account permitted a moderate recovery in official reserves during the last three quarters of the year.

However, the external liquidity position remained very tight. In view of this, and taking into account the relatively large share of short-term maturities in the outstanding foreign debt in convertible currencies, the authorities decided in the latter part of 1982 to strengthen their adjustment efforts further. A package of policies designed to achieve a sizable current account surplus in convertible currencies in 1983, while at the same time permitting a gradual dismantling of the import restrictions introduced in 1982, was supported by a 13-month stand-by arrangement for SDR 475 million with the Fund, which was approved by the Executive Board on December 8, 1982. The program includes measures of demand management, structural reform, and exchange rate policy.

Under the program, domestic absorption is projected to fall by 3-4 per cent in volume terms in 1983. Real private consumption is to be reduced through curbs on wage increases, higher taxes, cuts in consumer subsidies, a further quickening in price increases, and new measures to stimulate private savings. A similarly wide array of measures is being directed to curtailing the volume and raising the efficiency of fixed investment and to containing stockbuilding. These encompass further cuts in state investment outlays, including investment grants to enterprises; the freezing in compulsory reserve funds and the taxing away of a part of the earnings withheld by enterprises for investment purposes; higher interest rates on investment and working capital credits; early redemptions of certain outstanding loans to enterprises; and tighter conditions for the disbursement of new credits. In addition, government current expenditures are slated to decline in real terms. Nonetheless, a further marked improvement in the real foreign balance is expected to prevent a decline in overall economic activity in 1983.

The foregoing measures, aimed at securing an immediate further improvement in the balance of payments, are being accompanied by structural policies to strengthen the efficiency of the economy and the external balance in the medium term. A new wage system is designed to permit greater flexibility of wage formation in enterprises. To promote competition and to enhance the mobility of production factors, new legislation facilitates the creation of new enterprises, including small private businesses, compels inefficient firms to contract and to release capital and labor for more efficient uses, diversifies the channels of financial intermediation, and widens the independence and responsibility of management in state enterprises. Enterprises are also now permitted some latitude to increase wages according to their performance in increasing exports to the convertible currency area or achieving savings in imports from this area.

As an integral part of the adjustment effort, the authorities have adopted a more active exchange rate policy vis-a-vis the convertible currency area, geared to promoting a more rational use of imports and to raising the profitability of exports. The forint was depreciated against a basket of currencies by some 11 per cent during the second half of 1982, reversing part of the real appreciation in the previous two years. Incentives for investments aimed at expanding export capacities toward the convertible currency area were strengthened by a rise in the interest rebate. At the same time, the period in which export earnings from the new projects must exceed the value of the investment was shortened.

While these measures and the tightening of demand management take effect, temporary recourse has been made to measures to restrict imports. As of September 1, 1982, imports from the nonruble area of several primary products were subjected to quantitative restrictions and a 20 per cent surcharge was imposed on imports of component parts. The products affected by these restrictions accounted for about 30 per cent of 1981 imports from the nonruble area. Valued at 1981 prices, the quotas announced for 1982 were about US$60 million below 1981 imports. Import licensing was also tightened in 1982, involving both trade and payments restrictions.

The authorities have indicated that the import restrictions introduced in 1982 are temporary. Early progress toward their removal includes a reduction (by about 20 per cent) in the trade coverage of import quotas announced for 1983. In addition, simplified import licensing procedures were adopted from the beginning of 1983: quarterly limits relative to 1981 imports were introduced for all large and frequent importers, below which individual licenses will be automatically granted. This simplification did not apply to imports of capital goods, for which licenses remained subject to individual approval. The Fund believes that the projected improvement in the external current balance and the expected availability of financing from official and private sources as confidence on the part of foreign private lenders recovers should make it possible to increase holdings of reserves, while permitting the removal of the import restrictions introduced in 1982.