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IMMEDIATE ATTENTION

EB/CGATT/84/2

May 14, 1984

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, India, Israel, and Yugoslavia

The attached memorandum from the staff concerning preparation for forthcoming consultations with the CONTRACTING PARTIES on their consultations with Hungary is submitted for consideration by the Committee. Consultations are also being held with India, Israel, and Yugoslavia, but no statement by the Fund is expected for India and Yugoslavia, because these are consultations under the simplified procedures agreed by the CONTRACTING PARTIES. The statement on Israel is being issued separately.

In the absence of objection from a member of the Committee by close of business on Wednesday, May 16, 1984, 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

May 14, 1984

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, India, Israel, and Yugoslavia, to be held in Geneva during May 21-25, 1984. 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. This recommendation was approved by the Executive Board on April 27, 1984 (EBD/84/122).

In accordance with the procedures set out in EBD/56/102 (8/29/56), the latest Recent Economic Developments papers on Hungary, India, and Yugoslavia, and Supplementary Background Information on Yugoslavia, have been transmitted to the CONTRACTING PARTIES. It is expected that the Recent Economic Developments paper on Israel will be transmitted shortly.

It is expected that the CONTRACTING PARTIES will request the Fund's view with respect to Hungary and Israel. The statement on Israel is being issued separately. 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 key objective of Hungarian economic policy over the past several years has been to achieve a sustained improvement in the balance of payments position. The external current account deficit in convertible currencies was reduced, from US$727 million in 1981 to US$63 million in 1982 (or by the equivalent of nearly 3 percentage points of GNP). Although this strengthening permitted a moderate recovery in official reserves during the last three quarters of 1982, the external liquidity position remained very tight. The authorities' adjustment efforts were thus strengthened in late 1982. A stand-by arrangement for SDR 475 million was approved by the Fund on December 8, 1982.

However, the buoyancy of demand, already apparent in mid-1982, carried over into early 1983, and necessitated additional action in the course of 1983. In the early months of the year, measures were adopted which sought to reduce the rate of investment through a tightening of credit and an acceleration of credit repayment schedules. Measures to restrain consumption were introduced around midyear and included a reduction of consumer subsidies, increases in administered prices, a virtual freezing of wages in the government sector, and a depreciation of the forint. Steps were also taken to reduce the liquid funds of enterprises further and to increase the cost of investment.

The efforts of the authorities in pursuit of their adjustment program in 1983 met with only partial success. The current account surplus in convertible currencies for the year as a whole reached some US$300 million, about half the original target. The shortfall from the objective of the program stemmed mainly from a greater-than-expected fall in the terms of trade and a sharp drought-related reduction in the supply of farm exports. Nonetheless, the volume of exports settled in currencies other than the ruble is estimated to have grown--after adjustment for the effect of increased re-exports--by some 4.9 percent. The forint was depreciated against the basket of currencies to which it is pegged by about 18 percent in nominal terms--7 1/2 percent in real terms--between the middle of 1982 and the end of 1983.

Despite the various measures to contain domestic demand introduced in 1983, final domestic absorption is estimated to have been reduced substantially less than originally programmed. Household incomes grew more rapidly than envisaged, and the increase in consumer prices, at 7.3 percent, fell short of expectations. However, the resulting overrun on real personal consumption was more or less matched by additional output. The latter was associated in large part with a greater-than-anticipated expansion of private economic units, whose activities the authorities had liberalized in 1982. Fixed investment outlays also declined less in real terms than foreseen under the program. The stronger-than-programmed demand, however, appears to have spilled over into trade in convertible currencies only to a limited extent. The import restrictions vis-a-vis the convertible currency area introduced in September 1982, were maintained. The excess in fixed investment expenditures was accommodated by a rundown of machinery stocks, larger-than-anticipated imports from the nonconvertible currency area, and additional output in the construction sector. On the whole, real domestic demand is estimated to have fallen by 1.5-2 percent in 1983.

The stronger current account has brought a significant improvement in the attitude of financial markets toward Hungary. During the first six months of 1983, there was still a net outflow--albeit on a smaller scale than in 1982--of maturing short-term deposits. Since then, the availability of both short- and long-term capital has improved. In particular, short-term capital inflows amounted to SDR 390 million in 1983, compared to an outflow of SDR 900 million in the preceding year. At the same time, the maturity structure of the stock of external liabilities began to improve. Gross official reserves in convertible currencies rose to the equivalent of 5.6 months of imports in convertible currencies at the end of 1983, compared with 3.6 months of imports a year earlier.

A new one-year stand-by arrangement for Hungary in an amount equivalent to SDR 425 million (80 percent of quota) was approved by the Executive Board on January 13, 1984, in support of a program designed to strengthen the external position further. Key demand management policy elements include wage and price measures aimed at achieving a small reduction in real household income, improved incentives to save, a tighter credit policy and a further improvement of the position of the state budget. Reflecting these measures, domestic demand is programmed to be reduced by 2 percent in real terms in 1984. In addition, structural reform measures are being implemented to increase the efficiency of production and the intersectoral allocation of resources. These include steps to liberalize the process of price and wage formation, increase the autonomy of enterprises, and improve financial intermediation.

The authorities are committed to continue making active use of exchange rate policy vis-a-vis the convertible currency area, so as to ensure the profitability of exports and promote a more rational use of imports. The forint was devalued further, by 3 percent, against its basket of currencies on February 7, 1984; at the same time, tax rebates to exporters and fees on imports were reduced.

The program for 1984 envisages a current account surplus in convertible currencies of US$400 million, with most of the US$100 million improvement over 1983 deriving from an increase in the trade surplus. The larger trade surplus is expected to be achieved despite a projected further worsening of the terms of trade and the introduction of further liberalization measures. Accordingly, a strong performance of exports, with a further small gain in market shares, will again be required.

Effective September 1, 1982, several measures were introduced to restrict imports. Imports of specified primary products were made subject to quantitative restrictions, while imports of component parts became subject to a 20 percent surcharge. In addition, all import licenses were made subject to discretionary individual approval. The import license is subject to Fund jurisdiction as a joint exchange and trade license. Also, the quotas on imports of certain raw materials are part of this licensing system. The tightening of the import licensing system and the imposition of certain import quotas since September 1982 amounted to an introduction of an exchange restriction, which the Fund approved on a temporary basis under Article VIII, Section 2. Hungary avails itself of the transitional arrangements of Article XIV with respect to certain other exchange measures.

While the authorities had intended, in 1983, to eliminate the restrictions introduced in late 1982, unfavorable developments on the capital account in early 1983 and uncertain prospects for the remainder of the year concerning both capital inflows and foreign prices resulted in a postponement of their removal. Nevertheless, the quota and import licensing restrictions were eased partially as of January 1, 1983. Additional steps were taken in early 1984.

From January 1, 6 out of 12 existing quotas applying to imports of raw materials were removed. This represents more than one quarter of the value of imports of raw materials subject to quotas. In the first half of 1984, reference limits for large and frequent importers have been raised by 14.35 percent compared to the limits applied in the first half of 1983. The reference limits are set for the first six months of 1984, rather than quarterly, as in 1983. In addition, the 20 percent surcharge on imports of component parts was removed with effect from April 1, 1984. On the export side, the policy of authorizing domestic producers to export directly rather than through foreign trade organizations is to be continued. Foreign trading rights for export and import will be granted liberally upon proof of the ability of the enterprise to deal in foreign markets, and competition among foreign trading organizations will be permitted by the elimination of administrative restrictions on their activities.

The Fund welcomes the recent liberalization of the restrictions introduced in 1982, and believes that continuing adjustment efforts should permit Hungary to further liberalize its restrictive system.