

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

**FOR
AGENDA**

SM/82/186

CONTAINS CONFIDENTIAL
INFORMATION

September 17, 1982

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

This paper provides background information to the staff report on the 1982 Article IV consultation discussions with the Hungarian People's Republic, which was circulated as SM/82/176 on August 25, 1982.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

HUNGARIAN PEOPLE'S REPUBLIC

Recent Economic Developments

Prepared by Mr. Edouard B. Maciejewski (ETR), Mr. A. Mountford (EUR),
Mr. János Somogyi (EUR) and Mr. Subhash M. Thakur (EUR)

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

September 14, 1982

<u>Table of Contents</u>	<u>Page</u>
Basic Data	vi
Introduction	1
I. Supply and Demand	4
1. Production	4
a. The institutional framework	4
b. The development of production	6
2. Demand	9
a. Consumption and savings	9
b. Investment	10
II. Employment, Incomes, and Prices	33
1. Labor force and employment	33
2. Incomes	33
a. Enterprise profits	34
b. Household incomes	35
3. Prices	37
a. Producer prices	37
b. Consumer prices	38
III. Public Finance	51
1. The changing role of fiscal policy under the economic reforms	51
2. The public sector accounts	52

	<u>Table of Contents</u>	<u>Page</u>
3.	Developments in the state budget, 1980-82	53
a.	1980 and 1981	53
b.	1982	57
4.	Local authority finances	59
5.	Social security system	59
IV.	Money and Credit	68
1.	The role of money and credit	68
2.	The institutional structure	68
3.	Credit policies	71
4.	Interest rates	73
5.	Household cash balances	74
V.	External Sector	83
1.	Summary	83
2.	Exchange rate developments and changes in competitiveness	84
3.	Developments in the current account	85
a.	Exports	85
b.	The effects of restrictive measures in foreign markets on export earnings	87
c.	Imports	88
d.	Direction of trade	90
e.	Services and transfers	91
4.	Nonmonetary capital movements	92
5.	External debt	92
6.	External reserves	94
VI.	Exchange and Trade System	116
1.	The import licensing procedure and related aspects	116
a.	The import licensing procedure	116
b.	The advance import deposit scheme	116
c.	The forint cover	117
d.	Broken cross rates	118
e.	Commercial and noncommercial exchange rates for currencies of other Fund members	120
f.	Discriminatory restrictions	121
g.	Bilateral payments agreements	121
h.	Implementation of the exchange and trade system	121

Table of Contents

Page

Text Tables

1.	Developments in Plan Aggregates	3
2.	Breakdown of Gross Domestic Product by Social Sectors	13
3.	Breakdown of Land Area by Social Sectors, 1981	14
4.	Gross Domestic Product	15
5.	Developments in Socialist Industry	16
6.	Housing Construction	17
7.	Production and Imports of Energy	18
8.	Energy Resources	19
9.	Energy Balance	20
10.	Agricultural Production and Average Yields of Selected Crops	21
11.	Agricultural Production	22
12.	Uses of Net Material Product	23
13.	Household Disposable Income, Consumption, and Saving	24
14.	Disposable Income of Households	25
15.	Cash Receipts of the Population	26
16.	Developments in Retail Trade	27
17.	Investment by Social Sectors	28
18.	Sources of Investment Financing in the Socialist Sector	29
19.	Planned Investments in the Socialist Sector in Their Realization	30
20.	Investment in the Socialist Sectors by Origin of Capital Goods	31
21.	Sectoral Breakdown of Investments	32
22.	The Population, Manpower Resources, and Employment	40
23.	The Structure of Employment by Sectors	41
24.	The Development of Employment by Branches in the Socialist Sector	42
25.	Output, Employment, and Productivity in Socialist Industry and Construction	43
26.	Enterprise Profits	44
27.	Development of Nominal and Real Wages	45
28.	Unit Labor Costs in Socialist Industry	46
29.	Household Incomes by Major Sources	47
30.	Producer Prices	48
31.	Agricultural Sales Prices	49
32.	Consumer Prices	50
33.	Summary General Government Accounts	61
34.	The State Budget	62
35.	State Budget Expenditure (Functional Classification)	63
36.	State Budget Expenditure (Economic Classification)	64
37.	State Budget Revenues	65
38.	Local Governments Development Fund	66
39.	Summary Social Security Funds	67
40.	Monetary Survey	75
41.	Liabilities of the Monetary Sector	76

	<u>Table of Contents</u>	<u>Page</u>
42.	Balance Sheet of the National Bank of Hungary: Assets	77
43.	Balance Sheet of the National Bank of Hungary: Liabilities	78
44.	Short- and Medium-Term Working Capital Credits by the National Bank of Hungary	79
45.	Medium- and Long-Term Investment Credits by the National Bank of Hungary	80
46.	Deposit and Loan Interest Rates for Households	81
47.	Interest Rates on Credits to and Deposits from Enterprises	82
48.	Balance of Payments, 1977-82	96
49.	Balance of Payments in Convertible Currencies, 1977-82	97
50.	Balance of Payments in Nonconvertible Currencies, 1977-82	98
51.	Trade Indices and Terms of Trade, 1977-81	99
52.	Trade Balance with Socialist and Nonsocialist Countries, According to Currency of Settlement, 1977-1982	100
53.	Export Volumes, by SITC Commodity Groups and Groups of Countries, 1977-1981	101
54.	Export Prices by SITC Commodity Groups and Groups of Countries, 1977-1981	102
55.	Commodity Structure of Imports by Groups of Countries, 1977-81	103
56.	Import Volumes, by SITC Commodity Groups and Groups of Countries, 1977-1981	104
57.	Import Prices by SITC Commodity Groups and Groups of Countries, 1977-1981	105
58.	Direction of Trade, 1977-82	106
59.	Services and Transfers, 1977-82	107
60.	Services and Transfers in Convertible Currencies, 1977-82	108
61.	Total Foreign Liabilities, 1977-82	109
62.	Foreign Liabilities in Convertible Currencies, 1977-82	110
63.	Foreign Debt, 1977-82	111
64.	Interest Rate and Maturity Characteristics of Foreign Indebtedness, 1977-81	112
65.	Maturity Structure of Medium- and Long-Term Foreign Assets and Liabilities Outstanding at End-March 1982	113
66.	International Reserves and Other Foreign Assets, 1977-82	114
67.	Balance of Bilateral Accounts with IMF Member Countries, 1977-1981	115

<u>Table of Contents</u>		<u>Page</u>
Appendix I	Net Material Product and GDP	124
Appendix II	The Regulation of Enterprise Finances	125
Appendix III	The Wage Determination System	128
Appendix IV	The Price System	134
<u>Appendix Tables</u>		
68.	Derivation of Gross Domestic Product	124
69.	Distribution of Producer Prices by Pricing Categories	138
70.	Distribution of Consumer Prices by Pricing Categories	139
<u>Charts</u>		
1.	Developments in the Structure of Output	6a
2.	Developments in Household Incomes, Consumption and Savings	10a
3.	Development of Fixed Investment	10b
4.	Developments in Output and Demand	12a
5.	Development of Prices	38a
6.	Price Developments	38b
7.	Domestic Credit	72a
8.	Interest Rates on Enterprise Loans and Household Deposits	74a
9.	External Current Deficit, Terms of Trade, and External Debt	84a
10.	Exchange Rate Developments, 1970-1981	84b

Hungary--Basic Data

Population (1981 average) 10.7 million
GDP per capita (1981) SDR 1,786 1/

National accounts 1981 (at current prices) 1/:

	In billions of SDRs	Per cent of GDP
Private consumption	11.6	60.8
Public consumption	2.0	10.2
Gross fixed investment	5.1	26.5
Change in stocks	0.7	3.7
Exports of goods and services	7.8	41.0
Imports of goods and services	<u>8.1</u>	<u>42.3</u>
GDP	19.1	100.0

<u>Selected economic indicators</u> (changes in per cent)	<u>1979</u>	<u>1980</u>	<u>1981 1/</u>
Net material product <u>2/</u>	1.9	0.8	2.0
Net material product used <u>2/</u>	-5.5	-1.9	0.1
GDP <u>2/</u>	2.7	0.2	2.5
Private consumption <u>2/</u>	2.4	1.1	2.4
Gross fixed investment <u>2/</u>	0.8	-6.4	-5.1
GDP deflator	5.5	5.3	5.1
Consumer price index	3.9	9.1	4.6
Real wages	-1.7	-1.6	1.5
Money supply (end of year)	9.1	13.8	8.0
Domestic credit (end of year)	9.8	8.2	8.9
Foreign trade with ruble area			
Exports <u>2/</u>	8.8	-1.2	3.9
Imports <u>2/</u>	4.7	--	-3.4
Terms of trade	-1.8	-1.1	-3.9
Foreign trade with non-ruble area			
Exports <u>2/</u>	15.6	2.1	1.7
Imports <u>2/</u>	-9.6	-2.6	3.6
Terms of trade	-1.2	1.6	2.2

<u>Ratios to GDP</u> (in per cent)			
Gross value added in industry	40.3	37.6	38.1
Gross value added in agriculture and forestry	16.1	18.8	19.0
State budget balance	-0.5	-0.6	-1.2
balance of payments on current account	-4.9	-2.6	-4.0

1/ Preliminary data.

2/ In volume terms.

Hungary: Basic Data (concluded)

<u>Balance of payments</u> (in millions of SDRs)	<u>1979</u>	<u>1980</u>	<u>1981</u> <u>1/</u>
Trade balance	-433	-109	33
Invisibles, net	-286	-336	-792
Of which: Investment income, net	(-295)	(-301)	(-909)
Current balance	-719	-445	-759
Of which: In convertible currencies	(-628)	(-284)	(-617)
Medium- and long-term capital, net	724	599	824
Short-term capital, net <u>2/</u>	-204	257	-361
Changes in reserves (-increase)	199	-411	296
Of which: In convertible currencies	(213)	(-398)	(254)
<u>Foreign debt in convertible currencies</u> (end of period, in millions of SDRs)	6,301	7,127	7,473
<u>Exchange rate</u> (forint/U.S. dollar, period average)	35,578	32,532	34,314
IMF (as of August 31, 1982)			
Quota	SDR 375 million		
Fund holdings of forint	Nil		
Hungary's holdings of SDRs	Nil		
Representative rate	Ft 38.2359 = US\$1		

1/ Preliminary data

2/ Including errors and omissions.

Introduction

Hungary became a member of the IMF on May 6, 1982. This first Fund staff report on recent economic developments therefore pays more attention to describing the salient features of the Hungarian economic system than is usual in such reports. In addition, it reviews developments and policies in recent years.

Since 1968 the Hungarian authorities have implemented by stages a series of economic reforms. The New Economic Mechanism (NEM) inaugurated with the 1968 reforms was designed to correct some of the inefficiencies which had characterized the previous economic system with its heavy emphasis on central direction. Under the NEM, the five-year plans and annual plans have continued to play a predominant role, but the techniques of economic management have shifted from specific administrative directives to indirect controls through macroeconomic policies such as prices, monetary and fiscal measures, and the exchange rate. The reforms have granted a greater degree of autonomy to enterprises, particularly in investment decision-making. The price mechanism has become more flexible and partially free from central direction. The reformed system has also placed greater emphasis on profits, both as a measure of enterprise performance and as a source of incentive payments and of financing for investment.

Following the 1968 economic reforms, annual growth of Hungarian net material product (NMP), ^{1/} which had averaged 5.2 per cent during 1962-67, rose to 6.2 per cent during 1968-73. The standard of living of the population improved steadily, with consumption growing at an annual average rate of 5.4 per cent during 1968-73 compared with 4.6 per cent in the earlier period. The volume of foreign trade also picked up sharply, with exports against convertible currencies registering an annual average increase of 23 per cent during 1968-73 compared with 10 per cent between 1962 and 1967. The major consequence for Hungary of the large increase in world prices of oil and other imported raw materials in 1973-74 was a sharp deterioration in its terms of trade with the convertible currency area and, more gradually, with the CMEA partner countries. Between 1974 and 1978, the terms of trade loss approximated 20 per cent. This development, coupled with a rapid expansion of the volume of imports from the West, led to a steady increase in Hungary's convertible currency trade deficit, notwithstanding a marked deceleration in the growth of NMP (to 3.2 per cent a year on average during the 1976-80 plan period).

In response, beginning in 1979, the authorities initiated major shifts in economic policy and, in the Sixth Five-Year Plan (1981-85), enunciated their major policy priority as being to restore and sustain external equilibrium, while maintaining living standards, and improving economic efficiency. The shift in priorities was associated with an adjustment in macroeconomic policies and a major systemic reform involving changes in the institutional framework and in the main instruments of economic policy. While national economic plans were to continue to

^{1/} See Appendix I for a comparison of NMP and GDP.

play a key role in charting the general medium-term course of the economy, direct central interference in the economy was to be scaled down and greater autonomy to be given to enterprises. Consistent with this, the allocative function of prices was strengthened and incentives built into the rules determining enterprise and individual incomes.

The Sixth Five-Year Plan foresees continued austerity and envisages an annual growth in NMP of 2.7-3.2 per cent, with somewhat lower rates of growth in the initial years of the plan period (Table 1). Both consumption and investment are projected to increase at rates lower than that of NMP. During the first few years, domestic demand is expected to remain virtually stagnant with a decline in gross fixed investment. The Plan implies that the growth in output would be export led, though import substitution is also emphasized. Investment in export industries and in industries which contribute to savings in energy and raw material imports continue to be promoted. While some progress was made in the first year of the plan period, a sharp deterioration of the external environment subsequently necessitated a greater tightening of policies in 1982.

Table 1. Hungary: Developments in Plan Aggregates

(Percentage changes in real terms)

	1971-75		1976-80		1981-85							
	Plan		Plan		Plan							
	Actual		Actual									
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	2.5-4.1							
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	
	Plan		Actual				Plan		Actual		2/	
	Actual		Actual				Actual		Actual		Actual	
Net material product	3.0	8.0	4.2	1.9	3.0-3.5	-0.8	2.0-2.5	2.0			1.0-1.5	
Industrial production	4.6	6.6	4.9	3.0	3.5-4.0	-2.1	3.0-3.5	2.3			2.0-2.5	
Agricultural production	-2.7	10.3	2.0	-1.1	5.0-5.5	4.3	3.0	--			4.0-4.5	
Gross fixed investment	-0.1	13.0	5.0	1.0	-4.5	-5.8	-4.0	-6.1			-4.5	
Private consumption	1.8	4.6	3.6	2.4	1.0-1.5	1.1	1.5	2.4			0.5-1.0	
Consumer prices	5.0	3.9	4.6	8.9	3.7	9.1	4.5-5.0	4.6			4.8-5.2	
Real wages 1/	0.1	3.8	3.1	-1.7	2.2	-1.6	--	1.5			-0.5 to -1.0	
Net material product used	1.2	6.2	10.0	-5.5	-0.5	-1.9	-1.1	0.1			-1.0 to -2.0	

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

1/ Includes agricultural wages.

2/ Preliminary data.

I. Supply and Demand

1. Production

a. The institutional framework

The structure of gross domestic product has remained essentially unchanged in recent years, with the share of GDP originating in the socialist sector amounting to about 98 per cent (Table 2). Including output generated by individuals on their own account within the socialist sector (on household plots and auxiliary farms), private economic activities account for about 10 per cent of GDP. Data pertaining to the so-called second economy ^{1/} are deficient, but an estimated three quarters of households are involved to different degrees in such activities. Goods and services produced in the second economy probably account for about one sixth of household consumption.

New legislation in 1982 to encourage the growth of small enterprises, is designed mainly to legitimize already existing operations in the second economy and to widen the scope for private initiative. Licenses for new enterprises are to be issued liberally and the rules regarding pricing and income formation have been simplified. The new economic units may employ up to 100 persons for cooperatives and up to 30 for small-scale enterprises. During the first quarter of 1982 some 637 small economic units were created, including 271 individual enterprises and 303 cooperative staff associations for the execution of specific tasks within state enterprises. Furthermore, 5,000 state-owned shops and restaurants had been offered for lease, 20 per cent of which were taken up by private operators during the first quarter.

(1) Industry

Almost all industry is state owned. State and cooperative industry, which together comprise socialist industry, account for 99 per cent of gross industrial output. The share of cooperatives in the gross output of socialist industry is less than 10 per cent. Private industry is concentrated mainly in handicrafts and construction.

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 per cent of GDP during the past decade. During the initial postwar period, the expansion of heavy

^{1/} The sector is generally defined to include the institutionalized activities in small-scale farming on household plots and auxiliary or private farms, the operation of small enterprises in handicrafts, construction, retail trade, and restaurants, and the rental of rooms in private homes, as well as activities outside the institutionalized framework, including servicing and repair work and the renovation and building of private dwellings by moonlighting employees of the socialist sector, not dependently employed family members, and retired persons and room rentals.

industry was emphasized. Subsequently, as the industrialization drive moderated, there was a move to concentrate enterprises in a few 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. They adversely affected production of consumer goods, semifinished products, and spare parts, which mostly tend to be produced by small and medium-sized enterprises. Whereas in market economies the share of industrial employment represented by enterprises employing 50 persons or less is typically about 15 per cent, this ratio in Hungary was only 0.1 per cent in the socialist sector in 1980. The concentration process inhibited competition and entailed an expansion of industrial bureaucracy. It also hampered progress toward eliminating the vertical relations of dependence between enterprises and the central authorities, and thereby worked against the aim of increased enterprise autonomy. During the past two years, the authorities have taken steps to alleviate these problems, in particular to reduce the scope for intervention in enterprise activities by the supervisory authorities, to reduce the concentration in industry, and to promote establishment of new small and medium-sized enterprises.

(2) Agriculture

In 1981, 98.7 per cent of farm land was under socialist ownership, i.e., state farms or cooperatives. Of this, about 8 per cent was cultivated privately on household plots of members of cooperatives and on auxiliary farms made available to employees of different sectors (Table 3). According to 1980 data, state and cooperative farms yielded about two thirds of gross agricultural output, and household plots, auxiliary farms, and private farms close to one third. Until 1957, agricultural output was sold to the State under a compulsory delivery system. Subsequently, this system was abolished and greater flexibility was introduced in the marketing of agricultural products. At present, 80 per cent of agricultural products is sold to state purchasing agencies on a contract basis, while 20 per cent is traded on the free market.

The role of prices in resource allocation in farming has been constrained by social and incomes policy considerations. Apart from subsidization of food prices, producer prices have been kept considerably lower in agriculture than in industry. In 1968, the disparity was estimated to be about 25 per cent. This, coupled with the emphasis on maintaining income parity between those employed in agriculture and industry has constrained the operating surplus of farms relative to that of industrial enterprises. Farm prices were raised in the 1980 price reform, but the mix of price, incomes, and financial policy instruments in farming was not altered substantially. Since an important share of farm output is produced by individuals who do not benefit from all subsidies granted to farms in the socialist sector, the importance of setting appropriate prices has been recognized. Prices have, therefore, been adjusted when necessary to influence production according to the priorities of agricultural policy. The resulting structure of prices has in many cases deviated from the pattern of relative prices in world markets.

Following the introduction of new prices for industrial and farm products in the 1980 reform, the operating surplus of enterprises in agriculture remained low (38 per cent of value added) compared with industry (59 per cent). As a result mainly of the different application of production taxes and subsidies to the two sectors, profits were about one third of value added in both sectors. Under the current system, budget assistance to farming includes support for various forms of investment, a lump sum subsidy on energy use and other farm inputs, and export subsidies. While agriculture is subject to a similar system of taxes as industry, the rates are generally lower. Production taxes in farming accounted for 29 per cent of value added in 1980 compared with 43 per cent in industry.

Largely due to greater managerial freedom in state and cooperative farms and a pragmatic attitude of the authorities to small-scale private operations, the performance of the agricultural sector improved during the 1970s. The system accommodated the efforts of some managers to introduce agro-industrial activities, through joint ventures or looser associations between state and cooperative farms, or through links to industry. This fostered the introduction of advanced farming technologies and equipment in part obtained from abroad. Gross agricultural output rose markedly by international standards, and yields improved substantially. The growth of average net production was more moderate, however, as there was also a big increase in inputs.

A more novel development has been the rapid expansion of ancillary industrial, construction, and service activities of farms. By 1980, such activities accounted for almost 30 per cent of output in both state farms and cooperatives. The authorities have encouraged this movement as it helps to fill gaps in supplies, to generate funds for investment, and to improve food supplies and the export potential of agriculture. It has also contributed to the recent influx of labor to the agricultural sector.

b. The development of 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 per cent during 1971-78 to 1.8 per cent during 1979-81 (Table 4 and Chart 1). 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 (i.e., from almost 0 per cent to 1 per cent). The latter rate fell noticeably short of the annual average growth rate of 3 per cent foreseen in the Annual Plans for 1979-81. The Plans were underfulfilled in the first two years of the period, but the lower limit of the Plan was met in 1981 with a real increase in net material product of 2 per cent, while real GDP rose 2.5 per cent.

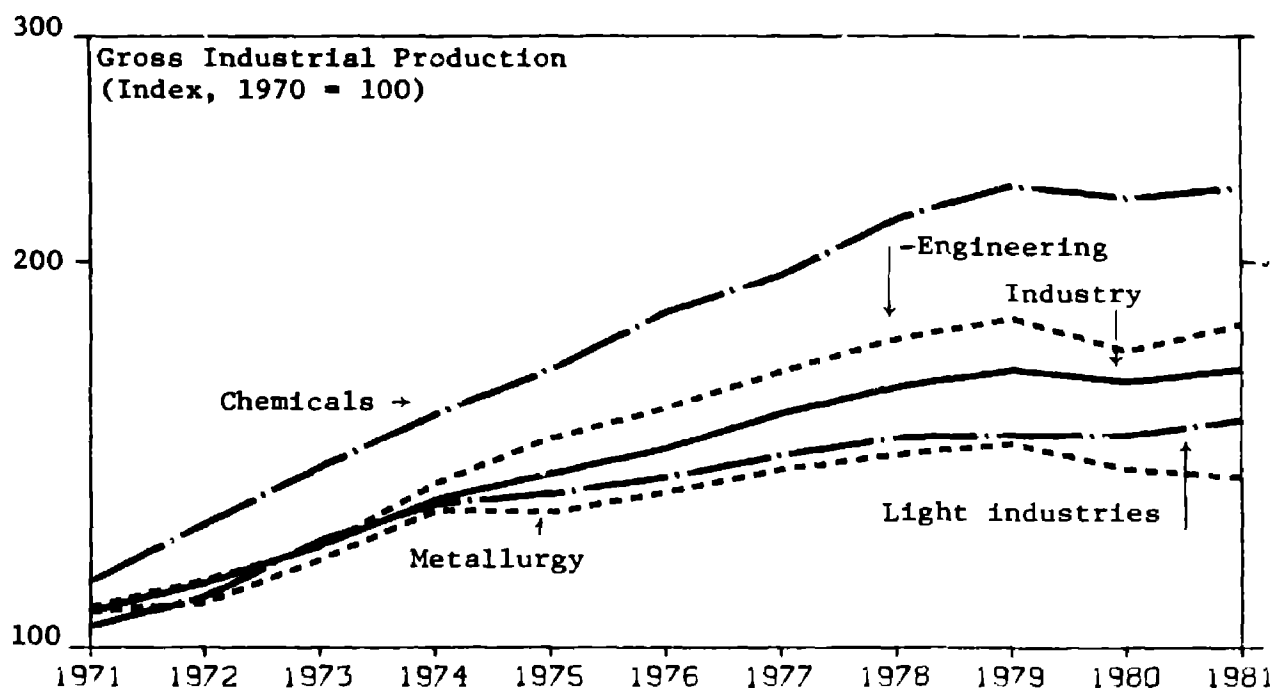
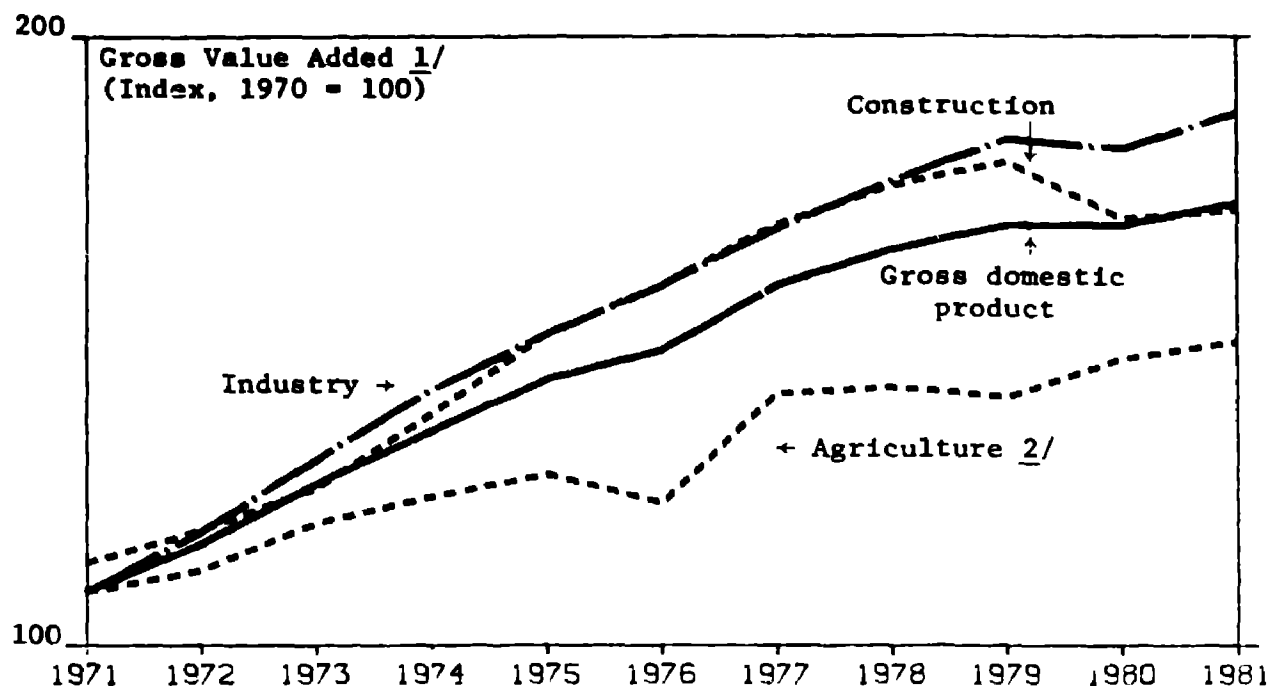
(1) Industrial production

Hungary's industrial sector has become increasingly export oriented over the past decade; by 1981 exports accounted for 22 per cent

Chart 1

Hungary

Developments in the Structure of Output



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

1/ In volume terms at 1976 producer prices.

2/ Agriculture, forestry, and water economy.

of total sales. The most important branches are engineering, chemicals, metallurgy, and food processing, which together accounted for over 70 per cent of gross production and close to 60 per cent of employment in socialist industry in 1981. Gross production of socialist industry 1/ increased at an annual average rate of 6 per cent during 1971-78 but slowed to 1.4 per cent in 1979-81. Gross value added in industry grew only moderately faster than gross production during the former period, but more pronouncedly so during 1979-81 (an annual average rate of 2.6 per cent). This reflected in part a more judicious use of inputs in response to changes and relative prices and particularly sluggish activity in energy- and raw materials-intensive branches (Table 5).

Industrial output declined in 1980. Industries producing capital goods for the domestic market experienced a marked recession, reflecting the sharp cutback in investment. In 1981, gross industrial output increased by 2.3 per cent and gross value added by 4.2 per cent. Whereas sluggish foreign demand in most branches, notably in metals, chemicals, and textiles, continued to depress production, this was mitigated by a growth in the volume of foreign sales in some subbranches of engineering and in food processing. The principal source of the growth in output was domestic demand, mainly reflecting higher private consumption. In the first four months of 1982 industrial output was about 2 per cent higher than a year earlier. It was bolstered by sustained consumer demand and stronger investment activity by enterprises. For the year as a whole, the Plan foresees a 2-2.5 per cent growth of industrial output (Tables 1 and 5).

(2) Construction

The construction industry accounts for 7 per cent of GDP and 8 per cent of total employment. Construction activity grew by 6.8 per cent per year on average during 1971-78. However, it fell at an average rate of 1 per cent during 1978-81, reflecting a sharp decline in 1980 attributable to cutbacks in state and enterprise investment (Table 6). In 1981, construction output grew by 1 per cent mainly due to developments in construction carried out by enterprises outside the construction sector proper. The Plan for 1982 foresees a 1 per cent decline in construction for the year as a whole. Developments in housing construction are shown in Table 6.

(3) Mining and energy

Hungary is not richly endowed with natural resources, with the exception of bauxite, the deposits of which are among the largest in Europe. There are also some copper and iron ore deposits. The domestic energy sources consist mainly of coal, lignite, natural gas, a small amount of oil, and some uranium. Hungary is therefore heavily dependent upon imports of raw materials and energy, mainly from the U.S.S.R.

1/ Gross output in socialist industry includes the value of intermediate inputs. Developments in gross value added in industry are shown in Table 4.

Bauxite production increased from under 2 million tons in 1970 to 3 million tons in 1980, but has declined subsequently. About 20 per cent of bauxite output is exported, mostly to CMEA countries and to the Federal Republic of Germany, while the rest is converted to alumina, part of which is also exported.

Developments in production, imports, and uses of energy are summarized in Tables 7, 8, and 9. Historically, the major source of energy was coal. With the development of highly energy-intensive industries, the share of oil and natural gas in total energy usage increased steadily during the 1970s, and reached a peak of 65 per cent by 1978 (Table 8). As a result of energy conservation efforts and weak domestic demand, energy requirements stagnated between 1978 and 1980 and fell by 0.7 per cent in 1981. Since imports of coal and electricity kept growing, however, Hungary's import energy dependence rose to 52 per cent by 1980 (Table 9).

Energy policy is aimed at promoting conservation, reducing the energy intensity of output, and fostering domestic energy production. Because of the rising price and reduced availability of crude oil from the U.S.S.R., two major objectives of the program are to lower the share of oil and natural gas in energy resources to 56 per cent and to reduce the energy dependence on imports to 47 per cent by 1985. The income elasticity of primary energy consumption is scheduled to decline to 0.4 for 1980-85 from 0.9 during the previous five years.

Price policy has been a major instrument of the energy policy. Under the new system since 1980, the prices of crude oil, petroleum products, and coke are linked to world market prices in the convertible currency area, and the price of natural gas is linked to that of gas imported from the U.S.S.R. Oil imports from the U.S.S.R. are priced annually 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 pricing scheme, the difference between the lower import price and the domestic producer price is taxed by the State. The price of domestically mined coal is about the level of production costs (i.e., about one third of the price of fuel value-equivalent hydrocarbons) in order to encourage substitution. However, energy prices are government-controlled at both the producer and the consumer levels and the authorities have not fully passed on to consumers the effect of the marked increases in the producer prices of energy since 1979. Moreover, lump-sum subsidies to offset the effect of energy price rises have been granted temporarily to agriculture and the construction materials industry.

During 1980-85, some Ft 30 billion through preferential credits for energy-saving investments will be extended by the National Bank or the State Development Bank. 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 will start production in 1982, with a capacity of about 2,000 megawatts when completed, which will meet about 5 per cent of Hungary's total energy needs by 1985.

(4) Agricultural production

Agriculture and forestry accounted for 21 per cent of employment, 12 per cent of fixed assets, and 17 per cent of GDP in 1981. At the same time 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 10. Plant cultivation and animal husbandry each account for about one half of aggregate output. About 73 per cent of crops and 56 per cent of livestock production stem from state farms and cooperatives and the rest is produced by private individuals.

Gross output in agriculture and forestry grew considerably during the 1970s, at an annual average rate of about 3.5 per cent, paralleled by a marked improvement in the yields of major crops. Taking account of rising costs of intermediate inputs and depreciation on capital, net value added grew by only 1.4 per cent (Tables 10 and 11). Following a poor harvest in 1979, agricultural output increased by 4.3 per cent in 1980. Plant production was again affected by adverse weather in 1981 and the continued growth in livestock production barely offset the decrease in crops, leaving little overall change in output for the sector as a whole. For 1982, output is expected to grow by at least 4 per cent.

2. Demand

Total domestic demand grew at an annual average rate of 5.7 per cent during 1971-78 and was accompanied after 1973 by a sizable deficit on the foreign balance, which reached 9 per cent of GDP in 1978. Following the introduction of adjustment policies in 1979, domestic demand fell at an annual rate of 1 per cent through 1981. Over the same period the foreign deficit declined to the equivalent of 1.3 per cent of GDP (Table 4).

Data according to the net material product (NMP) concept, which are comparable with most plan targets, show that domestic use of NMP fell during 1979-81 at an annual rate of 2.4 per cent (Table 12). This was more pronounced than the decline in overall domestic absorption, but the intended contribution to an improvement in the external balance was achieved only in 1979. In 1980, the domestic absorption of material product was reduced more than planned, but the shortfall in output from the Plan was even greater (Table 1). In 1981, while output grew in line with the Plan, domestic absorption remained unchanged instead of the planned reduction of more than 1 per cent. The contribution to the growth of NMP of the improvement in the foreign balance amounted to 1.9 per cent.

a. Consumption and savings

Public consumption generally grew more rapidly than private consumption during the 1970s. With the less expansionary macroeconomic policies after 1978, the rise in overall consumption slowed down. The annual average increase in real public consumption fell from 5.2 per cent during 1971-78 to 2.8 per cent during 1979-81, while that in private consumption declined from 4.2 per cent to about 2.0 per cent (Table 4).

Developments in household income, consumption, and savings are summarized in Tables 13 and 14 and Chart 2. Real disposable household income grew on average by some 4.6 per cent in the period 1971-78. This reflected annual increases in real labor income at a rate of 3.5 per cent (mainly due to a 2.8 per cent rate of growth in average earnings) and in real social incomes at a rate of about 8 per cent (mainly stemming from a 7.4 per cent rise in per capita benefits). During the subsequent three years, the average growth in real disposable income fell to 1 per cent, attributable to a decline in the growth of real labor income to 0.8 per cent a year and a deceleration in the average rise of real social benefits to 4 per cent. Although part of the fall in labor income resulted from a reduction in employment, the principal reason was the containment of real earnings by the incomes and consumer price policies of the authorities.

The growth in private consumption in relation to plan targets is shown in Table 1. The planned slowdown was achieved in 1979 and 1980, but the plan target was exceeded in 1981 when private consumption rose about 2.5 per cent. Real incomes continued to grow more rapidly in the first four months of 1982 than would be consistent with the planned increase for the year as a whole; the cash receipts of the population were 6.2 per cent higher than a year earlier (Table 15) while consumer prices increased by 5.7 per cent. In the same period, retail sales in real terms rose by about 2 per cent over a year earlier (Table 16), compared with a planned rise of 0.9 per cent for 1982 as a whole. Price and income policy measures taken by the authorities in response to these developments and worsening external conditions are intended to limit private consumption for 1982 as a whole to about its level in 1981.

b. Investment

(1) State and enterprise investment decisions and financing

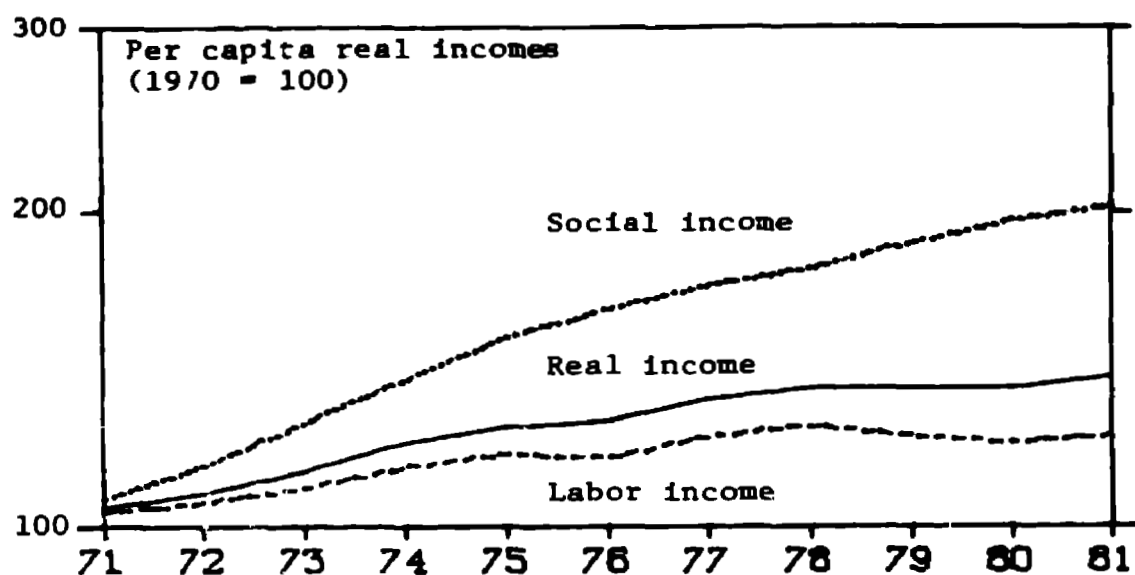
Approximately 90 per cent of investment in Hungary is undertaken by the socialist sector (Table 17). The remainder is mainly private sector investment in housing. Between 1980 and 1981, the share of total investment in the socialist sector decided by enterprises rose from 54 per cent to 57 per cent and that decided by the State fell accordingly. 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.

Following the 1968 reforms, investment decision-making has been partly decentralized by delegating greater authority to enterprises. The share of investments decided upon by firms and financed from their own resources has grown significantly (Table 18 and Chart 3), although implicit state guidance has been maintained in many investment decisions. Enterprises cannot generally finance their investments fully from their own funds and they therefore depend on budgetary resources or bank credit. Thus, the authorities are able to influence total investment. By 1981, enterprise investment financing by preferential state loans was cut to

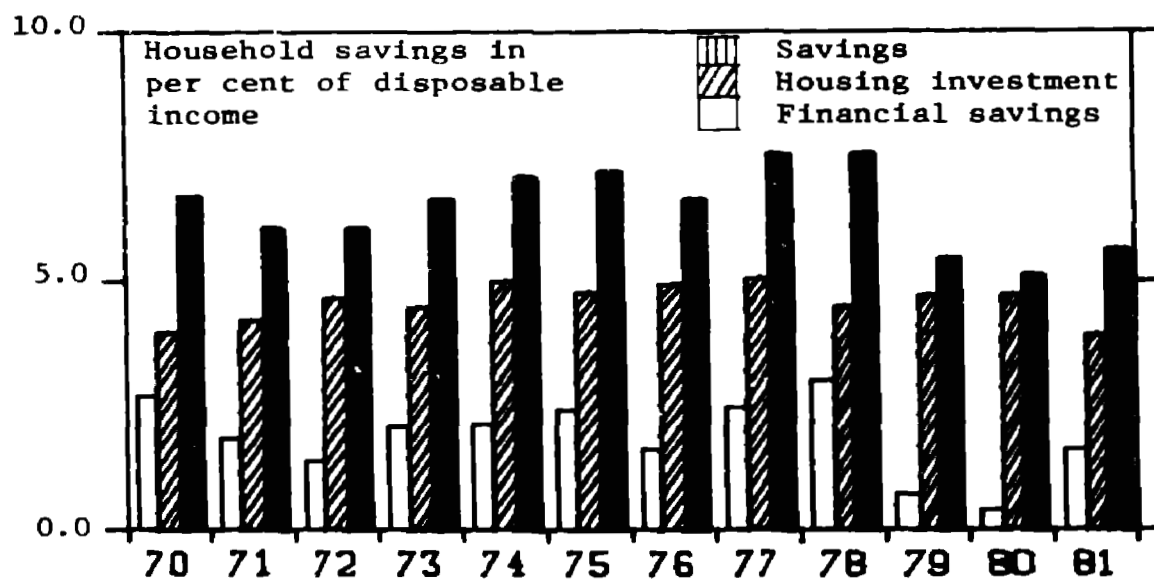
Chart 2

Hungary

Developments in Household Incomes, Consumption and Savings



Per cent



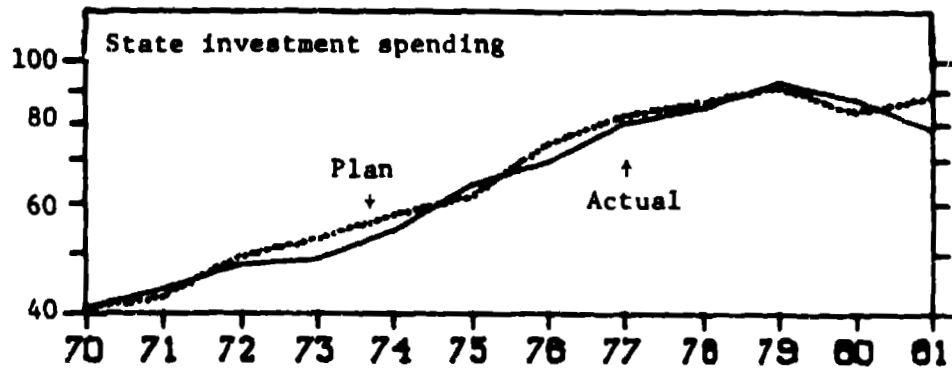
Sources: CSO, Statistical Yearbook, and data provided by the Hungarian authorities.

Chart 3

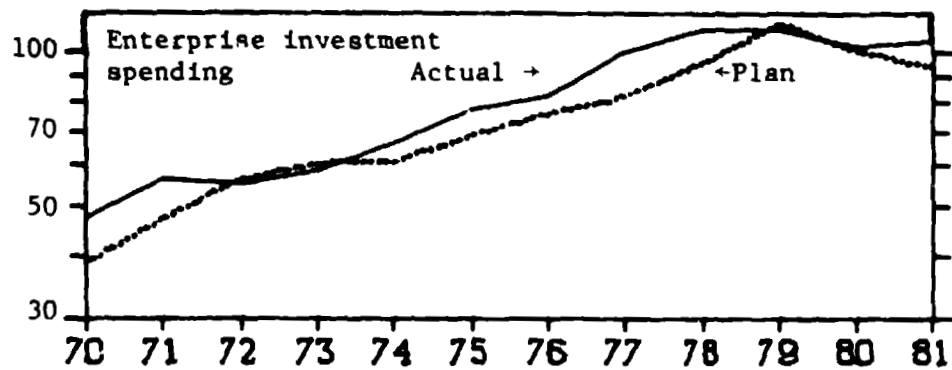
Hungary

Development of Fixed Investment

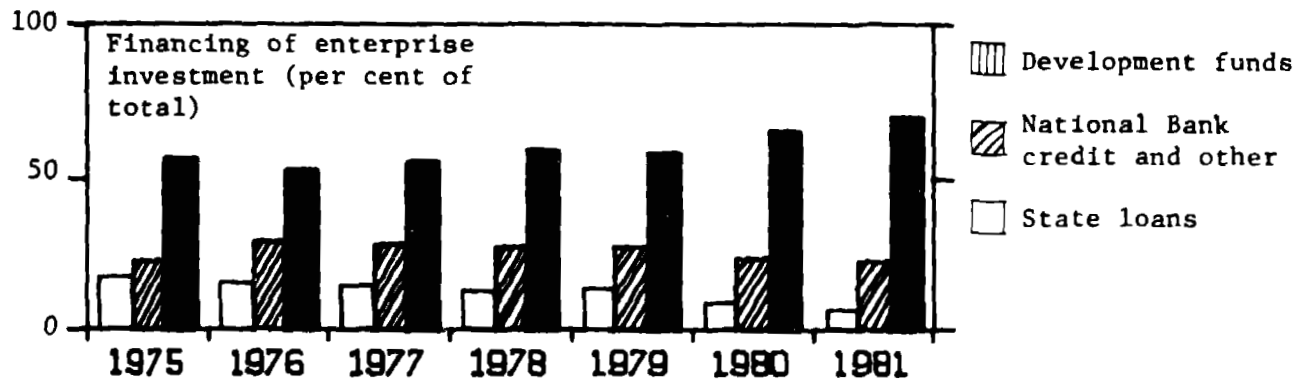
Billions of forint



Billions of forint



Per cent



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

6 per cent of investment expenditures, compared with some 17.5 per cent in 1975. On the other hand, the ample accumulated retained earnings and depreciation allowances in enterprises' development funds, permitted an increase in financing from this source by 9 per cent in 1981 to almost 70 per cent of enterprise investment outlays.

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, and that the projects yield a minimum return of 14 per cent annually on the funds invested. During the Fifth Five-Year Plan (1976-80) projects that were expected to help improve the external position accounted for close to 50 per cent of investment credits at preferential interest rates from the National Bank. There is a similar emphasis in the allocation of investment credits in the 1981-85 Five-Year Plan.

Until 1979, the amounts of investment credit specified in the Plans 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. In 1981, credit by the National Bank to finance enterprises' fixed investment remained roughly unchanged, at about 23 per cent of investment outlays by firms (Table 18).

The five-year and annual plans contain specific targets only for state investments, and the figures for enterprise investments are essentially forecasts. The past decade was generally characterized by over-fulfillment of investment plans, particularly by enterprises (Table 19 and Chart 3). The willingness of enterprises to invest heavily was partly due to the experience that in general expansion was financially profitable, because firms could either raise domestic prices or obtain subsidies.

(2) Developments in investment

Following the 1968 reforms, sharp gains in enterprise incomes led to an investment boom in 1971. Enterprise income regulations were subsequently modified, and state-controlled investment was reduced, resulting in a cooling down of investment activity in 1972-73. The protection of enterprise profits through import subsidies after the 1973-74 world oil price increase led to another investment boom in 1974-75. In early 1975, the compulsory division of after-tax profits between the sharing and development funds ^{1/} of enterprises was abolished, but the sharing fund was made subject to highly progressive taxation. This encouraged enterprises to place increased amounts in their development funds, which allowed a sharp growth in investment during 1977-78 (Table 19 and Chart 3).

The restrictive economic policies since 1978 have contributed to a considerable slowdown in investment activity. The annual average

^{1/} The function of these funds is described in Chapter II.

growth of gross fixed investment of about 6.5 per cent during 1971-78 was followed by an average decline of about 3.5 per cent through 1981 (Table 4). The ratio of gross fixed investment to GDP fell from a peak of about 35 per cent in 1978 to 26.5 per cent in 1981.

The provisions of the Plan for investment outlays in the socialist sector were met in 1979, but exceeded in the next two years because of buoyant enterprise investment. The 1982 Plan foresees further reductions in investment expenditures in the socialist sector (totaling some 2.5 per cent). Developments in the early part of the year suggested that state investment might again remain below the target, but that the forecast for enterprises would be exceeded, again due partly to the availability of free investment resources in development funds. The strength of company investment was reflected in an upsurge in applications for investment credit and a rise in investment starts. The authorities therefore introduced new measures to curtail the enterprises' funds and to raise the costs of investment. As a result, the initial 1982 Plan targets for investment in the socialist sector were lowered. Some measures to dampen investment, such as the raising of the construction tax and the imposition of a new tax on net investment after June 1, 1982, are also designed to reduce enterprise investment into the modernization of existing capacities.

The effects on various investment goods of the policy to curtail fixed investment in recent years is shown in Table 20 and changes in the sectoral distribution of investments in recent years in Table 21. The trend has been toward increased investment in energy, certain branches of agriculture, extractive industries, and infrastructure, while the shares of light industry and engineering in total investment have declined.

(3) Stockbuilding

Changes in stockbuilding have influenced domestic absorption and the foreign balance strongly in recent years (Table 5 and Chart 4). Enterprises have tended to maintain large inventories in part because of unreliable delivery of major inputs from socialist countries 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 since 1980 stemmed in part from higher stocks of finished goods confronted with sluggish demand, mainly affecting farm products and machinery and equipment, and from an expansion of inventories. According to enterprise balance sheet data, stockbuilding in the first quarter of 1982 fell by more than would be seasonally normal. In response to the worsening external situation, the authorities have recently adopted additional measures, including a tightening of working capital credits, to induce a lowering of stocks of tradables.

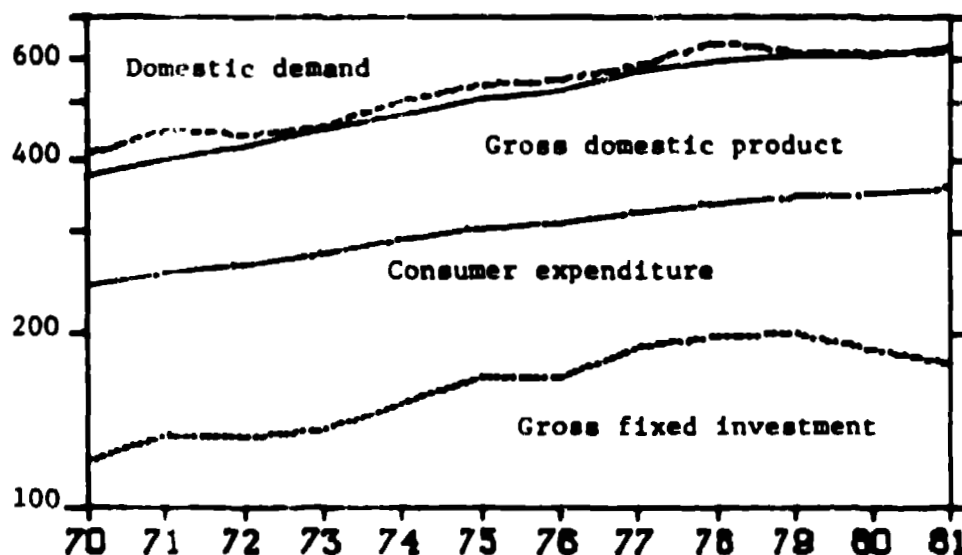
Chart 4

Hungary

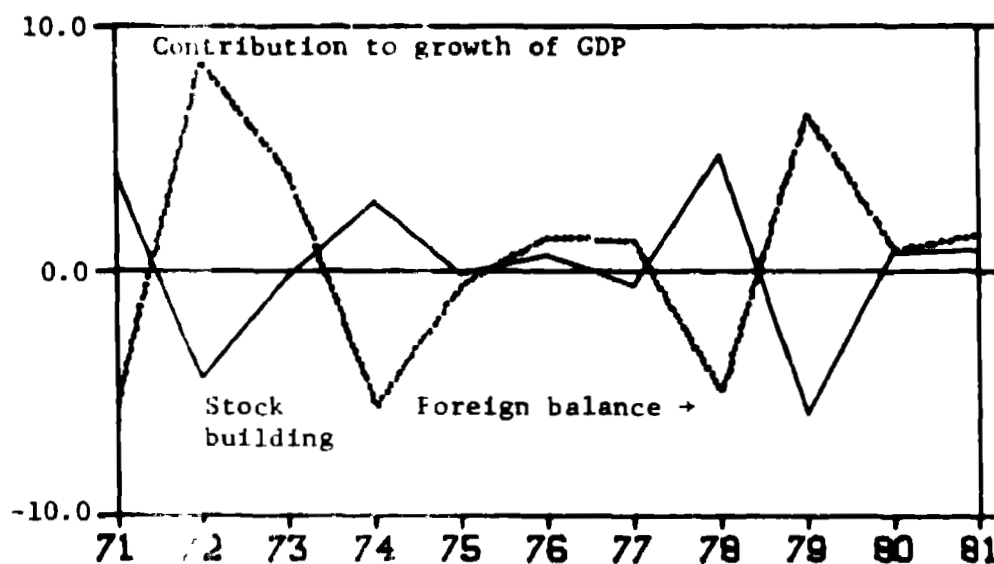
Developments in Output and Demand

(In 1976 constant prices)

Billions of forint



Per cent



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

Table 2. Hungary: Breakdown of Gross Domestic Product by Social Sectors

	1975	1976	1977	1978	1979	1980	1981 1/
	(In billions of forints; at current producers' prices)						
State sector	376.3	397.6	439.4	475.1	507.3	476.0	512.6
Cooperative sector 2/	96.5	100.6	110.6	117.9	122.2	125.3	138.6
Auxiliary farms of employees	18.0	22.0	25.1	24.0	23.3	25.7	28.6
Socialist sector	490.8	520.2	575.1	617.0	652.8	627.0	679.7
Private sector	8.7	9.0	10.2	12.0	13.7	16.0	16.7
Gross domestic product	499.5	529.2	585.3	629.0	666.5	643.0	696.4
	(In per cent of GDP)						
State sector	75.4	75.1	75.1	75.6	76.1	74.0	73.6
Cooperative sector 2/	19.3	19.0	18.9	18.7	18.3	19.5	19.9
Auxiliary farms of employees	3.6	4.2	4.3	3.8	3.5	4.0	4.1
Socialist sector	98.3	98.3	98.3	98.1	97.9	97.5	97.6
Private sector	1.7	1.7	1.7	1.9	2.1	2.5	2.4
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Data provided by the Hungarian authorities.

1/ Preliminary data.

2/ Including household plots privately cultivated by members.

Table 3. Hungary: Breakdown of Land Area by
Social Sectors 1981

	In thousands of hectares	In per cent of total
Total land area	<u>9,304</u>	<u>100.0</u>
State sector	2,877	30.9
Of which: state farms	(986)	(10.6)
Cooperative sector	5,922	63.7
Of which:		
Cooperative farms	(5,322)	(57.2)
Household plots	(413)	(4.7)
Auxiliary farms of employees	<u>393</u>	<u>4.2</u>
Socialist sector	9,192	98.8
Private farms	112	1.2
Cultivated land area <u>1/</u>	<u>8,285</u>	<u>100.0</u>
State sector	2,183	26.4
Of which: state farms	(933)	(11.3)
Cooperative sector	5,656	68.2
Of which:		
Cooperative farms	(5,130)	(61.9)
Household plots	(347)	(4.2)
Auxiliary farms of employees	<u>343</u>	<u>4.1</u>
Socialist sector	8,182	98.7
Private farms	103	1.3

Source: CSO, Statistical Pocketbook.

1/ Including forest area, 71 per cent of which is owned by state and 29 per cent by cooperatives.

Table 4. Hungary: Gross Domestic Product

	1980 1/		1971-75 2/	1976	1977	1978	1979	1980	1981 1/
	In billions of forints; at current prices	In per cent of total							
Sources									
Industry	265.4	34.3	7.3	5.7	6.8	5.5	4.8	-1.1	4.2
Agriculture and forestry	132.6	17.1	3.9	-3.8	13.7	0.4	-1.7	4.6	1.4
Construction	55.3	7.1	7.4	5.8	7.0	4.4	2.9	-6.2	1.0
Transportation and communications	64.3	8.3	5.2	2.2	5.1	4.0	3.4	-0.2	3.8
Other material sectors 3/	77.3	10.0	7.6	5.0	6.5	4.8	1.8	-1.6	2.3
Non-material services	101.5	13.1	5.7	4.5	5.2	4.9	3.7	3.1	--
Total	696.4	90.0	6.2	3.3	7.6	4.1	2.8	-0.5	3.0
Customs duties and valuation	77.8	10.0	---	---	---	---	---	---	---
Gross domestic product	774.2	100.0	6.3	3.6	7.6	4.4	2.7	0.2	2.5
Uses									
Consumption	550.4	71.1	4.8	2.1	4.4	4.5	2.8	1.0	2.5
Private consumption	(470.8)	(60.8)	(4.7)	(1.8)	(4.6)	(3.6)	(2.4)	(1.1)	(2.4)
Public consumption	(79.6)	(10.3)	(5.0)	(3.5)	(3.7)	(9.6)	(4.9)	(0.2)	(3.0)
Gross fixed investment	205.2	26.5	6.9	--	12.4	4.9	0.8	-6.4	-5.1
Final domestic demand	755.6	97.6	5.4	1.4	7.0	4.6	2.1	-1.4	0.1
Stockbuilding 4/	28.6	3.7	---	0.7	-0.6	4.7	-5.9	0.8	0.9
Domestic demand	784.2	101.3	5.7	2.1	6.2	9.1	-3.5	-0.6	1.1
Foreign balance 4/5/	-10.0	-1.3	---	1.4	1.2	-4.9	6.4	0.8	1.5
Gross domestic product	774.2	100.0	6.3	3.6	7.6	4.4	2.7	0.2	2.5

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

1/ Preliminary data.

2/ Annual average percentage changes.

3/ Trade and water economy

4/ Percentage contribution to GDP growth.

5/ The foreign balance as a component of GDP does not account for factor payments (including interest) between the domestic economy and the external sector.

Table 5. Hungary: Developments in Socialist Industry

	1981 1/		Average year-on-year percentage change in									
	Gross production In per cent of total	Employment	1971-75	1976	1977	1978	1979	1980	1981 1/	1982 1/2/		
Heavy industry	66.0	59.1	7.2	6.1	6.2	6.6	3.7	-3.6	1.4	...		
Mining	6.0	7.2	2.0	0.2	3.8	3.2	0.9	-5.2	-3.2	0.9		
Electric energy	4.3	2.2	7.6	7.6	7.6	10.1	1.3	3.3	3.6	1.5		
Metallurgy	9.9	5.9	5.0	3.6	4.2	2.7	1.9	-4.4	-1.6	-1.3		
Engineering	23.4	32.0	7.8	5.5	6.9	6.0	3.7	-5.7	5.0	3.4		
Construction materials	3.2	4.8	5.1	3.4	5.8	6.8	3.9	1.5	0.2	1.3		
Chemicals	19.2	7.0	10.5	10.8	6.9	10.7	6.1	-2.2	2.0	3.0		
Light industry	14.0	25.2	5.7	3.0	4.1	3.2	0.4	--	2.8	...		
Wood processing	2.1	3.0	8.6	5.2	3.0	7.3	3.2	-1.8	-1.6	1.8		
Paper	1.3	0.9	7.4	5.1	8.2	4.3	2.6	0.8	5.5	-0.6		
Printing	1.0	1.2	7.8	2.1	7.8	8.8	4.9	8.1	8.3	4.1		
Textiles	4.6	7.4	4.0	3.7	3.4	0.1	-0.7	3.2	1.8	0.9		
Textile clothing	1.8	4.8	4.9	1.2	0.2	1.4	1.4	8.4	3.5	-2.9		
Leather, fur, and shoes	2.3	3.8	5.1	-1.6	4.2	3.9	-4.5	-11.1	4.1	3.5		
Handicrafts	0.9	4.1	8.3	8.4	9.9	6.8	3.2	-3.8	5.1	1.2		
Food processing	18.6	12.3	4.7	1.4	9.9	0.4	2.6	2.5	2.4	1.1		
Miscellaneous	1.4	3.4	7.8	7.6	8.6	9.6	5.7	-7.7	8.7	7.2		
Total	100.0	100.0	6.4	4.6	6.6	4.9	3.0	-2.1	2.3	1.9		

Sources: CSO, Statistical Yearbook; and Monthly Bulletin of Statistics

1/ Preliminary data

2/ January-April

Table 6. Hungary: Housing Construction
(Number of units built)

	Financed from State or Cooperative Sources	Financed from Private Sources		Total	Of which: in Budapest
		Through loans from NSB 1/	Without loans from NSB 1/		
1970	32,954	35,149	12,173	80,276	15,615
1971	22,471	42,648	10,183	75,302	11,704
1972	29,489	49,909	10,796	90,194	15,503
1973	27,994	46,844	10,373	85,211	14,713
1974	30,764	45,455	11,624	87,843	15,498
1975	37,957	50,600	11,031	99,588	19,916
1976	32,212	52,418	9,275	93,905	16,474
1977	33,980	51,568	7,848	93,396	17,804
1978	31,660	50,282	6,211	88,153	16,386
1979	34,056	48,374	5,766	88,196	18,016
1980	30,337	53,590	5,138	89,065	16,908
1981	22,772	52,453	...	76,975	16,938

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

1/ National Savings Bank.

Table 7. Hungary. Production and Imports of Energy

	1975	1976	1977	1978	1979	1980	1981 1/
Coal (in thousands of tons)							
Production	24,887	25,257	25,454	25,670	25,659	25,701	25,942
Imports	1,438	1,297	1,524	1,420	1,515	1,623	1,678
Crude oil (in thousands of tons)							
Production	2,006	2,142	2,191	2,198	2,027	2,031	2,024
Imports	8,431	8,785	8,538	9,960	9,638	8,336	7,754
Of which from U S S.R.	(6,957)	(7,725)	(7,716)	(8,497)	(8,476)	(7,500)	(7,280)
Fuel oil (in thousands of tons)							
Production	3,381	3,361	3,443	3,615	3,970	3,267	3,082
Imports	326	336	612	845	796	908	717
Natural gas (in millions of cubic meters)							
Production	5,182	6,082	6,611	7,346	6,521	6,142	5,997
Imports	806	1,208	1,203	1,235	2,723	4,045	4,002
Electric energy (in millions of kilowatt hours)							
Production	20,465	22,049	23,401	25,554	24,514	23,874	24,219
Imports	5,802	5,578	5,408	5,762	6,040	8,418	10,625

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

1/ Preliminary data

Table 8. Hungary: Energy Resources

	1970	1975	1976	1977	1978	1979	1980	1981 ^{1/}
	(Indices, 1970 = 100)							
Total energy resources ^{2/}	100.0	114.5	119.0	124.7	131.5	135.7	135.8	133.1
Total energy requirements ^{3/}	100.0	118.4	...	...	138.7	138.7	138.7	137.8
	(In per cent of total energy resources)							
Coal and coke	50	36	34	33	30	29	29	30
Crude oil and derivatives of oil ^{4/}	30	39	39	40	42	41	37	36
Natural gas	13	19	21	22	23	24	26	26
Other ^{5/}	<u>7</u>	<u>6</u>	<u>6</u>	<u>6</u>	<u>5</u>	<u>6</u>	<u>8</u>	<u>8</u>
Total	100	100	100	100	100	100	100	100

Source: 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 9. Hungary: Energy Balance

	1960	1965	1970	1975	1980	1985 <u>1/</u>	1990 <u>1/</u>
(In Pcal)							
Domestic production	109.0	134.0	145.1	144.0	149.0	174.0	197.0
Of which: Coal	89.0	100.0	91.0	73.0	69.0	72.0	82.0
Crude oil	12.0	18.0	19.7	20.0	21.0	20.0	20.0
Natural gas	2.0	11.0	30.0	43.0	50.0	58.0	55.0
Nuclear energy	--	--	--	--	--	14.0	30.0
Others <u>2/</u>	6.6	5.0	4.4	8.0	9.0	10.0	10.0
Imports	38.0	60.0	85.2	124.0	163.0	152.0	165.0
Of which: Coal	18.0	28.0	24.2	23.0	22.0	21.0	20.0
Crude oil and petroleum products	15.0	25.0	47.9	82.0	90.0	77.0	90.0
Natural gas	2.0	2.0	1.6	7.0	32.0	28.0	30.0
Electric energy	2.0	4.0	10.9	12.0	19.0	26.0	20.0
Others	1.0	1.0	0.6	--	--	--	--
Total resources	147.0	194.0	230.3	268.0	312.0	326.0	362.0
Exports (-)	..	.	8.0	6.0	7.0	6.0	10.0
Stockbuilding (-)	..	.	5.0	5.0	4.0	5.0	12.0
Total energy requirements	..	...	217.3	257.0	301.0	315.0	340.0
(In per cent of total resources)							
Structure of resources							
Solid	72.8	66.0	50.0	35.8	29.1	28.	28.2
Hydrocarbon	21.1	28.9	43.0	56.7	61.9	56.1	53.9
Other <u>2/</u>	6.1	5.1	7.0	7.5	9.0	15.4	17.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Origin of resources							
Domestic	74.1	69.0	63.0	53.7	47.8	53.3	54.4
Imports	25.9	31.0	37.0	46.3	52.2	46.7	45.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source. Data provided by the Hungarian authorities

1/ Official projections.

2/ Includes some hydrocarbons and nuclear power.

Table 10. Hungary: Agricultural Production and Average Yields of Selected Crops

	1976	1977	1978	1979	1980	1981 ^{1/}
Index of gross production (1960 = 100)	149	165	168	166	173	173
Of which:						
Crops	135	152	153	148	159	155
Animal husbandry	168	182	187	189	192	197
Production of major crops (in thousands of tons)						
Wheat	5,148	5,319	5,677	3,709	6,077	4,614
Corn	5,141	6,077	6,655	7,396	6,673	6,993
Barley	749	708	763	710	929	903
Vintage	742	920	786	839	898	628
Fruit crops	1,482	1,606	1,393	1,414	1,653	1,791
Sugar beet	3,943	3,890	4,192	3,927	3,941	4,719
Vegetables	1,745	2,232	1,945	2,205	1,974	...
Livestock (in millions; end of year)						
Cattle	1.9	1.9	2.0	1.9	1.9	1.9
Pigs	7.9	7.9	8.0	8.4	8.3	8.3
Sheep	2.4	2.6	2.9	2.9	3.1	3.1
Poultry	43.4	43.3	43.3	41.2	42.8	42.8
	<u>1966-70</u>	<u>1971-75</u>		<u>1976-80</u>	<u>1981 ^{1/}</u>	
Average yields (in kilograms per hectare)						
Wheat	2,430	3,320		4,040	4,000	
Rye	1,160	1,510		1,640	1,560	
Winter barley	2,280	3,100		3,580	3,390	
Spring barley	1,860	2,690		2,990	2,920	
Oats	1,390	1,820		2,400	2,880	
Maize	3,230	4,170		4,840	5,860	
Rice	1,980	2,350		1,460	2,990	
Sugar beet	32,520	33,000		33,650	38,750	

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

^{1/} Preliminary data.

Table 11. Hungary: Agricultural Production

(At constant prices)

	Gross production			Productive consumption		Net production
	Plant cultivation	Animal husbandry	Total	Agricultural origin	Industrial origin	
(Indices, 1970 = 100)						
1971	109.5	105.5	107.6	102.5	113.5	106.8
1972	115.9	104.4	110.4	103.4	121.3	107.4
1973	124.9	109.1	117.3	104.6	137.5	111.9
1974	125.6	116.2	121.0	113.7	144.5	110.2
1975	131.5	119.1	125.5	114.7	157.8	111.7
1976	122.1	122.3	122.2	114.6	156.4	101.8
1977	136.8	132.5	134.8	122.8	168.5	116.4
1978	138.2	136.5	137.4	121.4	182.9	113.8
1979	133.8	138.2	135.9	121.4	184.0	108.5
1980	143.1	140.2	141.7	125.4	187.2	115.3
1981 1/	139.5	143.9	141.7	...	...	...
(Annual average percentage change)						
1971-80	3.7	3.4	3.6	2.3	6.5	1.4
1981 1/	-2.5	2.6	--	...	...	...

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

1/ Preliminary data.

Table 12 Hungary. Uses of Net Material Product

	In billions of forint at current prices 1981 1/	Per cent of total	Annual average percentage changes at 1976 prices					
			1971-75	1976	1977	1978	1979	1980 1981 1/
Consumption	504.8	80.0	4.7	2.1	4.6	4.9	2.9	1.1 2.4
Of which:								
Private consumption	(437.2)	(19.2)	(4.7)	(1.6)	(4.7)	(3.6)	(2.4)	(1.0) (2.2)
Net investment	136.6	21.6	8.1	-1.4	11.0	23.8	-24.9	-11.3 -8.1
Fixed investment	(93.6)	(14.8)	(9.0)	(-12.7)	(-0.1)	(10.5)	(3.7)	(-9.8) (-24.6)
Stock building 2/	(28.6)	(4.5)	(...)	(0.9)	(-0.8)	(5.8)	(-7.3)	(1.0) (1.2)
Domestic use	541.4	101.6	5.6	1.2	6.2	10.0	-5.5	-1.9 0.1
Foreign balance 2/	-10.0	-1.6	..	1.7	1.5	-6.1	8.0	1.1 1.9
Net material product	631.4	100.0	6.3	3.0	8.0	4.2	1.9	-0.8 2.0

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

1/ Preliminary data.

2/ Percentage contribution to the growth of net material product.

Table 13. Hungary: Household Disposable Income, Consumption, and Saving

	Disposable income 1/	Consumption 1/	Savings		Memorandum items: savings ratios	
			Total	Housing	Total	Financial 2/
			(At current prices, in level of forint)			
			(In per cent of disposable income)			
1970	208.1	194.1	13.9	8.3	6.7	4.0
1971	223.1	209.6	13.5	9.4	6.1	4.2
1972	237.9	223.5	14.4	11.1	6.1	4.7
1973	258.8	241.7	17.1	11.7	6.6	4.5
1974	281.4	261.4	19.9	14.0	7.1	5.0
1975	306.9	284.9	22.0	14.7	7.2	5.8
1976	327.6	306.0	21.6	16.3	6.6	5.0
1977	359.6	332.6	27.0	18.2	7.5	5.1
1978	389.6	360.3	29.4	17.5	7.5	4.5
1979	422.6	399.6	23.0	20.0	5.4	4.7
1980	463.3	439.7	23.6	21.7	5.1	4.7
1981 3/	498.7	470.8	21.9	19.7	5.6	4.0

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

1/ Including social benefits in kind.

2/ Net of credits to households.

3/ Preliminary data.

Table 14. Hungary: Disposable Income of Households

	Disposable income		Development of real disposable income		Memorandum items:	
	At current prices	At constant prices	Total	Per capita	Per capita labor income	Per capita social income
	(In billions of forint)		(Percentage changes)			
1970	208.1	256.9	...	...	...	...
1971	223.1	268.5	4.5	4.2	3.1	6.0
1972	237.9	278.3	3.7	3.3	2.1	7.6
1973	258.8	292.2	5.0	4.7	3.2	10.0
1974	281.4	311.9	6.7	6.2	4.8	10.1
1975	306.9	327.4	5.0	4.4	2.9	9.8
1976	327.6	331.7	1.3	0.8	-1.0	6.5
1977	359.5	349.7	5.4	4.9	5.1	5.3
1978	389.6	361.1	3.3	2.9	2.4	5.3
1979	422.6	361.9	0.2	0.1	-2.3	5.6
1980	463.3	363.7	0.5	0.4	-1.6	5.1
1981 1/	498.7	374.6	2.2	2.2	1.3	3.2

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

1/ Preliminary data.

Table 15. Hungary: Cash Receipts of the Population

	Wages 1/	Earnings in farm cooperatives	Other labor income	Sales of farm products	Social benefits in cash	Other receipts 2/	Total cash receipts 3/

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

1/ Excluding remuneration in cooperatives.

2/ Mainly including receipts of private craftsmen and shopkeepers, insurance receipts other than social benefits, and 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. They deviate from total money incomes of households in Table 14, derived from the national accounts. Compared with total cash receipts, the latter also include income payments within the household sector, net interest income, and the cash value of certain benefits in kind, but exclude taxes and production expenditures of private craftsmen and shop operators, taxes and customs duties paid by the population, and the exchange of forint into foreign currency by resident households.

4/ The data on absolute levels in forint exclude through 1981 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/ Preliminary data.

6/ January-April.

Table 16. Hungary: Developments in Retail Trade
(In volume terms, average year-on-year percentage changes)

	Food, beverages, and tobacco	Clothing	Miscellaneous manufactured products	Total
1971-75	5.7	3.7	8.0	6.2
1976	3.2	-3.6	1.2	1.4
1977	3.2	2.3	11.4	6.2
1978	2.1	2.8	6.6	3.9
1979	-0.4	1.6	4.2	1.7
1980	1.5	-11.2	-1.1	0.1
1981 <u>1/</u>	2.2	2.4	4.5	3.2
1982 <u>1/2/</u>	1.1	-3.0	4.2	1.9

Sources: CSO, Statistical Pocketbook; and Monthly Bulletin of Statistics.

1/ Preliminary data.

2/ January-April. Deflated by retail price indices.

Table 17. Hungary: Investment by Social Sectors

(At current prices, in per cent of total)

	Investment of Socialist Sector		Investment of Population	Total Invest- ment	Memorandum items: Investment by decision-making authority in socialist sector		
	State	Cooperatives			State	Enterprises	Total
1970	74.1	16.6	90.7	9.3	100.0	44.7	55.3
1975	76.8	12.9	89.7	10.3	100.0	43.9	56.1
1979	78.9	11.5	90.4	9.6	100.0	45.4	54.6
1980	77.2	11.7	88.9	11.1	100.0	45.7	54.3
1981 1/	74.9	12.9	87.8	12.2	100.0	42.7	57.3

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

1/ Preliminary data.

Table 18. Hungary: Sources of Investment Financing
in the Socialist Sector

(In billions of forint; at current prices)

	1970	1975	1976	1977	1978	1979	1980	1981 <u>1/</u>
State investments	<u>41.1</u>	<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>78.4</u>
State budget	23.7	38.7	40.6	49.3	50.5	57.2	54.7	37.2
Credits <u>2/</u>	6.5	12.7	15.9	18.9	21.2	21.4	19.8	22.3
Other <u>3/</u>	10.9	12.9	13.0	11.2	13.2	14.0	12.2	18.9
Enterprise investments	<u>47.3</u>	<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>
Development fund	24.9	43.5	43.1	55.3	65.1	64.2	66.6	72.7
State loans <u>4/</u>	8.2	13.5	12.3	14.4	13.9	14.6	9.1	6.2
National Bank credits	11.7	17.6	23.7	28.0	29.7	29.7	24.4	24.1
Other	2.5	3.2	2.7	3.4	2.9	2.9	2.9	2.1

Source: 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.

Table 19. Hungary: Planned Investments in the Socialist Sector
in Their Realization

(In billions of forint; at current prices)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Total investment in socialist sector												
Annual plan	79.5	90.0	105.8	113.0	118.5	130.0	150.0	164.0	182.0	205.0	184.0	182.0
Actual	88.4	100.7	103.1	108.2	120.3	142.1	151.3	180.5	196.5	204.0	189.7	183.5 1/
State investment												
Annual plan	40.9	42.8	49.5	52.2	57.5	61.3	74.2	81.9	86.3	91.0	83.0	99.1
Actual	41.1	43.8	48.2	49.2	54.0	64.3	69.5	79.4	84.9	92.6	86.7	78.4 1/
Enterprise investment												
Annual plan	38.6	47.2	56.3	60.5	61.0	68.7	75.8	82.1	95.7	114.0	101.0	93.9
Actual	47.3	56.9	54.9	59.0	66.3	77.8	81.8	101.1	111.6	111.4	103.0	105.1 1/

Source. Data provided by the Hungarian authorities.

1/ Preliminary data

Table 20. Hungary: Investment in the Socialist Sectors
by Origin of Capital Goods

	Total investment in socialist sector	Construc- tion	Domestic	Machinery		Other
				Imported from socialist countries	Imported from non-socialist countries	
<u>(At current prices in billions of forint)</u>						
1981 <u>1/</u>	183.5	89.8	35.7	19.5	19.5	19.0
<u>(Percentage changes in volume terms)</u>						
1976	-0.3	-1.2	-0.5	-5.8	14.4	-0.6
1977	14.4	14.2	9.3	12.6	23.7	18.3
1978	5.5	2.6	7.9	-1.0	14.6	14.0
1979	1.1	3.0	4.7	2.0	-15.8	6.1
1980	-6.7	-4.1	-8.6	-4.5	-19.8	-4.0
1981 <u>1/</u>	-6.6	-6.0	-2.8	-21.4	7.5	...
<u>(Year-on-year percentage change at current prices)</u>						
1982 <u>1/2/</u>	-0.5	-2.7	6.1	-20.6	17.0	...

Sources: CSO, Statistical Yearbook; and Monthly Bulletin of Statistics.

1/ Preliminary data.

2/ January-April.

Table 21. Hungary. Sectoral Breakdown of Investments

Industry	1975		1981 1/		1971-75		1976	1977	1978	1979	1980	1981 1/
	In per cent of total		Annual percentage changes; at constant prices									
Heavy industry	32.4	36.0			6.2	8.0	23.1	3.2	-2.0	-11.4	-9.5	
Of which: energy	23.9	24.6			5.4	8.9	22.8	1.8	1.6	-7.7	-10.7	
Light industry	4.6	6.1			10.1	7.3	18.8	10.4	15.4	4.0	-11.5	
Food industry	4.1	2.6			8.5	1.5	2.8	9.1	-23.6	-19.8	0.9	
	4.1	3.9			10.3	8.4	45.0	6.2	-5.3	-25.6	-10.4	
Agriculture and forestry	14.1	14.3			0.6	-5.7	9.1	9.1	-1.9	-11.4	11.5	
Construction	2.1	2.0			1.9	12.4	28.1	29.6	-16.9	-15.3	-22.9	
Transport and communications	13.7	11.8			8.6	-11.5	2.7	10.1	8.9	-3.2	-11.5	
Trade	4.7	5.1			16.3	2.3	-4.9	-0.9	4.9	16.1	0.1	
Other	33.1	35.2			10.1	-1.9	9.2	2.3	4.4	-0.3	-6.8	
Total investments	100.0	100.0			7.0	-0.1	13.0	5.0	1.0	-5.8	-6.1	

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

1/ Preliminary data

11. Employment, Incomes, and Prices

1. Labor force and employment

The labor market has been characterized for many years by an apparent shortage of labor, coupled with evidence of labor hoarding and low productivity in several sectors. The emergence of labor shortages has led to an emphasis on skill- and technology-intensive areas of production. The labor shortage was due in part to depletion of the agricultural labor surplus, and in part to a gradual decline in working age population. The effect of this development on the labor supply has been more than offset by a rise in the average participation rate of the working age population from 75.6 per cent in 1975 to 77 per cent at the beginning of 1982 (Table 22).

The structure and development of employment in the overall economy and the socialist sector are shown in Tables 23 and 24. The socialist sector accounted for 96.4 per cent of total employment in 1981 and the private sector for 3.6 per cent. During 1978-81 employment fell at an annual average rate of about 0.5 per cent in the economy as a whole as well as in the socialist sector. In the same period, private sector employment declined in small-scale farming and in individual housing construction activities, but picked up in small private shops in crafts and services.

The fall in employment in the socialist sector since 1978 has been mainly due to a reduction in staff in industry and construction (Table 25). The shift of labor out of agriculture halted in 1978, and during the following three years employment in farming and forestry grew at an annual rate of 0.9 per cent. This mainly benefited the ancillary industrial activities of farms, particularly in the cooperative sector.

Despite the slowdown in economic activity since 1978, unemployment has been avoided, partly at the cost of a deterioration in labor productivity. Labor released from industry and the construction sector, and to a lesser extent from the trade, transport, and communications sectors, has been largely absorbed by the nonmaterial services and farm sectors and by small private businesses. The residual decline in employment has essentially been offset by a net withdrawal from the labor force of persons above the retirement age.

Since July 1981 a five-day working week has been introduced by phases affecting close to 4 million employees by end-1981 and another 3.5 million in the first half of 1982, it will spread to further groups by 1984. Part of the impact on unit labor costs is expected to be offset by longer hours in certain branches and by increases in labor productivity.

2. Incomes

The Hungarian system of regulating enterprise incomes is described in Appendix II (p. 125), and the wage system is described in Appendix III (p. 128).

a. Enterprise profits

The growth in the operational surplus of enterprises fell to 1.4 per cent in 1980, from 8 per cent or more in previous years. While little change occurred in aggregate product or taxes and subsidies to enterprises, other deductions from the operational surplus rose markedly (Table 26). As a result, aggregate profits before taxes decreased by almost 3 per cent. With increases in the rates of the municipal contribution and the general profit tax, profits after taxes fell by 10 per cent. Despite this, allocations to the sharing fund changed little from 1979. Moreover, the contribution rate to compulsory reserve funds had been lowered, and enterprises were able to transfer resources from their reserve funds to development funds. Accordingly, the reduction in after-tax profits in 1980 did not prevent a further growth in retained earnings for investment purposes.

Because of this, the authorities adopted in late 1981 and 1982 new measures to contain the growth of investable resources. Interest rates on bank credit were raised; the exchange rate of the forint was appreciated; cuts were made in tax refunds to exporters above the general rate of 10 per cent, in modernization grants, in export support to agriculture, and in other subsidies, partly in conjunction with increases in energy prices ^{1/} and freight rates; profit margins in domestic trade were reduced; windfall gains on foreign trade were taxed, the tax on construction was raised from 10 per cent to 20 per cent, and the municipal contribution rate from 10 per cent to 15 per cent. In a further effort to contain enterprises' resources for investment, the compulsory reserve fund contributions were increased with retroactive application to 1981 profits from 15 per cent to 20 per cent in general and from 10 per cent to 15 per cent for agriculture, the latitude of certain enterprises to retain more than 60 per cent of depreciation allowances in their development funds was abolished, 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, and state investment support to enterprises was reduced.

The operational surplus of enterprises rose by 10.3 per cent in 1981, due to a variety of factors. Producer prices continued to rise markedly, while labor productivity improved sharply and unit labor costs increased more moderately. The ratios of energy and raw materials consumption to output decreased, due to conservation and a trend toward less energy- and raw material-intensive production induced by improvements in the price system. In response to the application of the competitive pricing scheme to producer prices in manufacturing, enterprises shifted the composition of exports in the convertible currency area toward products earning higher profit margins. Profits of exporters to the CMEA area, in particular in engineering and chemical products, also grew markedly.

^{1/} These measures also entailed increases in producers' differential turnover taxes.

Despite the strengthening of enterprise incomes and measures to curtail some subsidies, overall budget support to enterprises rose by almost 10 per cent in 1981, due mainly to operating subsidies to enterprises confronted with sluggish market conditions (the metallurgical sector) and temporary subsidies to the farm sector. The growth of after-tax profits was 16.7 per cent. Although allocations to the sharing funds rose only slightly, and a greater amount of profits was absorbed through increases in contribution rates to the compulsory reserve funds, allocations to development funds were again substantial (Ft 54 billion) and the planned reduction did not materialize.

Despite the overall buoyancy of profits, an analysis of the 1981 balance sheets showed that outside agriculture some 20 enterprises operated at losses, mainly in the food processing and metal industries and in construction.

Because of a growing pressure for new investment associated with the abundance of investment funds, and in view of a need to curb domestic absorption, the authorities adopted a broad range of additional measures to curtail the enterprises' own funds in 1981 and 1982. With effect from 1982 the tax rate on the wage bill was raised. Interest rates on bank credits were further increased, and subsidies for the purchase of machinery by agricultural units were reduced. Budget assistance to compensate for energy price increases were reduced. Some penalties and charges treated as enterprise costs were subjected to profit taxation. Contribution rates to the compulsory reserve funds were raised by 5 percentage points in general. Interest rates paid on obligatory reserve fund deposits were cut, and firms were obliged to deposit such interest earnings in the compulsory reserve funds as of July 1, 1982. The access of large agricultural enterprises to their reserve funds was constrained. A freeze on state investment grants to enterprises was extended through 1982. Enterprises were called upon further to speed up the redemption of investment credits from their developments funds. A portion (6 per cent) of developments funds formed from 1981 profits and depreciation allowances in 1982 were frozen in compulsory reserve funds. Finally, a new 25 per cent tax was imposed on net investments started after June 1, 1982 except for projects to promote exports to the convertible currency area and energy and raw materials conservation.

b. Household incomes

Since 1978, the authorities have placed increased emphasis on incomes policy together with price policy as a means of containing consumer demand. The growth in average real household income slowed down, principally because of a pickup in consumer prices and a moderate deceleration of nominal wage increases. In industry, this permitted a notable slowdown in the rise of unit labor costs. In 1980, however, average wages rose more rapidly than foreseen. This was matched by a more pronounced reduction in employment, which kept the rise in the wage bill within planned limits. Because of a faster than initially planned increase in consumer prices, real earnings declined. Nonetheless, the substantial shortfall in real output compared with the Plan would have required even greater

moderation in wages. Accordingly, unit labor costs accelerated markedly. Moreover, the buoyancy of the performance indicators for wage determination permitted many firms to accumulate wage reserves. By the beginning of 1981, wage reserves in companies subject to the wage bill regulation amounted to some 2.5 per cent of the wage bill. There was also a notable accumulation of unused latitude of increases in wage rates, amounting to about 2 per cent under the performance-oriented scheme of wage rate determination.

In an effort to keep real earnings in 1981 at their level of a year earlier, constraints were imposed on the latitude of enterprises to use wage reserves. Although wage increases decelerated somewhat in agriculture, they picked up in most other branches, particularly in those subject to the performance-oriented scheme of wage formation. Increases in average wages in industry beyond the plan targets were attributable in part to a reduction in staff. On the other hand, no corresponding cuts in wage rates ensued, as labor moved to the services and farm sectors where the wage bill regulation is not applied. In 1981, on the whole, average earnings increased by 6.2 per cent in nominal terms and 1.5 per cent in real terms (Table 27). The rise in unit labor costs in industry slowed down, notwithstanding the higher wage increases, owing to an upsurge in productivity (Table 28).

For 1982, the Plan initially foresaw a rise in average nominal earnings of some 4.5 per cent and a decline in real terms of 0.5-1.0 per cent, a moderation deemed necessary in the light of a more severe external adjustment effort. The slowdown was expected to be helped by measures to curtail enterprise profits. Moreover, the wage coefficients were lowered from 0.3 to 0.2 under the wage bill regulation and to 0.25 under the control of the wage rate, as of January 1, 1982. The centrally determined rates of tax-free increases in wages were reduced by 1 percentage point under the former and by 0.5 percentage point under the latter scheme. The general 3 per cent limit on the use of wage reserves to increase wages was maintained. Measures were also taken to control the development of wages in agriculture and budgetary institutions.

Nonetheless, wage increases picked up in the early part of 1982, exceeding the rise in consumer prices (Table 27). 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 per cent. In addition, they raised the tax on wage increases in agriculture by 50 per cent, and decided that tax liabilities on wage increases in excess of resources available in sharing funds could no longer be covered from the compulsory reserve funds but must be deducted from the sharing funds of the succeeding year. The resulting curtailment of wage awards coupled with additional consumer price increases officially are estimated to bring about a reduction in real earnings of 1-1.5 per cent in 1982 as a whole.

Despite the efforts of the authorities in recent years to encourage greater flexibility in wage formation in order to promote efficiency and labor mobility, wage differentials have, in practice, remained narrow.

The full scope for differentiation permitted by the system has not been used, mainly because of social pressures within enterprises. Since 1978, in continuation of the trend that began in the mid-1970s, the dispersion of wages has narrowed further. The coefficient measuring the extent at which the average remuneration of employees with earnings above the nationwide average exceeds that of employees below the average fell from 1.89 in 1976 to 1.82 in 1981. 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 in recent years the buoyant development of wage-related performance indicators has not constituted a severe constraint. The discretion of enterprises in granting wage awards was further enhanced by possible recourse to resources in the obligatory reserve funds when taxes due on wage increases could not be covered from sharing funds, until this facility was cancelled in early 1982. Wage differentiation has been further hampered because the determination of wages continues to be dominated by the so-called "base principle," i.e., the linkage of increases in wages in individual enterprises to improvements in their performance from the previous year.

In a renewed effort to stimulate wage differentiation according to efficiency, the authorities raised the maximum permissible tax-free rate of increase in average wages across all enterprises from the 9 per cent prevailing since 1980 to 12 per cent as of 1982. The system of the statutory wage preference and the rules of wage determination in the construction industry have also been made more flexible.

The growth in social benefits, although decelerating, has continued to outpace that of labor incomes (Table 29). They represented about 32 per cent of household incomes in 1981, compared with 23 per cent in 1970. Their increase is essentially determined by the rise in pensions, stemming from demographic factors and structural changes.

3. Prices ^{1/}

a. Producer prices

It was initially expected that the 1980 producer price reform would produce a fall in the level of producer prices. Due to the sharp increase in world energy prices in 1979, however, producer prices rose by about 11 per cent on average in 1980, with industrial producer prices rising by 15 per cent (Table 30 and Chart 5). The most notable adjustments in relative prices were increases in energy prices by some 65 per cent and basic materials prices by about 35 per cent, compared with prices of finished products.

Domestic industrial producer prices rose by 7 per cent in 1981 and by about 6 per cent on all sales, despite a marked deceleration of unit labor costs. The average producer price increase on domestic sales reflected in part the carry-over from the previous year (2.5 percentage

^{1/} See Appendix IV for a description of the price system.

points), the direct and indirect effects of renewed energy price increases in March and November 1981 (3.5 percentage points), and an increase in profit margins (1 percentage point). Domestic producer prices in engineering and the light industries rose by less than 2 per cent, but higher increases in prices were obtained on foreign sales. The most pronounced increases in producer prices occurred in the mining, electric energy, construction materials, and chemical industries, as these were most affected by the increase in energy prices (Table 30). Prices in the metal industry declined, although not by as much as world market prices.

In the first four months of 1982, producer prices in socialist industry were 5.6 per cent above their year-earlier level, largely because of the carry-over effect of energy price increases during 1981. For 1982 as a whole, the Plan foresees an increase of 4 per cent.

The adjustment of farm prices since the 1980 price reform fell well short of the increases that would have been required to eliminate subsidies on agricultural inputs. In 1980, prices for livestock were raised by 13.5 per cent, but for crops by only 4.5 per cent (Table 31 and Chart 5). The average farm price increase of 9.5 per cent offset only part of the higher cost of agricultural inputs resulting from the producer price reform. In 1981, there were further increases in input prices paid by the agricultural sector and a new round of increases in agricultural sales prices, averaging 7 per cent for the year as a whole. Energy cost increases in agriculture were to some extent offset in 1980 by partial lump-sum subsidies, so that price increases to consumers could be delayed; this policy was continued in 1981. In the first four months of 1982, farm prices rose by 2.5 per cent over their previous year's level, a somewhat higher rate than foreseen in the Plan for the year as a whole.

b. Consumer prices

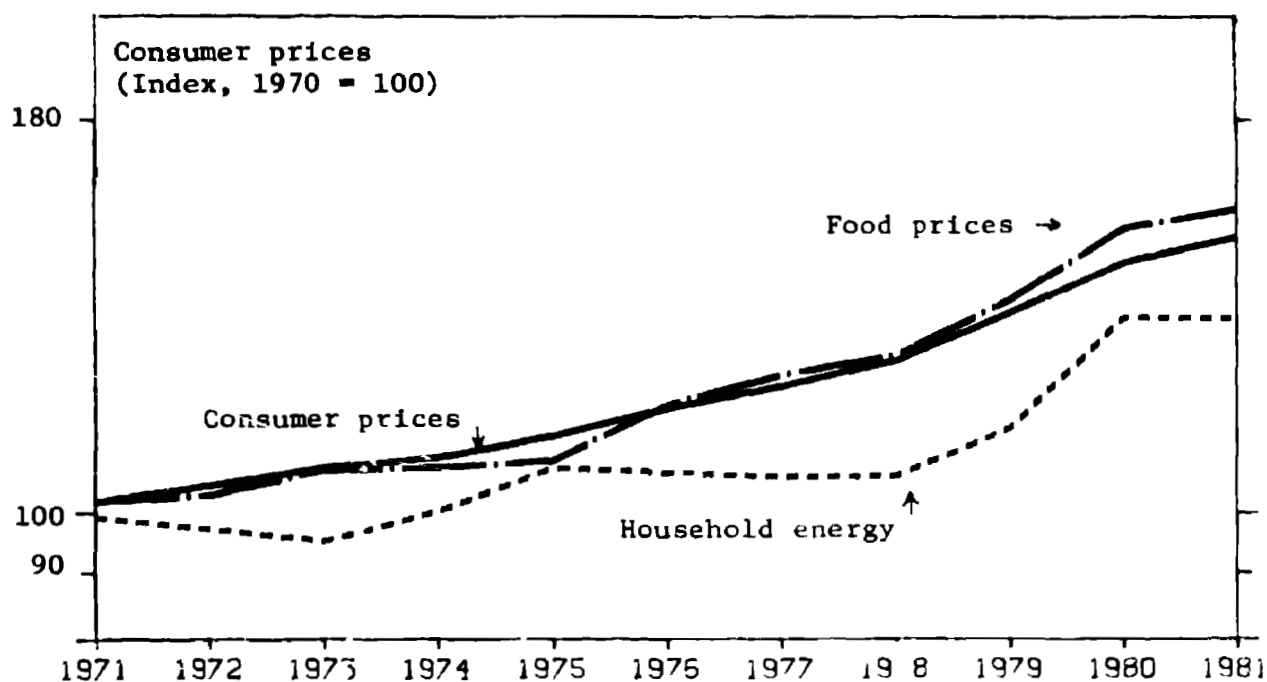
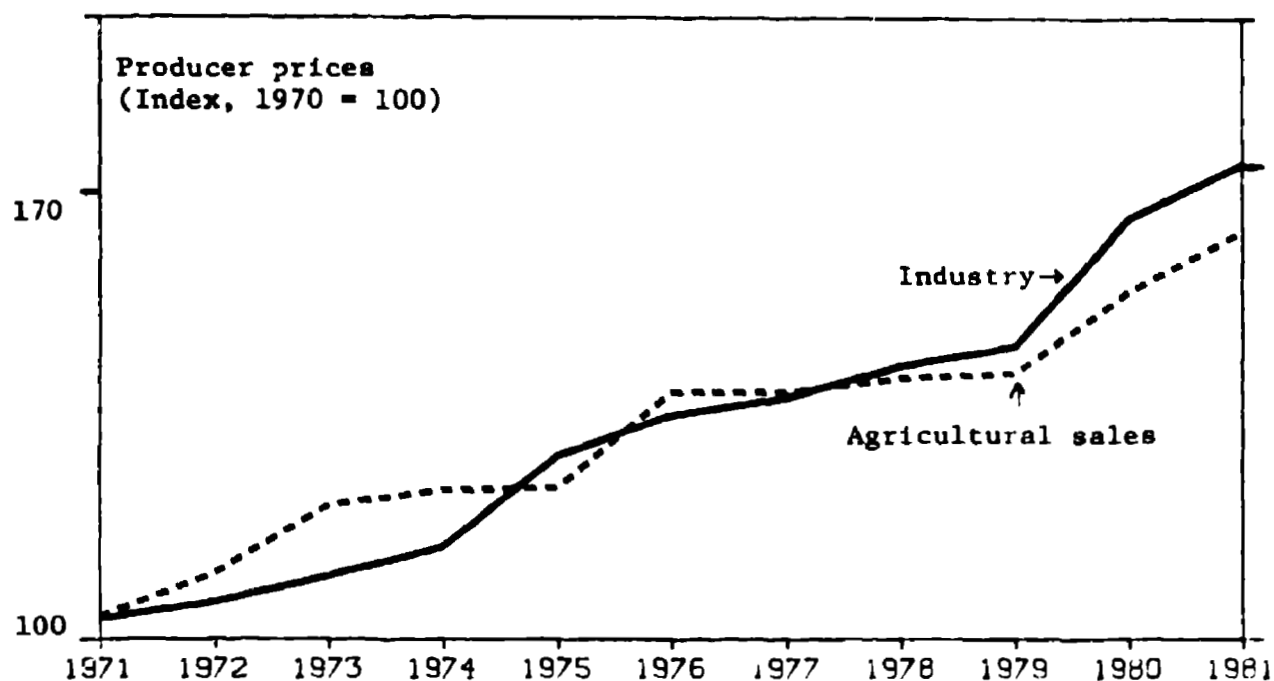
In the initial phase of the 1979-80 price reform, consumer prices were raised in advance, mainly to help achieve an improvement in the external balance. In July 1979 food prices were increased, on average, by 20 per cent, the price of home heating by 34 per cent, and the price of electricity to households by 51 per cent. These increases, however, did not wholly eliminate consumer subsidies for these items. These adjustments, and some market-related price developments (e.g., increases in fruit and vegetable prices), caused the consumer price index to rise by close to 9 per cent in 1979, compared with an average annual increase of just over 4 per cent since the last major price adjustments in 1976 (Table 32 and Charts 5 and 6). At the same time, the majority of the population received monthly income supplements which compensated for about 6 percentage points of the increase in consumer prices, and reduced the impact of these price increases on real incomes and private consumption.

The carry-over effect of the mid-1979 price adjustments, together with some further adjustments in early 1980 and market-related price increases, raised the consumer price level by about 9 per cent in 1980.

Chart 5

Hungary

Development of Prices



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

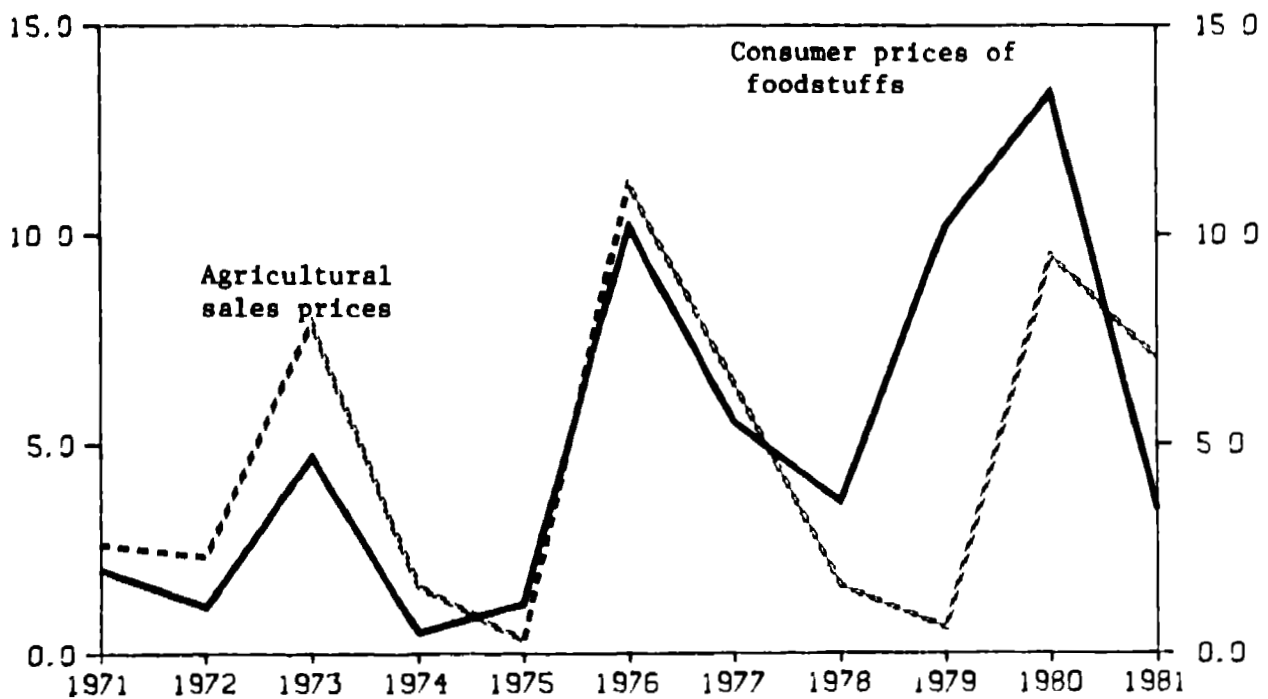
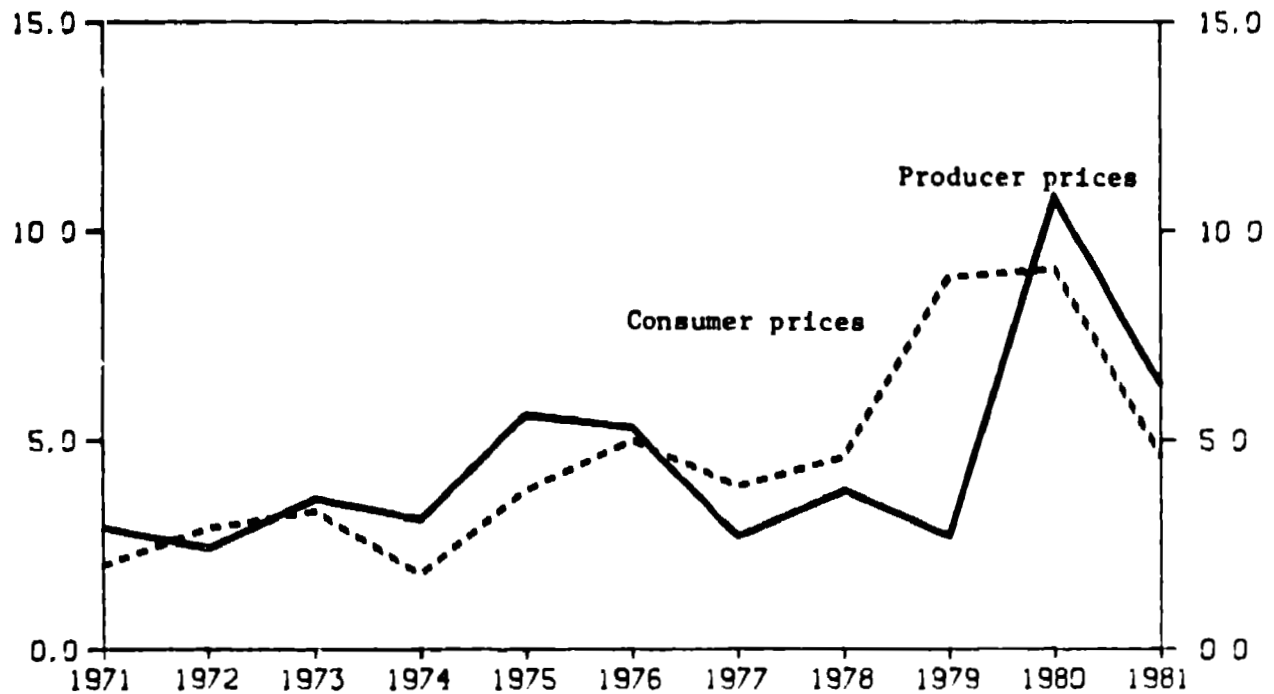
Chart 6

Hungary

Price Developments

(Average annual percentage changes)

Per cent



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

In 1981, consumer prices rose only 4.6 per cent, in line with the minimum increase foreseen in the Plan (see Table 1). The 1981 increase was due roughly equally to increases in centrally controlled prices (mainly cereals and meat prices) and in free consumer prices. The higher producer prices of energy and farm products since 1979 have not been fully passed on to households, and consumer price subsidies grew for most items through 1981.

The 1982 Plan foresaw an annual average increase in consumer prices of about 5 per cent, 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). Developments in the course of 1982 suggest that increases in free market prices will exceed the plan estimates. In a renewed effort to cut consumer subsidies and to dampen 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 per cent and 19 per cent, respectively. In July and August prices were increased by 10-30 per cent for certain construction materials, by 15-20 per cent for some services, by 40 per cent for coffee, by 25 per cent for some cereal products, and by 100 per cent for long distance transportation. These measures and the effect of the depreciation of the forint on July 13, 1982 may bring the increase in consumer prices for the year as a whole to about 7 per cent.

Table 22 Hungary The Population, Manpower Resources, and Employment

(In thousands, beginning of period)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981
Population by age brackets												
Persons under working age 1/	1,981 2	1,946 1	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	2,223 7
Working age population 2/	6,224 7	6,273 1	6,320 1	6 339 9	6 369 4	6 374 0	6 369 4	6,358 5	6,353 4	6 350 1	6,302 0	6,275 3
Retirement age population 3/	2,116 2	2,132 5	2,127 4	2,134 1	2,130 1	2,152 7	2,165 4	2,165 5	2,174 7	2,158 9	2,195 5	2,213 8
Total population	10,322 1	10,351 9	10,377 8	10,410 4	10,441 6	10,500 9	10,562 7	10,614 7	10,659 6	10,687 6	10 709 5	10,712 8
Manpower resources												
Manpower of working age 2/	6,224 7	6,273 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	6,275 3
Manpower of retirement age 3/	386 9	360 8	347 6	337 3	287 1	285 2	277 6	252 1	246 4	233 8	224 6	191 9
Total manpower resources	6,611 6	6,634 1	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	6,467 2
Distribution of manpower resources 4/												
Inactive dependents	1,351 2	1 311 4	1 279 8	1 231 5	1 168 7	1 106 4	1 027 0	969 0	939 8	909 3	847 0	853 7
Students	(628 0)	(614 1)	(602 0)	(579 5)	(548 8)	(534 2)	(518 0)	(503 3)	(490 1)	(487 6)	(489 8)	(500 8)
Other dependents	(723 2)	(697 3)	(677 8)	(652 0)	(619 9)	(572 2)	(509 0)	(465 7)	(449 7)	(421 7)	(357 2)	(352 9)
Inactive manpower 4/5/	269 7	300 9	337 3	372 5	403 2	456 3	517 0	552 4	585 8	587 6	602 0	595 0
Total inactive persons and dependents 4/	1,620 9	1,612 3	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	1,448 7
Active labor force 6/	4,990 7	5,021 8	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
Persons working abroad under international cooperation agreements	10 5	11 5	12 0	12 0	11 0	11 0	10 0	8 0	5 4	5 0	4 0	4 0
Total domestic employment	4,980 2	5,010 3	5,038 6	5,061 2	5 073 6	5,085 5	5,093 2	5,081 2	5,068 8	5 981 0	5 073 6	5,014 5

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

1/ Persons up to 14 years of age

2/ Men of 14-59 years and women of 14-54 years

3/ Men 60 years and older and women 55 years and older

4/ Working age persons

5/ Handicapped persons, persons in early retirement, and women on maternity leave drawing social benefits

6/ Manpower resources minus inactive persons and dependents

Table 23. Hungary: The Structure of Employment by Sectors

	1970	1975	1976	1977	1978	1979	1980	1981
<u>(In thousands; beginning of period)</u>								
Agriculture, forestry, and water economy	1,303	1,157	1,130	1,111	1,100	1,105	1,116	1,109
Industry	1,820	1,816	1,789	1,765	1,752	1,734	1,697	1,654
Construction	362	417	420	417	414	413	404	393
Transportation and telecommunications	339	390	402	404	407	409	407	400
Trade	400	458	468	476	480	485	488	488
Services and other	756	847	884	910	916	935	962	971
Total employment	4,980	5,085	5,093	5,083	5,069	5,081	5,074	5,015
<u>(In per cent of total)</u>								
Agriculture, forestry, and water economy	26.2	22.8	22.2	21.9	21.7	21.7	22.0	22.1
Industry	36.5	35.7	35.1	34.7	34.6	34.1	33.4	33.0
Construction	7.3	8.2	8.2	8.2	8.2	8.1	8.0	7.8
Transportation and telecommunications	6.8	7.7	7.9	7.9	8.0	8.0	8.0	8.0
Trade	8.0	9.0	9.2	9.4	9.5	9.6	9.6	9.7
Services and other	15.2	16.6	17.4	17.9	18.0	18.5	19.0	19.6
Total employment	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

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

Table 24. Hungary. The Development of Employment
by Branches in the Socialist Sector

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

	1971-75 1/	1976	1977	1978	1979	1980	1981	1982 2/3/
Agriculture and forestry	-3.5	-4.4	-1.3	0.3	0.7	-0.6	2.6	..
Industry	0.3	-0.8	-0.2	-0.1	-1.6	-2.8	-2.1	-2.8
Mining	-2.0	-1.2	-1.5	-1.9	-1.2	-0.7	-0.8	-0.6
Electric energy	1.3	0.4	-0.3	-0.4	-1.5	-1.8	-1.3	-0.8
Metallurgy	0.4	-1.0	--	-0.5	-0.8	-1.4	-2.7	-1.9
Engineering	0.4	-0.4	0.6	0.3	-2.0	-2.9	-2.4	-2.0
Construction materials	0.3	-2.4	-0.2	0.7	-0.9	-2.0	-2.7	-2.6
Chemicals	1.5	-0.2	-1.6	-0.1	-0.7	-2.0	-0.9	-1.0
Light industries	-0.4	-1.4	-1.2	-0.8	-2.7	-3.1	-2.8	-2.7
Food processing	1.8	--	1.4	1.7	-0.5	-1.7	-0.5	-0.3
Miscellaneous	2.1	-0.4	0.7	0.3	0.2	...	-2.2	-1.5
Construction	2.5	-0.3	-0.5	0.3	-1.7	-3.8	-3.7	-4.6
Transportation and telecommunications	1.4	1.1	1.0	0.7	0.1	-1.5	-1.1	...
Trade	2.2	1.7	1.7	1.5	1.1	-1.1	--	...
Water economy	2.7	1.4	1.7	2.8	3.5	0.1	0.5	...
Non-material services	3.5	2.7	2.1	2.4	2.1	1.5	0.9	.
Total	0.5	-0.3	0.4	0.8	--	-1.2	-0.4	.
Memorandum item								
Employment in overall economy 4/	0.3	-0.2	-0.2	0.2	-0.2	-1.2	-0.4	

Source: 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-April.

4/ Percentage changes during period.

Table 25. Hungary: Output, Employment, and Productivity
in Socialist Industry and Construction

(Average year-on-year percentage changes)

	Socialist Industry			Construction		
	Output	Employment	Productivity	Output	Employment	Productivity
1971-75 1/	6.4	0.2	6.3	7.0	2.0	4.9
1976-78 1/	5.3	-0.4	5.7	5.4	-0.1	5.6
1979-81 1/	1.1	-2.2	3.3	-2.5	-3.2	0.7
1976	4.6	-0.8	5.4	4.6	-0.5	5.1
1977	6.6	-0.2	6.8	6.4	-0.1	6.5
1978	4.9	-0.1	5.0	5.3	0.2	5.1
1979	3.0	-1.6	4.7	2.4	-1.8	4.3
1980	-2.1	-2.8	0.7	-7.1	-3.9	-3.3
1981 2/	2.3	-2.1	4.5	-2.6	-3.7	1.1
1982 2/ 3/	1.9	-1.8	3.8	-3.4	-4.6	1.3

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

1/ Annual average percentage changes.

2/ Preliminary data.

3/ January-April.

Table 26. Hungary: Enterprise Profits

(In billions of forint)

	1979	1980	1981 ^{1/}
National income ^{2/}	597.4	625.8	677.0
Gross labor income	295.4	319.5	339.0
Operating surplus of enterprises	320.0	306.3	338.0
Production taxes ^{3/}	-250.1	-250.4	-269.7
Other deductions ^{4/}	-15.0	-24.9	-22.4
Subsidies	135.7	136.8	149.9
Enterprise profits before taxes	172.6	167.8	195.8
Taxes paid out of profits	-99.1	-101.4	-118.4
Enterprise profits after taxes	73.5	66.4	77.4

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

^{1/} Preliminary data.

^{2/} Net domestic product at producer 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 27. Hungary: Development of
Nominal and Real Wages

<u>Average earnings of employees 1/</u>			<u>Average monthly wages</u>		Memorandum item Con- sumer Prices
Nominal	Real 2/	State Industry	Cooperative Industry		
<u>(Percentage changes on a year earlier)</u>					
1971-75	6.2	3.3	6.3	4.7	2.8
1976	5.1	0.1	6.1	5.3	5.0
1977	7.8	3.8	8.5	8.2	3.9
1978	7.8	3.1	8.4	8.1	4.6
1979	7.0	-1.7	5.7	5.3	8.9
1980	7.4	-1.6	6.4	5.9	9.1
1981 3/	6.2	1.5	7.2	6.5	4.6
1982 3/4/	...	..	8.2	6.7	5.7

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

1/ Including incomes of members of cooperatives and incomes from sharing funds Net of social security contributions of individuals.

2/ Deflated by consumer price index.

3/ Preliminary data

4/ January-April.

Table 28. Hungary: Unit Labor Costs
in Socialist Industry 1/

	Productivity <u>2/</u>	Average monthly wages	Unit labor costs
(Percentage changes on a year earlier)			
1971-75	5.4	6.2	0.8
1976	5.4	6.0	0.5
1977	6.8	8.4	1.5
1978	5.0	8.5	3.3
1979	4.7	5.7	1.0
1980	0.6	6.3	5.6
1981 <u>3/</u>	5.4	7.2	1.7
1982 <u>3/4/</u>	3.8	8.1	4.1

Sources: CSO, Monthly Bulletin of Statistics; and IMF, IFS.

1/ Data cover industrial enterprises in the state and cooperative sectors.

2/ Industrial output per employee.

3/ Preliminary data.

4/ January-April.

Table 29. Hungary. Household Incomes by Major Sources

	Labor income 1/	Social income		Other income 2/	Total income	Memo item: Total money income
		In money	In Kind			
<u>(In billions of forint)</u>						
1981 3/	331.0	94.1	65.4	159.5	8.2	498.7
						399.9
<u>(In per cent of total)</u>						
1981 3/	66.4	18.9	13.1	32.0	1.6	100.0
						80.2
<u>(Annual average percentage change in per capita real incomes)</u>						
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
1977	5.1	6.0	4.3	5.3	-17.8	4.9
1978	2.4	2.7	5.8	3.9	14.6	2.9
1979	-2.3	7.4	3.1	5.6	9.5	0.1
1980	-1.6	5.7	4.3	5.1	-10.1	0.4
1981 3/	1.6	3.3	3.0	3.2	19.0	2.2
						3.4
						0.5
						5.2
						3.0
						-0.2
						0.1
						3.4

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.

3/ Preliminary data.

Table 30 Hungary Producer Prices 1/
(Average year-on-year percentage changes)

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981 2/	1982 2/3/
Mining	-1.9	-0.4	-3.8	0.3	30.7	5.8	--	8.3	3.4	60.4	22.8	17.9
Electric energy	--	--	--	-0.1	1.7	12.8	--	8.5	0.3	27.3	10.0	19.9
Metallurgy	-4.0	4.5	2.1	7.1	7.7	-2.1	--	11.5	3.8	26.8	-1.9	2.7
Engineering	1.8	4.3	2.8	1.8	4.3	0.8	--	4.1	2.1	0.2	3.3	1.8
Construction materials	5.6	5.5	1.5	1.5	6.6	8.5	--	6.2	3.5	10.0	11.1	4.7
Chemical industries	0.8	-1.6	1.1	6.9	24.3	4.2	--	-1.4	2.5	38.3	9.0	9.4
Light industries	2.1	2.0	1.3	2.8	5.7	2.2	1.0	2.5	2.7	1.0	4.7	1.5
Food processing industry	7.9	2.8	9.0	-0.7	1.7	8.1	--	2.4	1.8	12.3	9.3	1.4
Other industries	-14.2	4.2	13.3	27.4	13.2	1.4	--	1.3	1.8	1.4	0.2	--
Total industry	2.0	2.5	3.2	2.9	9.6	3.9	--	3.7	2.4	15.3	5.9	5.6
Construction	3.8	5.2	3.6	4.1	2.7	6.0	5.3	5.4	3.1	2.7	5.0	--
Agriculture and forestry	4.7	0.6	6.3	1.4	0.9	12.0	0.8	2.4	2.6	10.9	6.7	2.5
Transportation and communications	2.3	0.7	2.6	0.2	3.9	9.7	3.8	4.4	1.7	11.2	7.1	--
Trade	4.6	3.6	1.0	6.6	-2.0	0.6	5.2	3.3	2.1	-4.3	5.3	--
Water economy	2.2	2.9	1.4	4.0	3.7	4.9	3.1	4.4	1.9	8.2	8.9	--
Total sectors	2.9	2.4	3.6	3.0	5.8	5.6	2.4	3.6	2.5	11.3	5.9	--
Nonmaterial services	3.3	2.5	3.0	3.9	4.6	3.4	5.1	4.9	4.7	6.8	9.8	--
Gross production	2.9	2.4	3.6	3.1	5.6	5.3	2.7	3.8	2.7	10.8	6.3	--

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

1/ Domestic and foreign sales

2/ Preliminary data

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

Table 31. Hungary: Agricultural Sales Prices

(Average year-on-year percentage changes)

	Crops	Livestock and Products	Total
1970	1.6	12.5	7.6
1971	7.9	-0.9	2.6
1972	2.5	2.1	2.3
1973	1.8	13.3	7.9
1974	2.2	1.1	1.6
1975	1.4	-0.6	0.3
1976	13.3	9.5	11.2
1977	-1.8	1.5	--
1978	2.0	1.3	1.6
1979	1.3	--	0.6
1980	4.5	13.5	9.5
1981 <u>1/</u>	8.2	6.1	7.0
1982 <u>1/2/</u>	11.0	1.4	2.5

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

1/ Preliminary data.

2/ January-April.

Table 32. 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 1/	3.4	2.6	6.0	-0.2	1.1	9.0	6.5	4.6
1982 1/2/	5.6	9.9	5.1	0.6	2.0	5.7	3.8	5.5

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

1/ Preliminary data.

2/ January-March

III. Public Finance

1. The changing role of fiscal policy under the economic reforms

Before the systemic reform process that began in 1968, the annual state budget was the most important policy tool for implementation of the macroeconomic and microeconomic objectives formulated in the annual plans. The bulk of investment, both by the state and by enterprises, was financed by budgetary grants and loans, and credits through the banking system played a lesser role. In addition, a complex system of subsidies and taxes, including special taxes on windfall profits, was necessary so long as the structure of domestic prices differed markedly from international prices, and as a result of the centralized fixing of producer and consumer prices. In addition, budgetary transfers and taxes were instrumental in the implementation of policies to control incomes, both of the population and of enterprises.

The basic philosophy of the reform process since 1968 has been to reduce the scope of direct state direction in the economy, to increase the autonomy of enterprises, and to rely more on indirect controls through financial policies. This has changed significantly the nature of fiscal policy in Hungary. Although a large proportion of investment is centrally determined or otherwise influenced by the authorities, the role of the budget in financing investment by the enterprise sector has been reduced markedly, as the importance of both self-financing through the development funds and credits from the banking system has been extended. In addition to infrastructure investment, the main sector in which the budget plays a dominant role is energy. The budget also provides interest rate subsidies for private housing, and various forms of support for investment by agricultural cooperatives, local authorities, and enterprises.

In other areas of policy, however, the role of the budget has been adapted rather than reduced. The gradual reform of the price system should have reduced the degree of reliance on subsidies and special taxes as adjuncts of price policy, but in practice progress has been slow. Use of such measures (the so-called "financial bridges") was intended to be temporary in order to ease the transition to the new economic system, but it remains a pervasive feature. Similarly, the increased emphasis on enterprise self-responsibility and autonomy should in theory have reduced the need for budgetary transfers to the industry sector, but in practice large-scale subsidies of various kinds continue to play a major role. In agriculture, also, efforts to promote expansion of production, under circumstances of widely varying physical conditions and by different types of organization have been supported by generous subsidies for capital expenditure, use of energy and fertilizer, and price support. Finally, the budget has continued to be the major instrument of incomes policy. The tax system complements the wage regulations as an instrument to influence income distribution, and on the expenditure side the importance of the government sector as an employer and of income transfers through the social security system have accounted for a significant proportion of budgetary expenditures. In summary therefore, although the role of fiscal policy has been modified as a consequence of

the economic reforms in other areas of economic organization and policy, the budget has kept many of its functions because of the uneven and partial implementation of those reforms. One rough indication of the budget's quantitative significance is that expenditures under the state budget accounted for 60 per cent of GDP in 1980, roughly unchanged from five years earlier.

The temporary setback to the reform process after the 1973 oil shock, and in particular the attempts to shield domestic prices and incomes from the consequence of adverse developments abroad, resulted in an interruption of the tendency to reduce the direct economic role of the budget. For several years after 1973, increased recourse to subsidies was used to damp the impact on domestic producer prices of higher costs of imports, and consumer subsidies were increased in order to maintain a high degree of price stability.

The renewed impetus given since 1978 to economic reforms, and especially the 1979-80 price reforms, has again involved some reform of the public finance system. In particular, the price reforms have reduced the need for special exemptions to turnover taxes, and have allowed some reduction in subsidy rates on some consumer goods, although not enough to avoid a rise in total allocations for such subsidies. An important change in the structure of tax revenues has resulted from a shift away from taxes assessed directly on factors of production 1/ and an increased emphasis on profit taxes and turnover taxes. A new 'producer's differential turnover tax' has been applied to collect as revenue the wide difference between costs to producers of some imported inputs (e.g., oil from the U.S.S.R. at CMEA prices) and world market prices. On the expenditure side, the renewal of the reform movement has been felt mainly in greater reliance on bank financing and reduced budgetary contributions to enterprise investments.

2. The public sector accounts

As in all socialist countries a broad definition of the public sector would encompass most economic institutions, including most productive activities. For the purpose of analyzing fiscal policy, however, it is appropriate to focus on a narrower definition of the public sector which corresponds to those institutions having a governmental character. In the case of Hungary, this includes the Central Government, local authorities, special state funds or extrabudgetary institutions, 2/ and the social security system.

1/ A wage tax and a capital levy were abolished in 1980.

2/ About 18 governmental funds operate outside the budget, with functions in such fields as water supply, culture, research and technical development, tourism, and development of services. Some have independent sources of revenue: they may also receive grants from the budget to cover their net operational deficits; and some may borrow independently from the banking system.

Only a partial indication of the activities and finances of the governmental sector is given by the state budget (Tables 33-37), which does not have complete coverage. The state budget comprises the current and capital expenditures and revenue of the Central Government and the social security system, plus net transfers to extrabudgetary institutions, plus the current and part of the capital expenditures of the local authorities. Thus part of the investment expenditure of the local authorities, and much of the expenditures of the special state funds, are not included in the budget.

The deficit of the state budget was low up to 1980, generally less than 1 per cent of GDP. It was financed by borrowing from the National Bank of Hungary. This deficit, however, is substantially lower than the borrowing requirement of the Central Government, as official borrowing abroad is included above the line as a revenue item. It also understates the borrowing by the government sector on a broad definition, as it excludes independent borrowing by the special state funds and the local authorities. Data on the total borrowing of the government sector have not been made available. For the state budget, the deficit rose in 1981 to Ft 9.5 billion (1.2 per cent of GDP), and the 1982 budget shows a further widening to Ft 15 billion or the equivalent of 1.8 per cent of GDP.

3. Developments in the state budget, 1980-82

a. 1980 and 1981

Total expenditures under the state budget rose by 3 per cent in 1980 and by 6.6 per cent in 1981 (corrected for changes in statistical coverage). ^{1/} In both years the rise in current revenues was insufficient to cover the increase in current expenditures, so that the current account surplus fell from Ft 68.4 billion in 1979 to Ft 53.2 billion in 1980 and Ft 26.4 billion in 1981 (Table 33). Although capital expenditures were reduced sharply, the capital account deficit did not fall sufficiently to offset the cut in the current surplus, with the result that the overall deficit rose marginally in 1980 to Ft 4.5 billion (0.6 per cent of GDP) and more markedly in 1981 to Ft 9.5 billion (1.2 per cent of GDP). In both years the deficit was financed by a combination of borrowing from the National Bank and changes in cash deposits (Table 33).

(1) Structure of expenditures

Expenditures on wages and other goods and services are shown on a functional classification (Tables 34 and 35). This classification illustrates in particular the high proportion of expenditures on social security and welfare (40 per cent in 1980) in the total or such

^{1/} On an unadjusted basis the increase was about 13 per cent (Table 33). The 1981 budget included expenditures by budgetary institutions on a gross basis that previously were on a net basis only.

expenditures. Of greater analytical interest is the classification of expenditures on an economic basis (Table 36). Payments of wages and salaries rose 10 per cent in 1980 ^{1/} but, with tightened fiscal policies, the 1981 increase was reduced to 6.3 per cent (Table 36). Wage payments accounted for about 10 per cent of current expenditures in 1981.

Other expenditures on goods and services also rose sharply in 1980 (17.7 per cent on an adjusted basis), implying a strong increase in real terms. Although the increase in such expenditures was reduced to 9 per cent in 1981, this still represented an increase in real terms. Part of the explanation for this steep rise was the growth of social security payments by 24.9 per cent in 1980 and 8 per cent in 1981, which is discussed further in section 5 below.

The item interest payments includes interest rate subsidies for housebuilding, extended through the National Savings Bank, as well as interest on state debt.

The item subsidies, which constitutes some 34 per cent of total current expenditures, includes the following:

(a) Price subsidies. Despite the 1979/80 price reforms, the budget appropriations for price subsidies rose sharply in both 1980 (24.7 per cent) and 1981 (15.2 per cent). Part of the explanation lay in increased consumer price subsidies on basic foodstuffs, especially meat. The main factor, however, was a very substantial increase in energy subsidies. The large increase in costs of imported energy in 1979 occurred when the 1979/80 price reform had been already decided, and resulted in price increases of 8.9 per cent in 1979 and 9.1 per cent in 1980, considerably higher than in previous years. ^{2/} Rather than risk the higher increase in consumer prices that would have resulted from immediately passing on to consumers the higher world prices, the authorities preferred to damp the effect by a temporary sharp increase in subsidy rates on coal, coke, fuel oil, and gas. In addition to consumer price subsidies, the budget allocations finance various producer price supports and import price subsidies.

(b) Subsidies to agriculture. In addition to food price support subsidies, the State grants a variety of subsidies to agricultural cooperatives to assist them in their purchases of fertilizer, raw materials, and other inputs. Additional energy subsidies were introduced as a temporary measure in 1980 and 1981, when the authorities wished to delay and spread out over time the impact on domestic food prices of the sharp increase in world energy prices. Direct energy subsidies to agriculture were preferred to the possible alternative of an increase in consumer price subsidies because these payments benefited state farms and cooperatives, which are heavy energy users, rather than

^{1/} Corrected for changes in statistical coverage. On an unadjusted basis the increase as shown in Table 36 is 37 per cent.

^{2/} See Chapter 11 on the 1979/80 price reforms.

the private farm sector. Agricultural cooperatives also receive investment subsidies, but these are included in the budget classification under capital expenditures.

(c) Export subsidies. Exporters receive a 10 per cent turnover tax rebate. Actual rates of turnover tax vary widely (see section 2 below); the 10 per cent rate of tax refund was chosen to ensure that this measure has more the character of a genuine tax refund than an actual subsidy.

(d) Modernization grants. These subsidies are granted, generally on a temporary and diminishing basis (three to five years) to assist in the modernization of production and marketing. Certain sectors of Hungarian industry, in particular the metallurgical and chemical sectors, have experienced substantial difficulties in recent years and have received large subsidies.

Other current transfers constitute only transfers to other parts of the public sector, such as the local authorities, the social security system, and the special state funds (extrabudgetary institutions).

Capital expenditures by the Central Government, and budgetary contributions to the development funds of local authorities, agricultural cooperatives, and enterprises, etc., declined in 1980 and 1981. Most of the item "acquisition of fixed capital assets" consists of grants to the State Development Bank to finance large infrastructure investments. Total capital expenditures through the budget fell by 15 per cent in 1980 and 16.6 per cent in 1981 (Table 36) so that their share in total budgetary expenditures declined to about 12 per cent compared to an average of 20 per cent two or three years earlier (1978 and 1979). To some extent, however, the cut in budgetary appropriations was offset by increases in the contributions to state investments from the State Development Bank and enterprises (see also Chapter 1).

(2) The structure of revenues

The Hungarian tax system is characterized by the relatively insignificant role of direct income taxes, and in particular the absence of any tax assessed directly on incomes of workers in the socialist sector. The former wage tax was abolished in 1980, even when it existed it was not a major source of revenue (Table 37). Income taxes are levied on persons in the private sector, but these accounted for only an estimated 2 per cent of total revenue in 1980. These taxes include a general income tax paid by shopkeepers, artisans, etc., and taxes on income derived from private sector agriculture. Such taxes constitute a more significant source of revenue for local councils (about 12 per cent of their total revenues).

Profit taxes, by contrast, constitute a major source of revenue (about 30 per cent), and take a variety of forms.

- a municipal contribution is collected by the State and distributed to local councils under revenue-sharing arrangements. The tax rate was increased from 6 per cent of enterprise profits to 10 per cent in 1980, when the former wage tax and capital levy (the revenue from which accrued mainly to local authorities) were abolished. The tax was raised again in 1981 to 15 per cent.

- a general profits tax of 45 per cent of enterprise profits, net of certain obligations including the municipal contribution and repayment of some types of state loan.

- a progressive tax on enterprise "sharing funds," whose rate depends on the profitability of the enterprise and on the increase in wages. this tax forms part of the wage determination system. 1/

Revenue from profit taxes rose only slightly in 1980 (3.4 per cent) but sharply in 1981 (18.0 per cent). the latter increase was due not only to the big increase in enterprise profits in 1981 but also to certain features of the collection system. Enterprises make tax prepayments during each fiscal year based on estimated profits, and there is a final settlement early in the next fiscal year. Since penalties for underpayment are heavy, most enterprises try to overestimate their tax prepayment, and such revenues were exceptionally high in 1981.

Production taxes, which accounted for 6.5 per cent of tax revenues in 1980, include a variety of special taxes, designed mainly to tax those enterprise profits that are not covered by the general profits tax. They include, for example, the following.

- taxes on the nonagricultural activities of farms,
- taxes on the industrial or construction activities of public or commercial service organizations;
- taxes on the wage bill of engineering and construction design enterprises;
- taxes on specialized foreign trade enterprises;
- construction taxes; and
- taxes on windfall profits.

Taxes on depreciation. With some exceptions, 40 per cent of enterprise depreciation is centralized through the budget to provide revenue for state-financed investments.

Social security contributions constituted 15 per cent of tax revenue in 1980. The rate of social security tax varies according to the type of contributor. Enterprises' contributions amount to 27 per cent of the

1/ See Chapter II on the sharing fund system.

wage bill, while for agricultural cooperatives the rate is 17 per cent and for budgetary institutions the rate is 10 per cent. For individuals employed in the socialist sector, progressive contribution rates to social security range from 3 per cent to 10 per cent. For self-employed persons in the private sector, the tax rate varies according to income, with an average rate of 32 per cent which includes individual contributions to the pension fund.

Indirect taxes, which comprise turnover taxes and import duties, have become an increasingly important source of tax revenue since the 1979/80 reform (Table 37). The producer's differential turnover tax was introduced in 1980 to tax away windfall profits resulting from the difference between the new domestic prices (based on world market prices) and the actual import costs of energy and raw material imports from the CMEA partners, which still lag behind world prices, particularly in the case of oil. Revenue from this tax should gradually decline if world prices stabilize and therefore the gap between CMEA trade prices and world prices narrows. In practice, the revenue from this tax has been considerable and rising in the three years since its introduction (Table 37).

Turnover taxes on consumer goods rose sharply in both 1980 and 1981, reflecting mainly the increase in consumer prices. Rates of turnover tax vary widely between categories of goods, ranging from zero for some items to very high rates for luxury goods (cigarettes at 67.5 per cent, liquor at rates between 72 per cent and 94 per cent). The turnover tax thus fulfills some of the same functions as an excise tax. The average turnover tax rate for industrial goods is estimated at about 10 per cent. Turnover taxes are also imposed on certain consumer goods imported from CMEA partners.

Import duties produced lower revenue in 1980, reflecting cuts in rates of customs duty in accordance with the 1979 Tokyo round of the GATT.

Nontax revenues also account for a significant share of total revenues, about 21 per cent in 1980. In addition to the usual items of incomes from fees, licenses, etc., this category includes foreign exchange conversion gains of the National Bank, which are excluded from the item profit tax. Revenues from charges by institutions financed out of the budget are also included as property income these include kindergarten, research institutions, and universities. The sharp increase in 1981 revenue is due mainly to a change in statistical coverage, as both the expenditures and revenues of some such institutions were included on a gross basis for the first time, whereas previously only net transfers to them from the budget had appeared as an expenditure item. Other nontax revenue includes the domestic counterpart of foreign borrowing by the State.

b. 1982

The state budget for 1982 provides for a 5 per cent increase in total expenditures and a 4 per cent increase in total revenues, resulting in an estimated deficit of Ft 15.0 billion, equivalent to 1.8 per cent of

estimated GDP. At the time the budget was formulated, inflation in 1982 was forecast to be in the range of 4.8 to 5.2 per cent, so that the budget assumed essentially no change in real expenditures and a slight decline in real revenues.

Under the Hungarian system of budgetary controls, some major categories of expenditure, namely, wages and most expenditures on goods and services, can normally be forecast with a reasonable degree of accuracy. Thus in most years it could be expected that wages would rise by 5 per cent and other outlays by 2 per cent. The 1982 budget, however, introduced a greater degree of flexibility, and hence somewhat greater uncertainty. In an effort to slow the growth of expenditures, for example, wage increases would be 5 per cent for "basic" services but only 4 per cent for nonbasic services, and expenditure on basic goods and services would rise by 2 per cent but for less essential categories by only 0.5 per cent. In addition, whereas before there had been automatic 100 per cent indexation adjustments for any major price increases that occurred during the fiscal year, the degree of automatic indexation was reduced for some institutions in 1982. ^{1/}

Current expenditures are budgeted to rise by 6.8 per cent in 1982 (Table 34), with the bulk of the increase due to higher social security payments (mainly pensions) and subsidies. Capital expenditures, by contrast, are forecast to decline for the third year in a row, to Ft 55.3 billion in 1982. This sustained and substantial decline in real terms has been achieved by keeping expenditures on some categories of infrastructure (e.g., roads) unchanged, and prohibiting any new starts in other fields such as education and recreation. As a result of a review of major investment projects in the energy sector, some projects were cancelled and others postponed.

The low increase in total revenues (4 per cent) results partly from a slight decline in nontax revenue, whereas total tax revenues are forecast to increase by 5.8 per cent (Table 37). A decline in profit tax receipts is forecast, largely on the basis that the exceptionally high level of tax prepayments in 1981 is not expected to be repeated and resulted in higher than usual refunds in early 1982.

Data for the first quarter of 1982 showed that investment expenditures were somewhat lower than expected, at 14 per cent of the annual budgeted total compared to a usual 16-17 per cent for this period. Data for revenues were distorted somewhat by the profit tax refunds made in February/March. The deficit recorded in the first quarter of 1982 (Ft 1.5 billion) was 10 per cent of the annual budgeted deficit.

^{1/} In particular, only 50 per cent of automatic indexation was provided for "revenue-oriented" institutions, which derive part of their revenue from fees or charges paid on the services they provide. It is intended that wage increases for such institutions should be linked more closely to their revenues, rather than be based on the 5 per cent rate of the public sector.

The financing of the 1982 deficit of Ft 15 billion is planned to be divided between a new instrument, namely an issue of savings bonds, amounting to Ft 7-8 billion, and borrowing from the National Bank of Hungary.

4. Local authority finances

The local authorities in Hungary share with the Central Government responsibility for providing certain services, particularly in the fields of health, education, administration, and housing, in addition to purely local activities. The current expenditures of the local authorities are included in and financed through the state budget (Table 38). The current revenues accruing to local authorities consist of (a) local taxes and fees assessed by local councils, and (b) revenues transferred from the Central Government under revenue-sharing arrangements, such as 50 per cent of profit taxes on enterprises controlled by them. Capital expenditures by the local authorities on roads, hospitals, housing, and other infrastructure are conducted through development funds. These are financed by a variety of sources, including a share of the municipal contribution and depreciation tax and transfers from the state budget. The local authorities also collect some tax revenue from fees, rental income, contributions from the development funds of local enterprises, etc. Both expenditures and revenues of the development funds have declined slightly since 1979 in line with the Central Government's policy of reducing overall investment. The local authorities in aggregate had a deficit of Ft 4.1 billion in 1981, financed from four main sources (a) borrowing from the National Savings Bank as an advance against future revenues, (b) borrowing from a special fund established in the National Savings Bank composed of surpluses of some local authorities, (c) credits from the National Savings Bank as an advance against sales of houses (financed by the authority) to the population, and (d) borrowing from the development funds of local enterprises, in return for which the local authority finances local infrastructure investment that benefits the enterprise.

5. Social security system

Hungary has an extensive social security system encompassing pensions, sickness benefits, maternity and family allowances, and child-care benefits. Most tax revenues accruing to the system are channeled through the state budget, and comprise social security taxes paid by enterprises, cooperatives, and individuals, and contributions to pension funds. The social security system has also in recent years relied to an increasing extent on transfers from the state budget to cover its operating deficit (Table 39). Such transfers rose from 18 per cent of expenditures in 1978 to 29 per cent in 1980. The growth of expenditures has outstripped that of tax revenue by a wide margin as a result mainly of increased pension payments. Changes in the pension law in 1981 raised the minimum pension and brought private artisans into the state pension scheme on a compulsory basis. In addition, the pension fund of the agricultural cooperatives, which previously was separate from the social security system, was recently brought within the scope of the system; state budget

transfers to cover the deficits of these funds are included as a separate item in Table 39. Finally, demographic factors tended to increase the total expenditures on pension payments, as the number of pensioners was increasing, and average pensions rose because most new retirees had been participants for a complete work-life period and had higher final wages. The annual average real increase in pensions during 1979/81 occurred despite the fact that most pensions received less than full indexation.

Table 33. Hungary: Summary General Government Accounts 1/

(In billions of forint except where indicated)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
	Outcome				Forecast
Tax revenue	305.9	334.9	334.5	382.9	405.0
Nontax revenue	<u>68.0</u>	<u>66.7</u>	<u>76.6</u>	<u>75.9</u>	<u>72.1</u>
Total current revenue	373.9	401.6	411.1	458.8	477.1
Current expenditure	<u>309.1</u>	<u>333.2</u>	<u>357.9</u>	<u>422.4</u>	<u>451.2</u>
Current account balance	64.8	68.4	53.2	36.4	25.9
Capital revenue	9.0	10.1	11.9	13.8	14.4
Capital expenditure	<u>77.3</u>	<u>81.9</u>	<u>69.6</u>	<u>59.7</u>	<u>55.3</u>
Capital account balance	- <u>68.3</u>	- <u>71.8</u>	- <u>57.7</u>	- <u>45.9</u>	- <u>40.9</u>
Overall balance <u>2/</u>	-3.5	-3.6	-4.5	-9.5	-15.0
Overall deficit as per cent of GDP	0.6	0.5	0.6	1.2	1.8
Financing <u>2/</u>					
A. By type of debt holder					
From National Bank of Hungary	1.5	2.5	3.5	2.7	5.6
From deposit money banks	..	...	...	...	7.0
Other domestic sources	2.0	1.1	1.0	6.8	2.4
B. By type of debt instrument					
Long term	1.5	2.5	3.5	2.7	12.6
Changes in cash deposits, etc.	2.0	1.1	1.0	6.8	2.4

Source Data provided by the Hungarian authorities.

1/ As in State budget, this table includes all transactions of the Central Government, current and part of capital expenditures of local authorities, and net transfers to special state funds.

2/ Foreign lending and borrowing are included above the line, as expenditure and revenue items, respectively.

Table 34. Hungary: The State Budget 1/

(In billions of forint)

	1978	1979	1980	1981	1982 Approved budget	1981 First quarter	1982 First quarter estimate
	Outcome						
Expenditures							
Investment	77.3	81.9	69.6	59.7	55.3	9.9	7.8
Price support	126.5	135.4	131.8	144.5	152.9	35.5	38.9
Social security	53.6	62.2	77.7	90.4	97.3	21.9	23.9
Health, education, culture	46.1	49.6	56.0	67.6	72.6	21.9	24.1
Defense, internal security	24.2	25.5	27.8	30.9	32.6		
Other	58.7	60.6	64.6	89.0	65.8	18.8	18.3
Total expenditures	386.4	415.2	427.5	482.1	516.5	108.0	113.0
Revenue							
Direct taxes							
Wage taxes and social security contributions	59.4	60.8	53.7	63.7	71.8	15.3	17.5
Profit taxes	97.0	99.2	102.6	121.1	115.2	24.7	24.0
Production taxes	57.3	60.7	21.9	20.6	28.5	5.5	6.4
Taxes on capital	28.8	30.9	2.4	1.1	0.6	0.1	0.1
Total direct taxes	242.5	251.6	180.6	206.5	216.1	45.6	48.0
Indirect taxes							
Turnover taxes	30.6	52.0	131.9	152.7	162.1	35.7	38.4
Tariffs and import taxes	32.8	31.3	22.0	23.7	26.8	6.9	6.5
Total indirect taxes	63.4	83.3	153.9	176.4	188.9	42.6	44.9
Other revenues	77.0	76.7	88.5	89.7	86.5	17.9	18.6
Total revenues	382.9	411.6	423.0	472.6	491.5	106.1	111.5
Budget deficit	3.5	3.6	4.5	9.5	15.0	1.9	1.5

Sources Ministry of Finance, and Official Gazette.

1/ Fiscal year is same as calendar year.

Table 35. Hungary: State Budget Expenditure 1/
(Functional Classification)

(In billions of forints)

	1978	1979	1980	1981	1982
General public services	5.7	6.1	6.6	7.4	8.2
Defense	15.0	15.4	16.9	19.1	20.1
Public order and safety	9.2	10.1	10.9	11.8	12.5
Education	21.3	22.6	23.4	29.1	31.8
Health	14.1	15.5	17.7	19.6	21.6
Social security and welfare	55.4	64.3	80.1	93.3	100.4
Housing and community amenities	5.9	6.9	8.4	11.2	12.6
Recreation, culture, and religion	9.0	9.4	12.5	15.9	16.2
Economic affairs and services	<u>19.2</u>	<u>19.0</u>	<u>20.7</u>	<u>33.1</u>	<u>32.3</u>
Total expenditures	154.8	169.3	197.2	240.5	255.7

Source: Data provided by the Hungarian authorities.

1/ Equivalent to total of wages and salaries and other purchases of goods and services in Table 4. Thus this total excludes interest payments, subsidies, and various transfers as well as capital expenditures.

Table 36. Hungary: State Budget Expenditure
(Economic Classification)

(In billions of forints)

	1978	1979	1980 <u>1/</u>	1981	1982
Current expenditures					
Wages and salaries	26.5	30.0	41.1	43.7	46.9
Other purchases of goods and services	128.3	139.4	180.5	196.8	208.8
Of which: Social security	(53.6)	(62.2)	(83.7)	(90.4)	(97.3)
Interest payments <u>2/</u>	3.8	4.3	5.1	5.7	7.7
Subsidies	126.5	135.4	131.8	144.5	152.9
Of which: Price subsidies	(40.9)	(43.2)	(53.9)	(62.1)	(65.4)
Other current transfers	21.1	20.0	18.1	31.7	34.9
Transfers to local governments	13.4	16.0	38.0	32.4	35.1
Transfers to social security system	<u>2.9</u>	<u>4.2</u>	<u>5.7</u>	<u>..</u>	<u>..</u>
Total current expenditures	309.1	333.3	382.3	422.4	451.2
Capital expenditures					
Acquisition of fixed capital assets	41.1	42.2	33.2	29.1	24.4
Capital transfers to other levels of government	<u>36.2</u>	<u>39.7</u>	<u>36.4</u>	<u>30.6</u>	<u>30.9</u>
Total capital expenditures	77.3	81.9	69.6	59.7	55.3

Source: Data provided by the Hungarian authorities.

1/ Due to change of coverage in 1980, 1979 and 1980 are not on a comparable basis.

2/ Includes interest subsidies on housing.

Table 37. Hungary: State Budget Revenues

(In billions of forint)

	1978	1979	1980	1981	1982
Direct tax revenue					
Taxes on wages	14.5	12.7	1.8	...	...
Profit taxes	97.0	99.2	102.6	121.1	115.2
Production taxes	57.3	60.7	21.9	20.6	28.5
Social Security contributions	44.9	48.1	51.9	63.7	71.7
Other direct taxes	<u>28.8</u>	<u>30.9</u>	<u>2.4</u>	<u>1.1</u>	<u>0.7</u>
Total direct taxes	242.5	251.6	180.6	206.5	216.1
Indirect tax revenue					
Turnover taxes	30.6	52.0	131.9	152.7	162.1
Of which:					
Producer's differential turnover tax	...	...	71.0	86.3	89.1
Consumer turnover tax	30.6	52.0	60.5	66.4	73.0
Import duties	<u>32.8</u>	<u>31.3</u>	<u>22.0</u>	<u>23.7</u>	<u>26.8</u>
Total indirect taxes	63.4	83.3	153.9	176.4	188.9
Total tax revenues	305.9	334.9	334.5	382.9	405.0
Nontax revenue					
Property income of nonfinancial public enterprises and public financial institutions	8.7	10.0	10.9	33.6	33.0
Other property income	1.7	1.8	1.9	0.8	0.5
Administrative fees and charges, etc.	4.0	4.5	4.7	4.8	4.8
Other nontax revenue ^{1/}	53.6	50.3	59.1	36.7	33.8
Capital revenue	<u>9.0</u>	<u>10.1</u>	<u>11.9</u>	<u>13.8</u>	<u>14.4</u>
Total nontax revenue	77.0	76.7	88.5	89.7	86.5
Total revenue	382.9	411.6	423.0	472.6	491.5

Source: Data provided by Hungarian authorities.

^{1/} Includes foreign borrowing.

Table 38. Hungary: Local Governments Development Fund

(In billions of forint)

	1978	1979	1980	1981	1982
Tax revenue	7.7	7.7	11.5	12.5	11.6
Other revenue	4.6	5.0	4.6	4.8	4.1
Grants from other levels of Government	<u>21.6</u>	<u>24.3</u>	<u>19.7</u>	<u>15.5</u>	<u>16.0</u>
Total revenues	33.9	37.0	35.8	32.8	31.7
Expenditures	<u>36.8</u>	<u>40.3</u>	<u>39.6</u>	<u>36.9</u>	<u>35.0</u>
Deficit or surplus	-2.9	-3.3	-3.8	-4.1	-3.3

Source. Hungary - Ministry of Finance.

Table 39. Hungary: Summary Social Security Funds

(In billions of forint)

	1978	1979	1980	1981	<u>1982</u> Forecast
Tax revenue	50.1	53.6	59.5	63.8	71.8
Nontax revenue	<u>0.6</u>	<u>0.9</u>	<u>0.8</u>	<u>0.7</u>	<u>0.7</u>
Current revenue	50.7	54.5	60.3	64.5	72.5
Grants	2.7	4.2	5.7	--	--
Total expenditure	<u>61.8</u>	<u>72.4</u>	<u>84.0</u>	<u>90.4</u>	<u>97.3</u>
Balance	-7.4	-13.7	-18.0	-25.9	-24.8

Source. Ministry of Finance.

IV. Money and Credit

1. The role of money and credit

The financial structure of the Hungarian economy is relatively less complex than that of a developed market economy. In this, it resembles the financial structures of many developing countries with relatively undeveloped money and capital markets. The roles of the central bank and of the commercial banking system are both performed by the National Bank of Hungary. The state banking system is the principal source of credit, since interenterprise credit is, in principle, not allowed. The central financial role of the National Bank facilitates the task of macroeconomic control over the behavior of enterprises as well as households. It also enforces a separation of the two types of money used by these two sectors. Thus, transactions between enterprises and those between the Government and enterprises are conducted entirely with demand deposits, while those between enterprises and households and within the household sector are conducted largely in currency. Enterprises' financial assets consist principally of demand and time deposits. Savings deposits and currency are the main financial assets that households can hold. Although currency is also the main medium of payments for households, a small amount of payments flows through the savings accounts.

In view of this relatively simple institutional and asset structure, the velocity of household money seems to have been relatively stable. With the increasing degree of autonomy ceded to enterprises in their output and investment decisions, credit policy of the National Bank has in recent years played an increasingly important role in regulating aggregate investment. The scope for an active credit policy, based on the cost of credit, which remained largely unexplored before, has become progressively wider. In contrast to the pre-reform system in which the total volume of credit was almost automatically determined by the production and distribution goals set in real terms, the new system accords a more autonomous role to credit policy in the task of macroeconomic management. Profitability of enterprises and an evaluation of their efficiency are factors which the National Bank increasingly has been taking into account in its allocation of credit to enterprises.

Since the National Bank of Hungary 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. It performs all the usual fiscal agency functions carried out by most central banks. In addition, it is the main settlement and clearing center in the economy. Most bank operations such as cash withdrawals, book transfers, and credit extensions involve an audit function. The National Bank of Hungary, in view of this audit function, plays a key role in the economic policy and administrative apparatus.

2. The institutional structure

The National Bank of Hungary, fully owned by the Government, is the sole bank of issue and has the responsibility for establishing and

administering credit policy. The Bank also conducts commercial banking business, accepts deposits, and grants loans to Hungarian enterprises and cooperatives for working capital and investment purposes. The activity of the Bank conforms with the annual economic plan as approved by the Council of Ministers. The Bank is in charge of administering the country's gold and foreign exchange reserves; it carries out payments, credit, and other banking operations relating to foreign trade and other external economic relations; and administers exchange control. The volume and direction of credits to be granted by the banking system, 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.

The Hungarian banking system, which was nationalized in 1947, consists of, in addition to the National Bank of Hungary, the following institutions

a. The State Development Bank (SDB) was established on January 1, 1972, taking over the functions of the Investment Bank, which was dissolved. The principal task of the SDB is the preparation, financing, and control of state investments except those under the supervision of local councils. In the case of infrastructure investment, the plan provides general guidelines and the financing targets. The principal source of funds for the SDB is credits from the National Bank, additional funds may be obtained from the central budget and from loans by the International Investment Bank of the CMEA. The SDB disburses the funds at its disposal in the form of grants and loans. Grants tend to finance infrastructural and mining projects in full and so-called 'productive state investment projects in part. Loans finance much of the remaining portion of major productive state projects. During 1976-80, 58 per cent of the amount invested in 'productive' projects was financed through state loans, 38 per cent through grants, the remaining 4 per cent from other sources. During this period, the share of loans increased and that of grants decreased compared with earlier periods. This trend continued in 1981 when 80 per cent of the amount invested in major productive state investments was financed through loans and only 20 per cent through grants and other sources.

b. The National Savings Bank (NSB), with an extensive branch network, is essentially the bank for the local councils and for the general public. It keeps accounts for and grants credits to the councils, provides a wide range of general banking services to individuals (including personal loans, hire purchase credit, and financing of home building), makes loans to private industry and, on behalf of the National Bank, handles foreign exchange transactions with tourists. Its principal sources of funds are time deposits of individuals. Nearly 90 per cent of the loans of the NSB outstanding at the end of 1981 were long-term credits granted to individuals for the building or purchase of housing. In addition to the NSB, there are savings cooperatives and the postal savings system, essentially extensions of the NSB.

c. The Hungarian Foreign Trade Bank (HFTB) is a fully authorized commercial bank, specializing in import and export trade and in foreign exchange transactions. In these areas its activities supplement those of the National Bank. In recent years it has been responsible for about 20 per cent of Hungary's trade-related convertible currency transactions. In Hungary it deals primarily with small and medium-sized enterprises and has principal responsibility for special types of trade transactions, such as re-export, transit, clearing, barter, and counterpurchase trade. It is also responsible for the development and financing of industrial cooperation type activities, such as wage processing (the import of semi-finished goods to be re-exported after processing or packing), major projects entered into by Hungarian firms with Western partners in production and marketing, and the founding, financing, and supervising of joint enterprises abroad and enterprises established abroad independently by Hungarian firms.

Based on authorizations or guidelines from the National Bank, the HFTB grants short-term import and export credits as well as investment credits for export capacity expansion. Its sources of funds include short-term and medium-term loans, which the HFTB raises on the international capital market.

d. The Central Bank of Exchange and Credit Limited is owned fully by the National Bank and engages in all types of commercial banking and foreign exchange transactions. These latter activities are for the most part effected through Central Wechsel- und Creditbank A.G., Niederlassung Wien, the Bank's branch in Vienna, Austria. In Hungary the Bank sponsors and finances through a special innovation fund the market-oriented development of Hungarian inventions and innovations. It provides risk capital for the development or marketing of innovations judged to be particularly important. The fund obtains its capital partly from central technical developments funds (i.e., the state budget) and partly from a portion of the National Bank's profits.

e. The Central Corporation of Banking Companies conducts special banking activities related to international or, in certain cases, domestic real estate transactions. It is also engaged in supervising and assisting the activities of partly or fully foreign-owned companies operating in Hungary.

f. The Central European International Bank Limited (CEIB) was established in late 1979 as a joint venture by six foreign banks and the National Bank of Hungary. The Bank is an "offshore" bank, especially authorized to conduct commercial banking business in convertible currencies without geographic limitation. Although the Bank is registered under Hungarian company law, it is exempt from Hungarian foreign exchange laws and the regulations of the National Bank. It cannot engage in transactions in forint or transferable ruble.

g. The General Banking and Trust Company represents and handles the claims of Hungarian citizens or institutions abroad and offers its

legal, accounting, and financial expertise in international economic transactions related to Hungarian participation in joint ventures outside Hungary."

h. The Insurance Enterprise of the State is the only insurance company in Hungary. It is engaged in both domestic and foreign insurance business and also in export credit insurance. It writes policies in domestic as well as in foreign currencies.

i. The Interinvest Deposit Company for the Development of Foreign Trade was established in 1980 by 37 foreign trading companies and the Hungarian Foreign Trade Bank. It is designated to operate as a business venture extending credit to any of its founders or their affiliates for the purpose of promoting exports. It is funded partly from a profit tax allowance that cannot be used for any other purpose and partly from the trading companies' development funds.

3. Credit policies

The expansion of total domestic credit has generally paralleled the stance of general economic policies in recent years. Thus, in 1978, the sharp increase in total credit (of 16 1/4 per cent) was a reflection of the excessive growth of domestic demand, including a rapid accumulation of stocks by enterprises. Since 1979, credit policy has generally reflected the shift in economic policy toward a greater effort at external adjustment and total credit has increased by about 10 per cent in 1979 (nominal GDP growth of 8 1/2 per cent) and by 8 to 9 per cent in the last two years (nominal GDP rose by 5 1/2 per cent in 1980 and 7 1/2 per cent in 1981) (Tables 40-43 and Chart 7).

The main objectives of the credit policy in 1981 were (i) the promotion of exports to the convertible currency area by extension of preferential credit, (ii) promotion of import-substituting and energy-saving activities, and (iii) support for small enterprises producing spare parts in short supply or providing services to the household sector. As the external environment deteriorated and the need for a tightening of credit policy in order to restrain demand came to be recognized, the National Bank tried to strike a balance between promoting the above objectives and the objective of macroeconomic restraint over enterprise investment.

Some steps were taken in the last half of 1981 to restrain investment. The minimum profitability test on credits for export promotion--stipulating that an enterprise receiving investment credit had to recoup the cost of the investment in terms of its net foreign exchange earnings over a period of four years after the completion of the project--was tightened. The new rules stipulated that this recoupment period would begin from the date of the initiation of the project rather than its completion. Despite this and other measures such as an increase in interest rates in September 1981, the demand for credit for investment by enterprises remained buoyant. The rates of investment applications and approvals in respect of credit from the National Bank of Hungary

exceeded those in 1980. The industrial sector in general, and the food processing industry in particular, benefited from the growth in credit disbursement. Agricultural cooperatives also increased their demand for credit, their applications for credit doubling from their 1980 level. The average maturity of credits to enterprises for investment purposes (about eight years) remained unchanged compared with 1980.

In 1981, the National Bank's credit guidelines put increased emphasis on the profitability test for enterprises. Currently, a rate of profit of 15 per cent on fixed and working capital is prescribed for the processing industry, of 11 per cent for industries producing basic materials and enterprises engaged in transport and domestic trade, and 8 per cent for the agricultural and service sector enterprises.

As explained earlier, enterprises in Hungary have traditionally carried a large amount of stocks in order to secure their production scheduling from unforeseen delays in deliveries. Working capital credit is granted by the National Bank of Hungary to finance stocks. During the period 1979-81, such credits were about 60 per cent of the total credit extended by the National Bank. Enterprises are expected to finance their working capital requirements related to a 'permanent' increase in working assets out of their own development funds. If their development funds are inadequate for this purpose, the Bank can finance their working capital needs. Since 1981, the guidelines for such financing have been tightened so that enterprises can borrow only up to 50 per cent of the value of the increase in their 'permanent' stocks (calculated as the average stocks over a number of years). Enterprise stockbuilding was at a record high in 1981, when total stocks in the economy increased to Ft 30 billion. Most of the stock accumulation took place in the foreign trade, domestic trade and machinery sectors. Accordingly, credit to finance those stocks rose substantially. There are no rigid rules governing the extension of working capital credits and the National Bank has considerable leeway in determining the volume of such credits.

Although stock accumulation reversed in the first quarter of 1982, mainly reflecting seasonal factors, outstanding working capital credits increased by 9 per cent at end-March compared with their end-March 1980 level, reflecting partly price increases and probably some precautionary borrowing (Tables 42 and 44). They declined in June by about 5 per cent, partly as a result of new restrictions on the extension of such credits imposed in April-May by the National Bank. The planned increase in such credits in 1982--based on preliminary projections of industrial output and producer prices and an anticipated decline in enterprise funds available for working capital purposes--was 9 per cent, compared with the increase of 5 1/2 per cent recorded in 1981. However, steps to reduce stocks and restrain credits taken in June and July are likely to result in a lower rate of increase than that planned earlier.

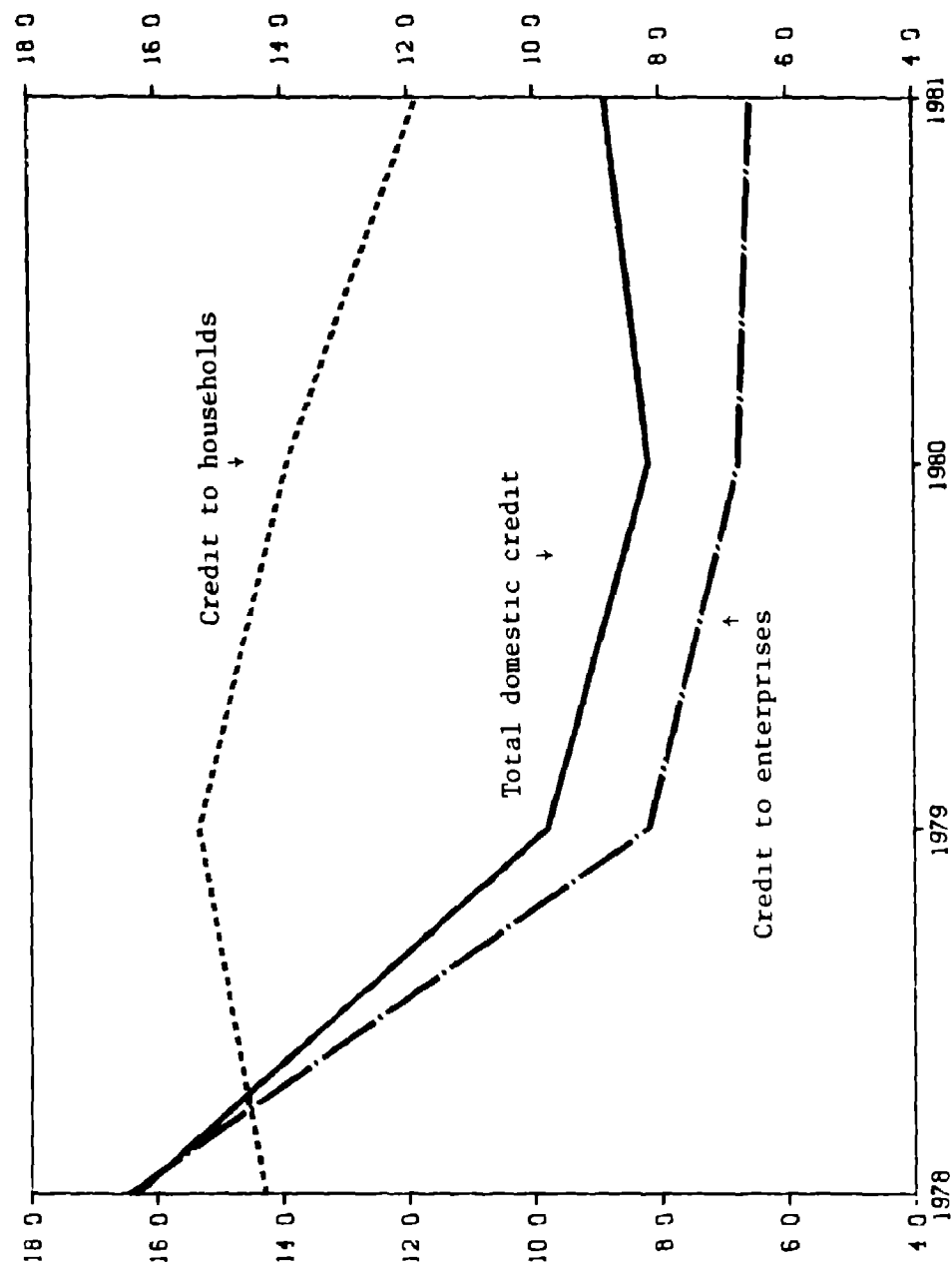
The preliminary plan envisaged little or no increase in outstanding National Bank credits for investment in the year to end-1982. In the first three months of the year, medium- and long-term investment credits by the National Bank rose by about 1 per cent over the corresponding

Chart 7

Hungary

Domestic Credit

(Per cent change over previous period)



period of 1981 (Tables 42 and 44). Nevertheless, enterprise investment continued to be buoyant, partly on account of their improved liquidity position as a result of the sharp increase in profits in 1981.

The distribution of total credit by the main sectors in recent years suggests that the Government sector has preempted an increasing share of total credit. The share of the Government sector (excluding the special funds) rose from about 4 to 5 per cent in 1978-79 to over 16 per cent in 1981. The share of the household sector has been around 25 per cent. The share of the rest of the economy including the enterprise sector has declined from about 70 per cent in 1979 to 60 per cent in 1981. Within the enterprise sector, the engineering goods sectors accounted for about 25 per cent of total investment credits of the National Bank, metallurgy and chemical sectors received about 16 per cent, while light industry and the food processing industry received about 12 per cent each. Although precise data on the share of credit to small enterprises are not available, there are indications that these enterprises--mostly in the services sector--may have experienced some difficulty in obtaining credit from the banking system. In terms of economic sectors, agriculture and exports to the convertible currency area are the two main priority sectors. Almost half of all investment credits extended by the National Bank in the Fifth Five-Year Plan (1976-80) went to projects which added to the nation's export capacity. This emphasis on export promotion to the convertible currency area has continued in the current Five-Year Plan.

Credit to the household sector is extended by the National Savings Bank and is principally for housing (construction and purchase) purposes. Thus, at end-1981, about 90 per cent of the total outstanding credit of Ft 120 billion went for housing. The credits for housing are granted at a highly concessional rate--an average of 2 per cent on long-term loans--and reflects the Government's social policy of promoting the growth of housing. Credit for hire purchases is increasing as a result of a growing demand for consumer durables. In 1981, some steps were taken to curb the rising demand for such credits; these included a reduction in the maturity period of some types of short-term credits and a shortening of the list of consumer goods eligible for hire purchase financing. In the preliminary plan, credits to the household sector were projected to increase by 13 per cent in 1982, compared with the increase of 11 3/4 per cent in 1981, reflecting once again growing demand for housing loans.

4. Interest rates

The National Bank has begun to use interest rate policy more actively than in the past to affect the enterprises' demand for credit. Interest rates on medium- and long-term investment credits as well as those on working capital credits were increased by a percentage point at the beginning of 1981 and again in September 1981. Partly on account of the very liquid position of enterprises, these increases did not have a noticeable restraining effect on the demand for credit. From January 1982, interest rates on investment and working capital credits were raised by 1 percentage point to 11 per cent and 12-13 per cent,

respectively. For investment credits, there was a further increase of 1 percentage point to 12 per cent effective July 1, 1982 (Table 46 and Chart 8). As a result of these increases, real interest rates on credit to enterprises (deflated by changes in producer prices) rose from an average of 2 to 3 per cent during 1981 to about 5 per cent in mid-1982.

Despite the increase in interest rates on credits, there has been no increase in the interest rates paid on the savings deposits of the households (Table 47). The interest rate on savings deposits of one year has remained at 5 per cent for many years and, with the increase in the rate of inflation, it has more recently become negative in real terms. The rate of interest on savings notes issued by the Government was raised in 1981 from 6 to 7 per cent. With the growth of the small private enterprise sector, demand for credit is growing, and there are some indications that an unorganized money market may be developing in Hungary. If deposit rates remain rigid, there is a possibility that some of the household savings may be diverted away from the banking system.

5. Household cash balances

Cash balances of the household sector increased by 12 per cent in 1981 and were growing at a similar rate in the early months of 1982 (Table 41). Demand for cash balances in Hungary has been increasing in recent years, partly on account of the growth of small enterprises which use cash rather than deposits. The growing demand for cash also reflected the increase in demand for consumer durables since many households tended to accumulate cash in order to purchase these. Since the economy is characterized by excess demand in many sectors, the demand for cash balances is correspondingly higher on account of the costs of search, queuing, etc. The growth of the so-called "second economy" in recent years is also contributing to the increased demand for cash. There was some evidence that households were recently shifting their savings from less to more liquid forms. The rate of growth of fixed deposits of longer maturities had slowed down and the use of checking accounts was gradually increasing. The Government intended to promote the habit of payment by check and had raised the interest on current accounts at the National Savings Bank from 3 to 4 per cent in order to encourage the use of such accounts by households. Nevertheless, at present, these accounts were very small, accounting for less than 3 per cent of household deposits.

Chart 8

Hungary

Interest Rates on Enterprise Loans and Household Deposits

(In per cent per annum)

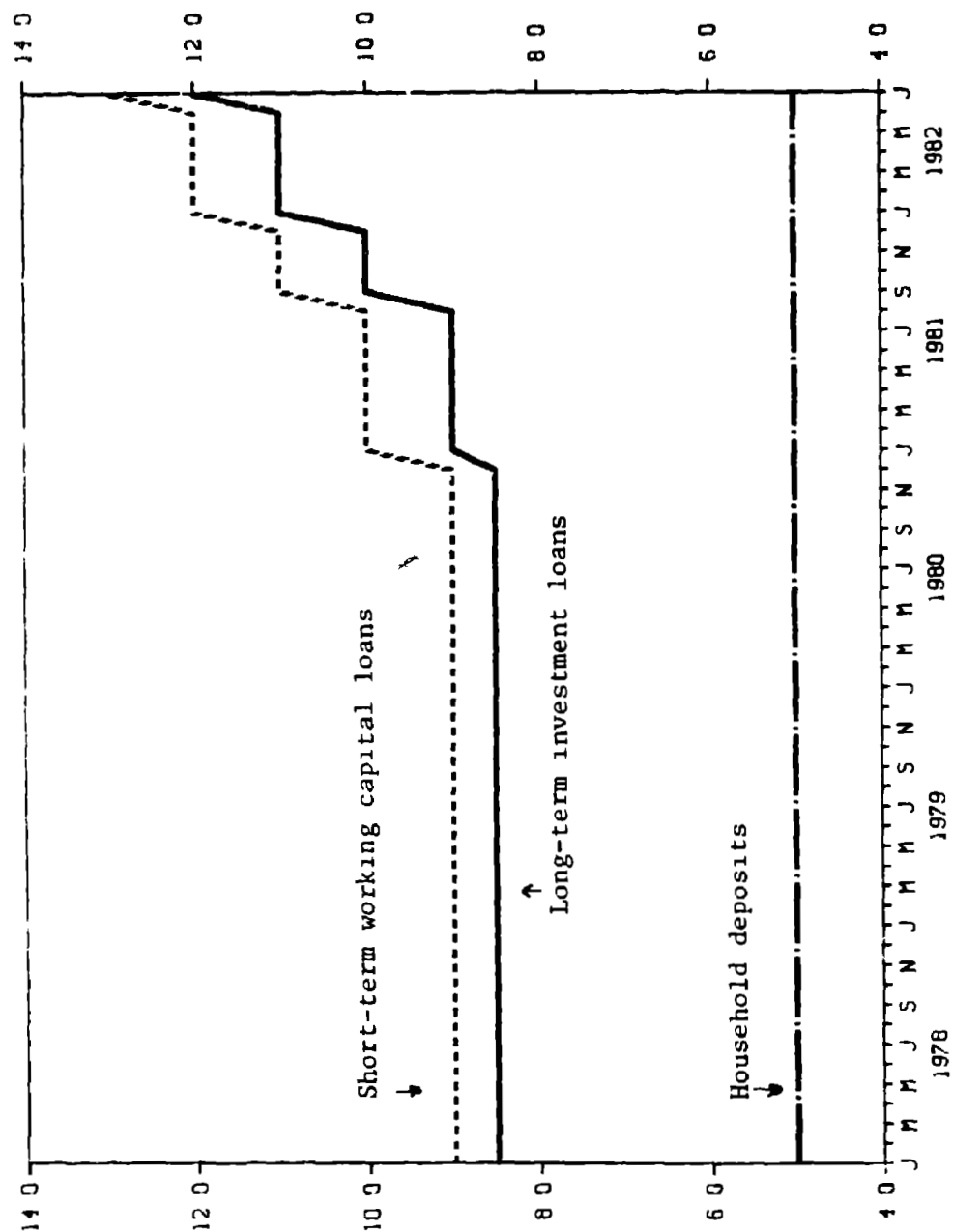


Table 40. Hungary: Monetary Survey 1/
(Outstanding, in billions of forint)

	1977	1978	1979	1980	1981	March 1982
Monetary survey						
Foreign assets (net)	-19.5	-35.7	-22.8	-24.2	-21.1	-32.9
Domestic credit	436.7	508.0 (16.3)	557.8 (9.8)	603.5 (8.2)	657.0 (8.9)	
Claims on government (net)	4.0	5.7	8.5	10.3	19.2	121.2
Claims of households	71.4	81.6 (14.2)	94.1 (15.3)	107.2 (13.4)	119.9 (11.8)	...
Claims on rest of domestic economy	361.3	420.7 (16.4)	455.2 (8.2)	486.0 (6.8)	517.9 (6.6)	...
Money	117.1	125.1 (6.8)	136.4 (9.0)	155.3 (13.9)	167.0 (7.5)	157.5
Quasi-money	145.0	160.3 (10.6)	172.5 (7.6)	186.8 (8.3)	198.1 (6.0)	205.7
Long-term foreign borrowing	117.1	150.7	184.1	185.7	202.8	199.4
Enterprises reserve fund	27.7	31.2	36.2	38.3	40.0	45.8
Other items (net)	10.3	5.0	5.8	13.2	28.0	...

Source: National Bank of Hungary.

1/ Consolidating the balance sheets of the National Bank of Hungary, the National Savings Bank, the Hungarian Foreign Trade Bank, the State Development Bank and the Central Exchange and Creditbank.

Table 41. Hungary: Liabilities of the Monetary Sector
(Outstanding, in billions of forint)

	1977	1978	1979	1980	1981	April 1982
Money	117.1	125.1	136.4	155.3	167.0	158.9
Banknotes and coins						
Enterprises and cooperatives	50.7	57.2	63.5	72.8	81.3	86.0
Individuals	2.7	3.1	3.8	3.5	3.8	3.5
Other	46.5	52.4	58.0	67.9	75.9	81.2
	1.5	1.7	1.7	1.4	1.6	1.3
Demand deposits						
Enterprises and cooperatives	66.4	67.9	72.9	82.5	86.3	72.9
Individuals	54.2	54.6	60.5	67.4	70.0	58.1
Other	2.7	3.2	3.9	4.5	5.8	6.5
	9.5	10.1	8.5	10.6	10.5	8.3
Quasi-money						
Enterprise fixed deposits	145.0	160.3	172.5	186.8	198.1	205.1
Savings deposits	41.9	41.3	44.0	50.2	50.2	51.9
	103.1	119.0	128.5	136.6	147.9	153.2
Broad money	262.1	285.4	308.9	342.1	365.1	364.0

Source: National Bank of Hungary.

Table 42. Hungary: Balance Sheet of the National Bank of Hungary: Assets

(Outstanding at end-period, in millions of forint)

	1977	1978	1979	1980	1981
Gold, currency and foreign exchange, securities, and sight accounts <u>1/</u>	<u>64,123</u>	<u>69,548</u>	<u>74,813</u>	<u>78,375</u>	<u>65,106</u>
Advances, loans, and credits					
Medium- and long-term					
Banks	108,669	134,269	143,691	152,606	162,190
Enterprises	146,056	165,838	185,823	188,663	189,474
State budget	<u>16,381</u>	<u>17,603</u>	<u>20,312</u>	<u>23,686</u>	<u>26,698</u>
	<u>271,106</u>	<u>317,710</u>	<u>349,826</u>	<u>364,955</u>	<u>378,362</u>
Short-term (up to 12 months)					
Banks	8,675	16,922	17,845	19,174	24,767
Enterprises	63,313	74,765	75,364	92,053	103,867
State budget	<u>443</u>	<u>701</u>	<u>512</u>	<u>624</u>	<u>313</u>
	<u>72,431</u>	<u>92,388</u>	<u>93,721</u>	<u>111,851</u>	<u>128,947</u>
Other assets <u>2/</u>	<u>27,388</u>	<u>28,438</u>	<u>28,147</u>	<u>26,399</u>	<u>27,301</u>
	435,048	508,084	546,507	581,580	599,716

Source: National Bank of Hungary.

1/ Gold is valued for 1976-77 at US\$42.22 per ounce; for 1978 at US\$126 per ounce; since the second half of 1979 at US\$226 per ounce. Foreign assets and liabilities are valued at average commercial exchange rates.

2/ Includes fixed assets and investments in the Bank's affiliates.

Table 43. Hungary: Balance Sheet of the National Bank of Hungary: Liabilities

(Outstanding at end-period, millions of forints)

	1976	1977	1978	1979	1980	1981
Authorized capital	6,000	6,000	6,000	6,000	6,000	6,000
Reserves	788	996	1,999	2,050	2,275	3,364
Deposits and other commitments						
Fixed deposits						
Banks	119,654	147,071	191,016	215,614	219,799	225,233
Enterprises	68,374	69,630	72,548	80,249	88,464	90,944
State budget	826	1,036	1,127	1,480	1,324	1,834
Total	188,854	217,737	264,691	297,343	309,587	318,011
Sight deposits and accounts						
Banks	56,510	61,732	80,985	79,823	82,778	84,710
Enterprises	51,113	54,165	54,588	60,513	67,380	70,023
State budget	11,631	11,721	11,469	10,849	12,636	5,960
Total	127,406	137,111	157,178	159,675		171,202
Notes and coins	45,063	50,691	57,156	63,529	72,777	81,343
Other liabilities	4,797	7,107	7,494	7,463	7,690	9,252
Profit	13,933	15,405	13,566	10,447	9,852	10,544
	386,841	435,048	508,084	546,507	581,580	599,716

Source: National Bank of Hungary.

Table 44. Hungary: Short- and Medium-Term Working Capital Credits
by the National Bank of Hungary

(Outstanding, in billions of forints)

	1977	1978	1979	1980	1981	March 1982	June 1982
Industry total	73.1	85.3	87.6	97.4	101.0	107.1	98.6
Of which:							
Engineering	16.2	18.9	21.4	25.3	24.9	28.7	29.1
Light industry	8.6	9.5	8.1	9.0	7.7	10.7	9.6
Food processing industry	23.9	29.7	30.4	28.9	32.9	25.0	16.2
Construction	11.1	12.0	11.4	11.7	12.6	18.0	20.1
Agriculture and forestry	15.4	17.5	19.6	22.2	24.7	35.9	44.8
Domestic trade	10.5	10.7	9.0	10.3	12.1	15.4	15.4
Specialized trading enterprises	18.6	19.7	20.9	18.1	17.6	18.6	17.1
Other	9.5	10.1	11.6	13.7	15.2	14.2	15.0
Total	127.1	143.3	148.7	161.7	170.6	191.2	190.9

Source: National Bank of Hungary.

Table 45. Hungary: Medium- and Long-Term Investment Credits
by the National Bank of Hungary

(Outstanding, in billions of forints)

	1977	1978	1979	1980	1981	April 1982
Investment credits	82.2	97.3	112.5	119.0	122.7	114.0
To cooperatives	11.7	12.1	12.5	14.3	15.9	16.5
To enterprises	70.5	85.2	100.0	104.7	106.8	97.5
Which includes:						
Industry	54.9	68.5	81.8	85.2	83.4	74.1
Engineering	19.9	23.9	26.4	27.2	26.5	23.5
Light industry	13.0	14.3	15.0	13.6	12.4	10.2
Metallurgy	3.3	4.5	5.8	6.6	6.4	6.1
Chemicals	5.3	6.2	7.8	8.8	12.1	9.7
Food processing	4.8	7.4	11.4	12.9	12.9	11.9
Nonindustrial activities	15.6	16.7	18.2	19.5	23.4	23.4

Source: National Bank of Hungary.

Table 46. Hungary: Deposit and Loan Interest Rates for Households
(In per cent per annum)

	1975	1978	1981	Real 1/ 1981
Deposits				
Time and savings deposits	2-5	2-5	2-5	- 6-0.4
Premium deposits	3.8	4	4-4.7	-0.6-0.1
Savings notes	--	6	6-7	1.4-2.4
Check accounts	0-3	0-5	0-6	-4.6-0.4
Loans				
Housing loans	0-6	0-6	0-6	-4.6-1.4
Hire purchase loans	6-8	6-8	6-8	1.4-3.4
Agricultural loans	6-8	6-8	6-8	1.4-3.4
Loans to small private business	6-10	6-10	7-10	2.4-5.4
Personal loans	8	8	8-10	3.4-5.4

Source: National Bank of Hungary.

1/ Defined as nominal rate minus the consumer price increase during the year.

Table 47. Hungary: Interest Rates on Credits to and Deposits from Enterprises
(In per cent per annum)

	Basic interest rate					
	From Dec. 1, 1970	From Feb. 1, 1975	From Jan. 1, 1981	From Sept. 1, 1981	From Jan. 1, 1982	From July 1, 1982
Interest rates on credits						
State development loans	7	7-8.5	8	9	10	10
Investment credits						
Long-term credits	8	8-9.5	9	10	11	12
Medium-term credits	9	9-10.5	10	11	12	12
Short term credits (granted for the anti- icipation of amortization)	9	9	10	11	12	12
Working capital credits						
Medium-term working fund credits	9	9	10-11	11-12	12-13	13-14
Working fund supplementary credits	5-8	9	9	9	9	
Short-term capital credits	8	9	10	11	12	13
Other credits						
Credits for innovation purposes			9	10	11	11
Medium- and long-term export credits	6	6	7 25	7.25	8 25	8.25
Reorganization credits	6	6	6	7	8	8
Credits for advancing the technical development fund medium-term	7	8	9	10	11	11
Interest rates on deposits						
For time deposits fixed for at least						
Six months	2	3	2	3	3	3
One year	3	5	3	6 1/	4	6 1/
Eighteen months	4	6	4	7 1/	5	7 1/
Two years	6	8	6	9 1/	7	9 1/

Source National Bank of Hungary

1/ In case of voluntary deposits.

V. External Sector 1/

1. Summary

Three distinct phases characterized the evolution of the balance of payments during the 1970s. Until 1974, the trade balance was in approximate equilibrium as surpluses and deficits alternated. Over the same period, the external current deficit averaged 0.5 per cent of GDP (Chart 9). Subsequently, the current account deficit widened rapidly to more than SDR 1.1 billion in 1978, equivalent to 8.7 per cent of GDP. This reflected in part a lack of adjustment to the worsening external environment. Financing the current deficits caused a rapid expansion of foreign borrowing and gross external debt tripled from the end of 1973 until the end of 1978.

The trend of rapidly widening current deficits was reversed after 1978 as the current deficit was reduced to SDR 0.7 billion in 1979 and SDR 0.4 billion, equivalent to 2.6 per cent of GDP in 1980 (Table 48). The improvement in the external current balance was achieved despite a continued widening of the deficit in respect of services and transfers and reflected a substantial improvement of the trade balance in response to increased export capacity and control of domestic demand.

This trend was arrested in 1981. In spite of a small trade surplus, the current deficit increased again in 1981 to about SDR 0.8 billion, equivalent to 4.2 per cent of GDP. This, together with a sharp reduction in net capital inflows, resulted in a swing of the overall balance of payments from a surplus of SDR 0.4 billion in 1980 to a deficit of SDR 0.3 billion in 1981. Net capital inflows decreased from SDR 0.9 billion in 1980 to SDR 0.3 billion in 1981, mainly on account of a sharp reduction in net short-term credits received.

During the first quarter of 1982, a relatively large current account deficit (SDR 0.3 billion) and exceptionally large net outflows of non-monetary short-term capital (SDR 0.9 billion) resulted in an exceptionally large reduction in international reserves. The latter fell from SDR 1.5 billion at end-1981 to SDR 430 million at end-March 1982. The liquidity situation remained difficult thereafter, although the international reserves recovered during the second quarter to SDR 550 million at end-June 1982.

1/ Comments on overall balance of payments developments are based on data provided by the National Bank of Hungary (NBH), while comments on specific foreign trade developments are based on data provided by the Central Statistical Office (CSO). Owing to the use of different concepts especially with respect to exports and imports of merchandise and tourism receipts and expenditures, the two data series may differ significantly.

2. Exchange rate developments and changes in competitiveness ^{1/}

Starting in 1968, the exchange rate has been used more actively as an instrument of economic policy. In 1968, the exchange rate system was substantially simplified through the unification of a multitude of foreign trade coefficients. ^{2/} This simplification reduced the number of exchange rates to three: the foreign exchange forint used for statistical purposes, the value of which was based on gold parities; the noncommercial rate of exchange of Ft 30 = US\$1 which applied to tourism and certain other nontrade transactions; and the commercial rate of exchange of Ft 60 = US\$1. The foreign exchange forint was abolished in 1976, reducing the number of rates to two. The noncommercial rate of exchange was adjusted proportionately with the commercial rate until February 1979, when a gradual narrowing of the spread between the two rates was initiated. The noncommercial rate was depreciated gradually from Ft 20.33 = US\$1 to Ft 35 = US\$1 on October 1, 1981, when the commercial and noncommercial rates were unified.

The basic principle of exchange rate policy during the period since 1968 has been to adjust the exchange rate to limit the influence of foreign inflation on domestic prices. However, in adjusting the exchange rate some consideration has been given to the profit situation of exporting enterprises. Thus, adjusted for relative rates of inflation, ^{3/} the effective exchange rate index relative to the currencies of Western trade partners (Chart 10) shows no overall trend during the 1970-81 period, periods of depreciation (1970-74 and 1977-79) alternated with periods of appreciation (1975-76 and 1980-81). However, a marked deterioration in export price competitiveness during 1980-81 virtually offset the improvement recorded during 1977-79, and this trend continued in early 1982.

The exchange rate for the forint relative to the transferable ruble appreciated by 48 per cent on a cumulative basis from 1968 until 1981. Exchange rates for the forint relative to the national currencies of member countries of the CMEA were also adjusted during this period, although generally by smaller amounts. ^{4/} Except for the exchange rates relative to the Bulgarian lev, the Cuban peso, the Polish zloty, and the Vietnamese dong, the adjustments resulted in a depreciation of the forint.

^{1/} Recent developments in the exchange and trade system are described in detail in Chapter VI.

^{2/} These were in effect exchange rates which were previously implemented through taxes and subsidies differentiated almost at the product level.

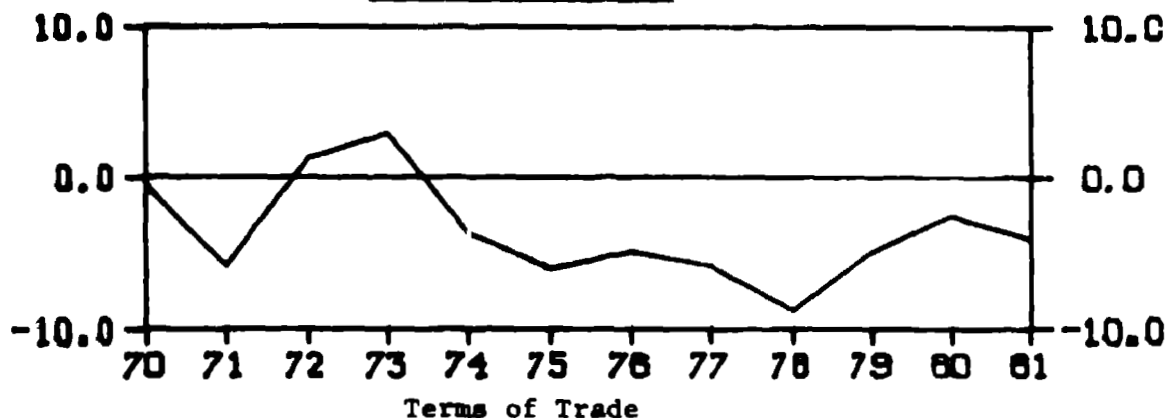
^{3/} Wholesale prices proxied by producer prices.

^{4/} Trade-related settlements with member countries of the CMEA are effected in transferable rubles and those with Albania and the Democratic People's Republic of Korea in clearing rubles.

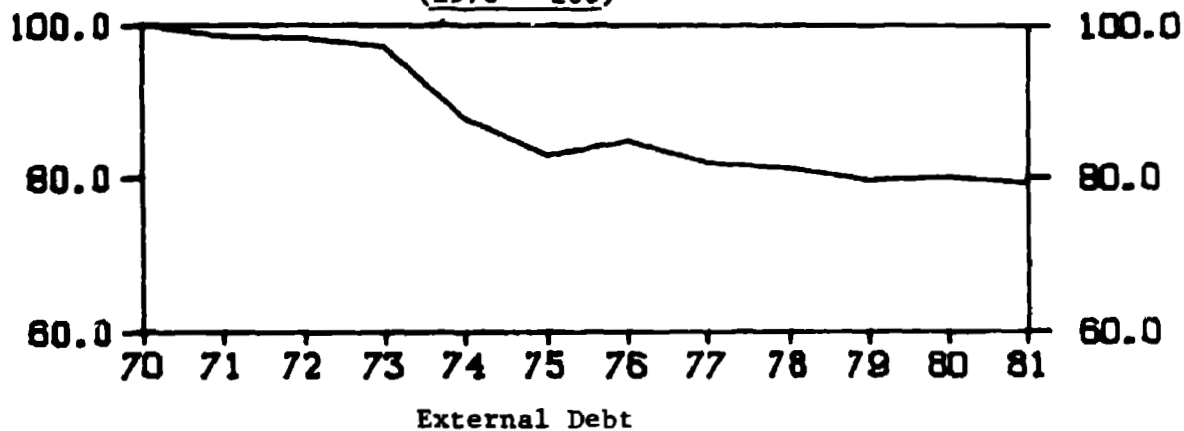
Chart 9
Hungary
External Current Deficit, Terms of Trade,
and External Debt

External Current Balance

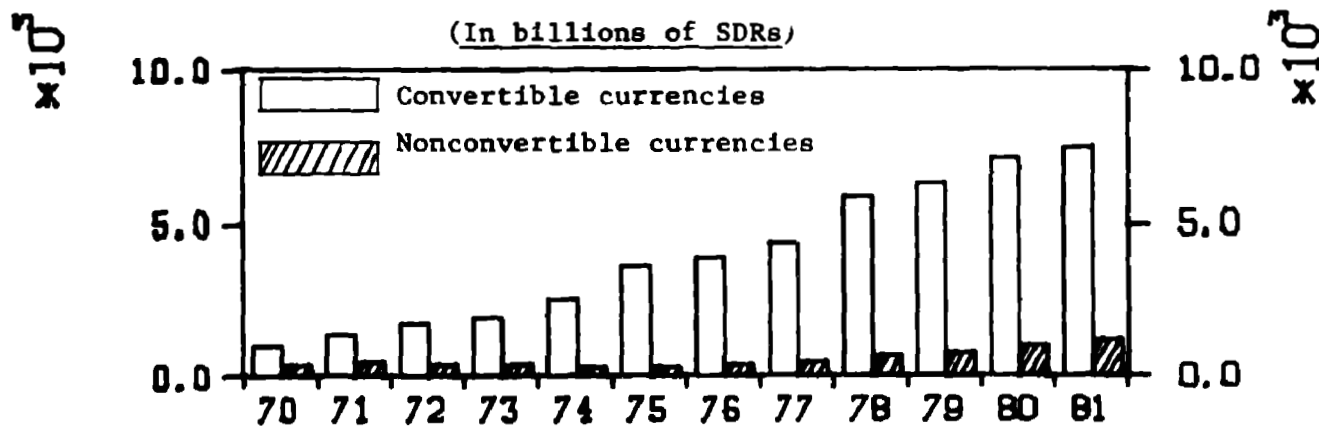
(In per cent of GDP)



(1970 = 100)



(In billions of SDRs)



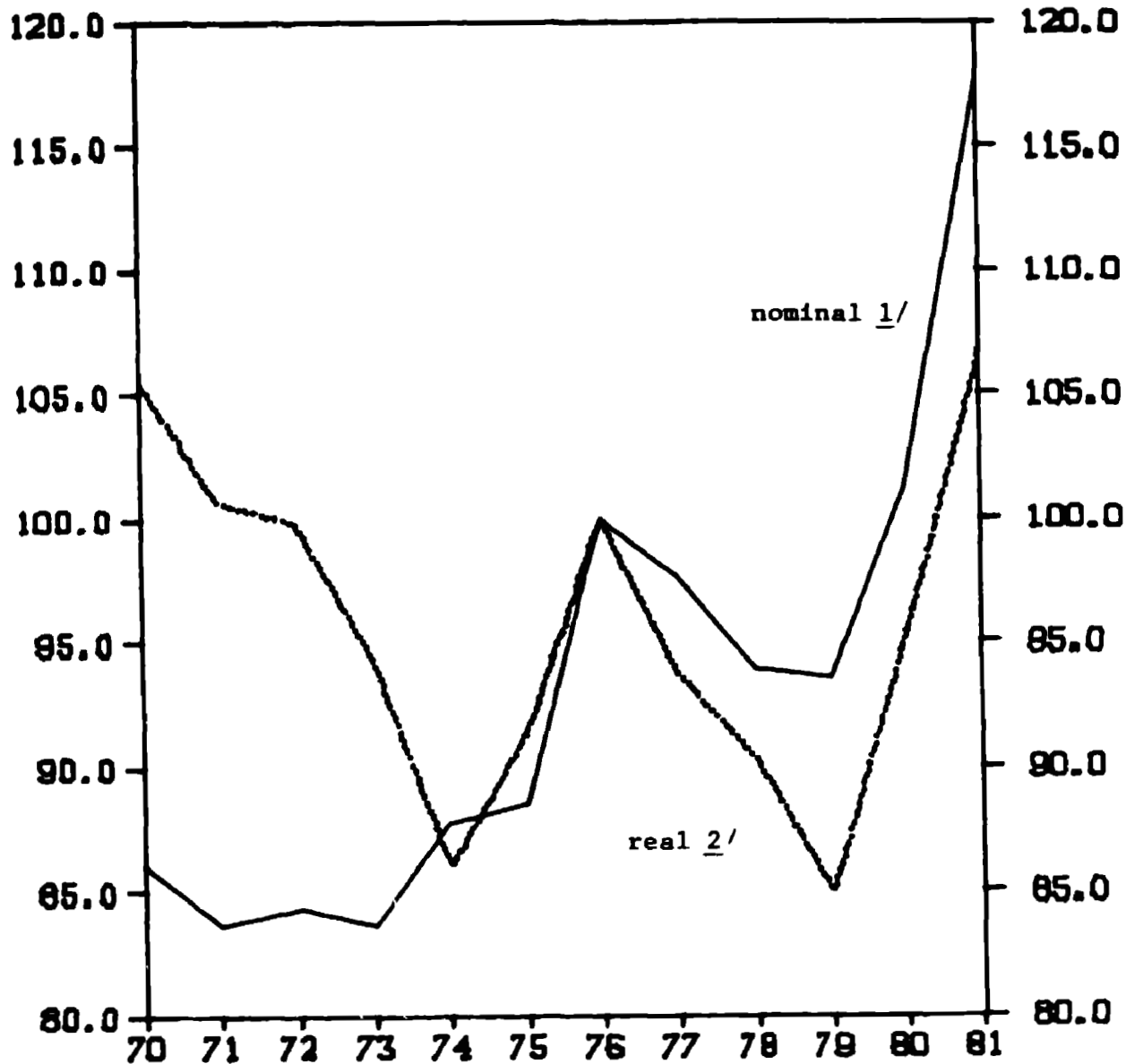
Source: National Bank of Hungary.

Chart 10

Hungary

Exchange Rate Developments, 1970-1981

(1976 = 100; Annual Data)



Source: Staff estimates.

1/ Nominal effective exchange rates calculated on the basis of the basket of nine currencies used by the National Bank of Hungary in setting the exchange rate for the forint and of weights derived on the basis of the geographical destination of Hungary's exports in convertible currencies in 1981.

2/ Nominal deflated by producer prices.

3. Developments in the current account ^{1/}

The current account deficit of the balance of payments, which had increased to SDR 1.1 billion in 1978, was subsequently reduced to SDR 0.7 billion and SDR 0.4 billion in 1979 and 1980, respectively (Table 48). The narrowing of the current deficit reflected an improvement in the trade balance and was especially marked in the case of the deficit in convertible currencies (Tables 49 and 50) which fell to SDR 0.3 billion in 1980. Four major influences were responsible for the improvement of the balance of payments on current transactions during 1978-80: (a) the decline in the rate of growth of domestic demand; (b) the reversal of the stockbuilding of 1978, as bank credit policy was tightened during the second half of 1978, (c) the expansion of export capacity; and (d) the increase in world demand.

The trend to smaller current deficits was arrested in 1981 and for the year as a whole a large current account deficit of about SDR 0.8 billion was recorded mainly on account of a rapidly widening deficit on current external transactions settled in convertible currencies. Stepped-up interest payments on short-, medium-, and long-term credits received more than offset the increase in the trade surplus and in receipts from tourism in convertible currencies. The trade surplus in convertible currencies increased from SDR 0.2 billion in 1980 to almost SDR 0.4 billion in 1981, due mainly to improved terms of trade (Table 51). The current account deficit in nonconvertible currencies decreased somewhat in 1981, in spite of a somewhat larger trade deficit that resulted from a further deterioration in the terms of trade.

Current external developments continued to deteriorate during the first quarter of 1982, mainly on account of a large trade deficit in non-convertible currencies due to a continued deterioration in the terms of trade and large interest payments in convertible currencies and a current account deficit of SDR 312 million was recorded in the first quarter of 1982.

a. Exports

Exports increased strongly during 1977-79, reflecting the emphasis on export promotion that was a major element in adjustment policies. These policies included credit and external borrowing policies geared to production of exports.

Since 1980 the growth of exports has slowed considerably. In both 1980 and 1981 total export receipts increased by less than 11 per cent in SDR terms ^{1/} (Table 48). Convertible currency exports increased by less than 11 per cent (in SDR terms) in 1981 compared with 19 per cent ^{1/} (in SDR terms) in 1980 and 24 per cent (in SDR terms) ^{1/} in 1979 (Table 49). There was a somewhat faster growth (14 per cent) in exports settled in rubles in 1981 and an acceleration in the growth (30 per cent) of exports

^{1/} Based on balance of payments data provided by the NBH.

to socialist countries settled in currencies other than rubles (Table 52). Export receipts continued to increase during the first four months of 1982, but at a lower rate. There was, however, a marked slowdown in the growth of exports to the socialist countries settled in currencies other than rubles, owing to a large extent to a continuing slowdown in demand and increasing lack of foreign exchange in these countries.

The volume of total exports increased by only 2.6 per cent in 1981 ^{1/} (Table 53). The volume of convertible currency exports increased by only 1.7 per cent in 1981, compared with 2.1 per cent in 1980, due mainly to continuing stagnation in Western markets and restrictive measures ^{2/} in those markets. Other factors that influenced the export performance were the price reform, which gave the enterprises an incentive to raise export prices (even at the cost of a loss of market shares) and a continuing deterioration in export price competitiveness, which resulted in part from the appreciation of the forint against the currencies of most of the EC countries. Exports in rubles increased by almost 4 per cent in volume terms in 1981, mostly on account of large agricultural, food, and chemical exports.

Exports of industrial and manufactured goods, which account for more than two thirds of total exports, developed moderately in 1981. Exports of chemicals performed relatively well both in value and volume terms. They expanded by 12 per cent in volume terms in 1981, owing to large exports of nitrogen fertilizer, this result was achieved in spite of continuing unfavorable market conditions for tire and PVC exports (Table 53). By contrast, the export performance of the metallurgical and light industrial sectors remained poor in 1981. Exports of manufactured goods and machinery declined in volume terms, in spite of significant gains in machinery exports to the nonsocialist countries. In a number of cases, (e.g., metal products, rolled articles, aluminum, most light industrial products), the effects of declining export volumes were aggravated by declining prices. Exports of some light industrial products (e.g., footwear, textiles, and clothing articles) were adversely affected by buoyant domestic demand. Exports of industrial and manufactured goods other than chemicals to the socialist countries continued to decrease in volume terms as a result of low demand.

Convertible currency exports of agricultural and food products performed well in 1981, owing to a large extent to large exports of wheat and meat to socialist countries. Such exports to the nonsocialist countries continued to fall in volume terms, mainly because of the restrictive provisions of the EC Common Agricultural Policy and the accession of Greece to the European Communities.

Price developments were more favorable in 1981, with an overall increase of about 5 per cent due to large price increases on exports to the socialist countries (Table 54). Export prices on the nonsocialist markets remained sluggish.

^{1/} Based on foreign trade data provided by the CSO.

^{2/} The effects of these measures are discussed in detail in subsection b.

During the first four months of 1982, exports to the ruble area took place as planned, while exports to the nonruble area increased by 1.4 per cent in volume terms. 1/ Compared with the first four months of 1981, exports to the ruble area were up by 9 per cent. There was a noteworthy increase in machinery exports; deliveries of oil and coal were on target. Exports of machinery to the nonruble area expanded by 40 per cent, notwithstanding a 4 per cent decline in prices in dollar terms. Agricultural exports increased by 6 per cent. As in 1981, the light industrial sector encountered serious difficulties, and foreign sales declined by almost 10 per cent. The chemical sector also encountered difficulties, with 30 per cent less exports in the first four months of 1982 than in the same period of 1981. This poor performance was due both to market access difficulties and to the continuing appreciation of the forint against the currencies of the EC countries. Prices were also unfavorable, with export prices for most agricultural and food exports declining noticeably and export prices for other industrial and manufactured products remained depressed. These developments contributed to a 1.1 per cent decline in the terms of trade during the first four months of 1982.

b. The effects of restrictive measures in foreign markets on export earnings

In recent years, Hungary's exports to the western markets have been adversely affected by restrictive measures applied in these markets. These include the restrictive provisions of the EC Common Agricultural Policy (CAP), customs duties and import quantitative restrictions in both EC and non-EC countries, tariff disadvantages in both EC and EFTA markets, and an increasingly large number of nontariff barriers. About 46 per cent of Hungarian exports in convertible currencies are now subject to such restrictive measures.

The restrictive measures applied in the main markets for Hungarian exports affect both agricultural and food exports and industrial and manufactured exports. According to official preliminary calculations, these measures resulted in a potential loss in 1981 in export earnings of up to SDR 320 million, 2/ excluding an additional loss of SDR 150 million 3/ on account of tariff disadvantages.

According to the same calculations, Hungarian agricultural exports to the EC markets, including Greece, suffered a loss of about SDR 220 million

1/ Exports settled in currencies other than rubles increased by 1.6 per cent only in volume terms, during the first quarter of 1982, this compares with a 9 per cent increase during the first quarter of 1981. Exports settled in rubles decreased during the first quarter of 1982 but were in line with the original Plan targets and the seasonal pattern. However, prolonged contract negotiations and transportation problems, in certain cases, had also some adverse effects on the relatively poor outcome compared with that of the first quarter of 1981.

2/ Estimate based on calculations made by both the National Bank of Hungary and the Ministry of Foreign Trade.

3/ Estimate of the Ministry of Foreign Trade.

on account of both price and volume factors resulting from the restrictive provisions of the CAP. Losses due to price factors stemmed from the need for Hungary to export competitive products in terms of quality and price to non-European markets at lower prices. High-quality meat exports were subject both to relatively severe import quotas and to a voluntary restraint agreement, which gave rise to a potential loss of SDR 110 million. The accession of Greece to the European Communities resulted in an additional loss of SDR 25 million on account of reduced meat exports. Hungarian agricultural exports were also adversely affected by protectionist measures in the Austrian and Swiss markets.

A number of manufactured and industrial products were subject to quantitative restrictions and discriminatory measures in both EC and non-EC markets. Such measures are deemed to have induced a loss of at least SDR 55 million; this estimate excludes the potential effects, which result from the fact that import quotas could not be opened for certain exports for which Hungary had some competitive advantage. In addition, exports of textiles, clothing articles, and steel were subject to voluntary export restraints under bilateral agreements reached with the European Communities. Owing to the terms of these agreements, Hungary suffered losses of up to SDR 40 million.

Hungary experienced further losses on account of tariff disadvantages that resulted from tariff policies within both the EC and EFTA markets, including the preferential treatment given to some of Hungary's direct competitors. About 80 per cent of Hungarian exports to the developed Western industrial countries are subject to tariff disadvantages. On the EC markets, the level of tariff disadvantage (weighted according to Hungary's export structure) was estimated at 9.6 per cent in 1981, resulting in a potential loss of export earnings of about SDR 125 million. On EFTA markets, the levels of tariff disadvantage ranged from 6.2 per cent to 14.1 per cent, resulting in a potential loss of SDR 25 million. For a number of specific commodities, the effective tariff disadvantage was such as to discourage exports of these commodities to certain markets.

Hungarian exports have also been adversely affected by increasing nontariff barriers, which affected the exports of a number of commodities to most developed Western industrial markets. Such nontariff barriers ranged from specific import licensing procedures in some of these markets to prior inspection in some other markets on account of quality, safety, or sanitary requirements.

c. Imports

The substantial increase in import payments since the early 1970s reflects both the large increase in oil and raw material prices during the period 1973-75 and the maintenance of relatively ambitious growth targets through the mid-1970s. The volume of imports increased at an average annual rate of 12 per cent from 1976 until 1978, mainly related to the increase in investment spending for both fixed capital formation and stock accumulation in 1977-78. The volume of imports fell by 4 per cent, on a cumulative basis, from 1978 until 1980, largely in response

to both the tightening of demand management policies and a slowdown in stock accumulation. Fluctuations in the volume of imports were particularly marked in the case of convertible currency imports, whose volume increased by 16 per cent in 1978 but fell by 10 per cent and 4 per cent in 1979 and 1980, respectively. These fluctuations reflected both the relatively high income elasticity of demand for imports from the non-socialist area and to the substantial swing in certain imports, e.g., chemicals for stocking purposes.

Total import payments increased by more than 8 per cent in 1981 (in SDR terms) compared to 5 per cent in 1980. 1/ Imports settled in rubles increased slightly faster (10 per cent) than imports settled in currencies other than rubles (9 per cent). The volume of imports settled in rubles continued to decline, while the volume of imports settled in other currencies increased by about 4 per cent. However, the decline in the volume of imports settled in rubles was more than offset by a 9 per cent increase in prices, as contract prices applied to intra-CMEA trade were adjusted with a lag to reflect changes in world market prices. As a result, the share of total imports from the nonsocialist countries declined somewhat in 1981 (Table 55).

The volume of total imports remained virtually unchanged between 1980 and 1981, after a small decline in 1980 (Table 56). 2/ Imports from the nonsocialist countries continued to increase as a result of larger imports of industrial and manufactured goods, including stepped-up imports of consumer goods. There were large volume increases in imports of manufactured goods (17 per cent) and chemicals (about 10 per cent). 3/ Imports of machinery grew 5 per cent in line with enterprise investment requirements, especially in the construction sector as a result of a rebuilding of stocks. The exceptionally large increases in manufactured goods imports was primarily due to strong domestic demand for imported consumer goods, which was facilitated by accommodating credit policies, good enterprise profitability, and an increase in the quota for consumer goods imported from the convertible currency area. Imports of consumer goods increased by almost 20 per cent. The implementation of a border trade agreement with Yugoslavia, which called for an increase in mutual deliveries of goods settled in U.S. dollars also encouraged the import of certain consumer goods. Imports of pharmaceutical products rose as a result of an increased quota allocated to the Ministry of Public Health. Although there were large decreases in imports of mineral fuels and lubricants (almost 30 per cent) and crude materials, this was more or less offset by the large increase in oil prices.

Imports from the socialist countries declined in volume terms (-3.5 per cent), owing primarily to lower imports of machinery (8.5 per cent) and of mineral fuels and lubricants (6 per cent). The share of mineral fuels and lubricants imported from socialist countries represented almost one third of the imports from the socialist countries,

1/ Based on balance of payments data provided by the NBH.

2/ Based on foreign trade data provided by the CSO.

3/ On a SITC basis.

Hungary imports most of its oil from the U.S.S.R., part of which was settled in convertible currencies. Imports of crude materials from the nonsocialist countries also declined in volume terms in 1981, owing to stepped-up imports of such commodities from the socialist countries. Imports of consumer goods settled in rubles increased by 4 per cent in volume terms and 12 per cent in value terms, while they were targeted to decrease under the 1981 Plan. This development resulted from larger barter transactions carried out by the Ministry of Internal Trade, while transactions with border trade areas continued to increase. Another factor was that Hungary imported more consumer goods from the socialist countries in exchange for a larger number of visitors and tourists from the same countries.

Import prices from the nonsocialist countries remained virtually unchanged in 1981. The effects of the reduced import prices for imports of a large number of commodities, including food and live animals, chemicals, and manufactured goods, were offset by those of increased import prices for machinery and mineral fuels and lubricants 1/ (Table 57). Import prices for imports from socialist countries increased by 9 per cent in 1981, mainly because of a sharp increase in the prices of mineral fuels and lubricants. Average import prices from all sources, therefore, rose about 5 per cent.

Imports increased more rapidly than exports in value terms in the first four months of 1982, even though there was an increase of 0.5 per cent only in volume terms. Wage developments, increased investment by the enterprises and continuing stocking of certain goods (e.g., machinery and spare parts) were mainly responsible for the increase in imports. There was a 10 per cent decrease in imports of mineral fuels and related products, owing to a lower consumption by the energy industry. Imports of agricultural products and foodstuffs decreased by 23 per cent, owing to a 10 per cent decline in prices and lower import volumes of coffee, cocoa, and protein fodder. However, there was an exceptionally large increase (40 per cent) in imports of spare parts and accessories, while imports of machinery for investment purposes increased by 18 per cent. Imports of materials and components also continued to increase rapidly. Imports of semifinished products for the manufacturing industry grew by 9 per cent.

Import price developments were uneven during the first four months of 1982. Import prices of agricultural products declined by 13 per cent and those of mineral fuels by 10 per cent. The average import price of materials, components, and machinery remained virtually unchanged.

d. Direction of trade 1/

Exports to socialist countries account for 55-60 per cent of total exports (Table 58). Since a portion of trade with socialist countries is settled in convertible currencies, 2/ however, the share of exports

1/ Based on foreign trade data provided by the CSO.

2/ Trade with the People's Republic of China, Yugoslavia, and with CMEA member countries outside intra-CMEA annual trade agreements.

settled in rubles is somewhat lower, accounting for 45-50 per cent of export receipts. The Federal Republic of Germany (9 per cent of total exports), Austria (more than 4 per cent), and Italy continued to be Hungary's main trading partners in the convertible currency area--in 1981 and early 1982. The share of developing countries increased markedly in recent years to 28 per cent of total exports in 1981, as a result of the authorities' policy of trade diversification. Similarly, exports to the United States, Canada, and Japan increased noticeably in 1981.

Imports from socialist and nonsocialist countries each account for about half of total imports. Including imports from Yugoslavia, the People's Republic of China, and imports from CMEA member countries effected outside the intra-CMEA annual trade agreements, about 55 per cent of imports is effected against payments in convertible currencies. Hungary's main suppliers in the convertible currency area are the Federal Republic of Germany, (about 12 per cent of total imports), Austria (more than 5 per cent), Italy (more than 3 per cent), Switzerland, and France. No significant changes were recorded during the first quarter of 1982.

e. Services and transfers 1/

The payments deficit in respect of services and unrequited transfers widened steadily from SDR 165 million in 1977 to SDR 333 million in 1980 and to SDR 792 million in 1981 (Table 59). The major factor underlying this development has been the rapid increase of the deficit in respect of net interest payments in convertible currencies as a result of the expansion of external debt in the form of floating interest rate credits and of increasing interest rates on world capital markets (Table 60). A surplus continued to be recorded in respect of services in nonconvertible currencies.

Partly offsetting the bigger deficit in investment income, the surplus on travel 2/ in both convertible and nonconvertible currencies increased strongly during 1978-81. Net receipts in currencies other than rubles more than doubled in 1981. These developments continued during the first quarter of 1982, except that net receipts in rubles declined. Important factors which contributed to the increase in travel receipts include the elimination in 1978 of the minimum conversion requirement for incoming tourists, and, in 1979, elimination of the visa requirement for tourists from Austria. In spite of the introduction of the spending/conversion requirement in 1980, both the number of Yugoslav tourists or visitors and average spending by them increased in 1981.

1/ Based on balance of payments data provided by the NBH.

2/ Only actual expenditures by tourists in Hungary or expenditures of Hungarian tourists while abroad are recorded under the travel item. Related transportation expenses and receipts are recorded under "other current items."

4. Nonmonetary capital movements ^{1/}

The financing of the current account deficits and additions to reserves have required an increasingly large reliance on foreign capital in the form of both medium- and long-term credits since the early 1970s (Table 48). In more recent years, however, net medium- and long-term capital inflows have been on a declining trend, owing in part to increasingly large principal repayments and difficulties to raise new medium- and long-term credits in the Eurocurrency markets. As a result, recourse to short-term capital has increased, leading to a rapidly mounting short-term external indebtedness and to a weakening of the overall external financial position.

In 1981, net inflows of medium- and long-term nonmonetary capital in convertible currencies were not sufficient to help finance the increased current account deficit. These developments were primarily due to higher amortization of existing credits and difficulties in raising new medium- and long-term credits. In contrast to previous years, Hungary negotiated only two major long-term financial loans in the second quarter of 1981. Part of the drawings on these two loans was used to offset the effects of the ongoing withdrawal of short-term deposits and to build up international reserves.

Large outflows of short-term nonmonetary capital were recorded in 1981. Seasonal factors helped improve the liquidity position during both the first and the second quarters of 1981, but international reserves declined again during the third quarter of 1981, partly as a result of a weakened underlying current account and lower medium- and long-term net capital inflows, while withdrawals of short-term deposits resumed.

Exceptionally large outflows of short-term capital (mostly in convertible currencies) were recorded in the first quarter of 1982, resulting in net outflows of SDR 0.9 billion (Tables 61 and 62). Such outflows were mostly due to exceptionally large withdrawals of short-term convertible currency deposits by foreign banks, amounting to SDR 720 million and to seasonal factors. Another contributing factor was the external current deficit in convertible currencies of SDR 230 million in the first quarter of 1982. These unfavorable developments were partly arrested in April and May 1982, owing in part to short-term BIS credits of about SDR 190 million and other short- and medium-term borrowing.

5. External debt

Gross external debt trebled from the end of 1973 until the end of 1978. The growth of external indebtedness then slowed down during 1979-80 (Table 63), as a result of lower external current deficits and less recourse to short-term credits. Also, the fact that a substantial portion of the debt was denominated in currencies which have since weakened relative to the SDR also contributed to the lower growth in total indebtedness.

^{1/} Based on balance of payments data provided by the NBA.

At the end of December 1981, total gross short-, medium-, and long-term external debt amounted to SDR 8.6 billion, of which 87 per cent was denominated in convertible currencies. About one third of outstanding external debt in convertible currencies was in the form of loans of original maturities of less than one year. At the end of March 1982, owing to the large short-term capital outflows, gross external debt in both convertible and nonconvertible currencies was reduced to SDR 7.8 billion (of which 85 per cent was in convertible currencies). Short-term debt in convertible currencies declined from SDR 2.6 billion at the end of December 1981 to SDR 1.5 billion at the end of March 1982. Total gross external debt on nonconvertible currencies increased slightly at the end of March 1982, after a significant increase recorded at end-1981. Medium- and long-term external debt in nonconvertible currencies, which increased sharply by the end of 1981, continued to increase during the first quarter of 1982. These developments reflect partly increased trade deficits and partly the transformation of accumulated short-term debt into medium- and long-term debt on a government-to-government basis, in line with normal CMEA practices.

Most foreign borrowing activity is undertaken directly by the National Bank, in order to take advantage of the more favorable terms generally obtained by the National Bank, and to prevent enterprises from circumventing the regulations of domestic credit. As a result, financial loans contracted by domestic financial institutions account for more than 90 per cent of total external debt in convertible currencies. Recourse to suppliers' credits has been limited, representing less than 5 per cent of total external debt in convertible currencies in 1981, however, such recourse increased by 50 per cent in 1981 and continued to increase during the first quarter of 1982.

In contrast, recourse to financial loans in nonconvertible currencies continued to be limited, and diminished substantially in 1981. Such loans represented only about 20 per cent of total external debt in nonconvertible currencies at the end of March 1982. At the same time, however, recourse to intergovernmental credits increased sharply, representing 78 per cent of the total debt in nonconvertible currencies at the end of March 1982 compared with 52 per cent in 1980.

New commitments in terms of medium- and long-term foreign loans amounted to SDR 938 million in 1981, including SDR 923 million in convertible currencies. The latter amount included the two major long-term financial credits mentioned earlier, amounting to SDR 130 million and SDR 340 million, respectively, and a number of smaller medium-term loans. In early 1982, Hungary concluded a number of medium-term operations, including a Sw F 75 million (SDR 34 million) operation with a two-year maturity, a fl57 million (SDR 90 million) bankers' acceptance facility with a two-year maturity, and a US\$10 million (SDR 9 million) facility with Austrian and French banks with a 1 1/2-year maturity.

There was a hardening in the terms of foreign debt denominated in convertible currencies in 1981 and early 1982 (Table 64). The average interest rate on outstanding debt in convertible currencies increased

from 9.7 per cent in 1980 to more than 14 per cent in 1981, compared with less than 6 per cent in 1979. Moreover, Hungary had to pay increasing spreads on several short-, medium-, and long-term loans contracted in 1981 and in early 1982. The conditions of foreign debt denominated in rubles also became somewhat less favorable in 1981, though the average interest rate remained comparatively low and the average maturity continued to exceed that of the loans denominated in convertible currencies.

As a result of the large share of financial loans in total external debt, about 80 per cent of the debt in convertible currencies of original maturities of at least one year outstanding at the end of December 1981 will fall due within five years. In 1982 repayments of almost SDR 0.8 billion came due, about 15 per cent of total medium- and long-term outstanding debt in convertible currencies at the end of December 1981. On the basis of the medium- and long-term debt outstanding at end-March 1982 (Table 65), repayments in 1983 will exceed SDR 0.8 billion. Amortization on medium- and long-term credits in nonconvertible currencies falling due in 1982 and 1983 are less than SDR 1.0 billion a year on a net basis.

In 1981 debt service payments in convertible currencies, including interest payments on debt of original maturity of less than one year, amounted to 35-36 per cent of receipts in convertible currencies from exports of goods and services. Excluding interest payments on debt of original maturities of less than one year, the corresponding ratio was 28 per cent. Total debt service payments (both convertible and nonconvertible), including interest payments on debt of original maturity of less than one year, amounted to about 21 per cent of receipts in both convertible and nonconvertible currencies from exports of goods and services. Excluding interest payments on debt of original maturities of less than one year, the corresponding ratio was 17 per cent.

6. External reserves ^{1/}

Gross external reserves, ^{2/} amounted to about SDR 1.5 billion at the end of December 1981, equivalent to 2 months of imports from all sources (Table 66). Of this amount, 98 per cent was in the form of gold and reserves in convertible currencies, the equivalent of 4.4 months of convertible currency imports. With gold valued at market prices, gross external reserves in gold and convertible currencies amounted to about SDR 2.0 billion, equivalent to 6.0 months of imports settled in convertible currencies. Reserves in nonconvertible currencies include short-term assets in transferable and clearing rubles (including short-term creditor positions at IBEC) and creditor positions on bilateral clearing accounts. Such reserves declined sharply in 1981, due to the large current deficit and outflows of short-term capital.

^{1/} Based on reserves data provided by the NBH.

^{2/} Including actual holdings of 1,668 thousand ounces of gold, valued at SDR 35 per ounce. In the official reserves statistics, gold is valued at US\$42.22 per ounce up to 1978, US\$126 per ounce in 1978, and US\$226 per ounce thereafter.

The large outflows of short-term capital in the first quarter of 1982 led to a sharp decline in gross external reserves to SDR 0.4 billion at the end of March of 1982, equivalent to less than three weeks of imports. With gold holdings of 487,000 ounces valued at market prices, gross external reserves in gold and convertible currencies amounted to SDR 0.5 billion, equivalent to 1 1/2 months of imports in convertible currencies. Reserves in nonconvertible currencies were virtually depleted at the end of March 1982.

Holdings of foreign assets other than reserves amounted to SDR 1.6 billion at the end of March 1982, of which SDR 1.2 billion was denominated in convertible currencies. These assets include working balances of the National Savings Bank and the Foreign Trade Bank and foreign claims of enterprises in the form of export bills and suppliers' credits.

Hungary has bilateral accounts with seven Fund members either in clearing U.S. dollars or in clearing Swiss francs, with one Fund member in transferable rubles and with another Fund member in clearing rubles. At the end of 1981, Hungary had a deficit in its bilateral accounts in clearing U.S. dollars and Swiss francs of SDR 79 million compared with a deficit of SDR 112 million at the end of 1980 (Table 67).

Table 48. Hungary: Balance of Payments, 1977-82

(In millions of SDRs)

	1977	1978	1979	1980	1981	1982 Jan.-March
Exports	5,034	5,246	6,152	6,821	7,542	1,814
Imports	-5,564	-6,194	-6,586	-6,930	-7,509	-1,868
Trade balance <u>1/</u>	-530	-948	-433	-109	33	-54
Freight and insurance (net)	-179	-210	-204	-258	-277	-72
Travel (net)	70	94	139	148	212	28
Investment income (net)	-148	-212	-295	-301	-909	-270
Government expenditure (net)	-25	-27	-31	-31	-37	-7
Unrequited transfers (net)	38	79	33	37	41	10
Other current items (net) <u>2/</u>	<u>78</u>	<u>76</u>	<u>72</u>	<u>69</u>	<u>178</u>	<u>53</u>
Current account	-696	-1,148	-719	-445	-759	-312
Change in capital account, excluding reserves	483	1,453	542	938	346	-926
Direct investment	-5	-3	5	2	2	--
Medium- and long-term credits, net	546	914	719	597	822	4
Received	(558)	(975)	(802)	(726)	(926)	(96)
Extended	(-12)	(-61)	(-83)	(-129)	(-104)	(-92)
Short-term credits, net	-58	542	-182	339	-478	-930
Received	(-94)	(677)	(-193)	(394)	(-409)	(-912)
Extended	(36)	(-135)	(11)	(-55)	(-69)	(-18)
Errors and omissions, net	241	-165	-22	-82	117	-141
Overall balance	28	142	-199	411	-296	-1,379
Change in reserves (- increase)	-28	-142	199	-411	296	1,379
Gold <u>3/</u>	(-6)	(-107)	(155)	(-171)	(-11)	(334)
Foreign exchange	(-22)	(-35)	(44)	(-240)	(307)	(1,045)
Memorandum item						
Forint/SDR (period average)	47.822	47.446	45.967	42.342	40.464	39.263

Sources National Bank of Hungary, and staff estimates.

1/ Certain transactions for freight and insurance are not separable from merchandise trade, on a financial settlements basis. This is thought to affect exports, mainly.

2/ Comprises current account transactions not included elsewhere, notably transportation receipts and payments for goods in transit through Hungary (which goods are not regarded as exports/imports) and tourists' transportation expenses billed separately from the travel item reported above.

3/ Staff estimate: changes in terms of fine troy ounces valued at the period average price for gold in the London market, as reported in IFS.

Table 49. Hungary: Balance of Payments in Convertible Currencies, 1977-82

(In millions of SDRs)

	1977	1978	1979	1980	1981	1982 Jan.-March
Exports	2,280	2,539	3,145	3,736	4,135	1,056
Imports	-2,587	-3,164	-3,274	-3,524	-3,758	-941
Trade balance 1/	-307	-625	-129	212	377	115
Freight and insurance (net)	-127	-144	-145	-182	-183	-50
Travel (net)	34	27	56	65	113	19
Investment income (net)	-140	-201	-283	-314	-898	-282
Government expenditure (net)	-23	-25	-29	-33	-40	-9
Unrequited transfers (net)	18	20	31	35	39	10
Other current items (net) 2/	-100	-45	-129	-67	-25	-37
Current account	-645	-993	-628	-284	-617	-234
Change in capital account, excluding reserves	412	1,375	428	720	286	-983
Direct investment	-5	-3	5	2	2	--
Medium- and long-term credits, net	400	853	611	514	435	-9
Received	(419)	(898)	(697)	(610)	(523)	(85)
Extended	(-19)	(-45)	(-86)	(-96)	(-88)	(-94)
Short-term credits, net	17	525	-188	204	-151	-9 4
Received	(-16)	(622)	(-219)	(216)	(-177)	(-9. 3)
Extended	(33)	(-97)	(31)	(-12)	(26)	(-54)
Errors and omissions, net	246	-156	-13	-38	77	-145
Overall balance	13	226	-213	398	-254	-1,362
Changes in reserves						
(- increase)	-13	-226	213	-398	254	1,362
Gold 3/	(-6)	(-107)	(155)	(-171)	(-11)	(334)
Foreign exchange	(-7)	(-119)	(58)	(-227)	(265)	(1,028)
Memorandum item:						
Forint/SDR (period average)	47.822	47.446	45.967	42.342	40.464	39.263

Sources: National Bank of Hungary; and staff estimates.

Footnotes: See Table 48.

**Table 50. Hungary: Balance of Payments in Nonconvertible
Currencies, 1977-82**

(In millions of SDRs)

	1977	1978	1979	1980	1981	1982 Jan.-March
Exports	2,754	2,707	3,008	3,085	3,407	758
Imports	-2,977	-3,030	-3,312	-3,406	-3,751	-927
Trade balance <u>1/</u>	-223	-323	-304	-321	-344	-169
Freight and insurance (net)	-52	-66	-59	-76	-94	-22
Travel (net)	36	67	83	83	99	9
Investment income (net)	-8	-11	-12	13	-11	12
Government expenditure (net)	-2	-2	-2	2	3	2
Unrequited transfers (net)	20	59	2	2	2	--
Other current items (net) <u>2/</u>	<u>178</u>	<u>121</u>	<u>201</u>	<u>136</u>	<u>203</u>	<u>90</u>
Current account	-51	-155	-91	-161	-142	-78
Change in capital account, excluding reserves	71	78	114	218	60	57
Direct investment	--	--	--	--	--	--
Medium- and long-term credits, net	146	61	108	83	387	13
Received	(139)	(77)	(105)	(116)	(403)	(11)
Extended	(7)	(-16)	(3)	(-33)	(-16)	(2)
Short-term credits, net	-75	17	6	135	-327	44
Received	(-78)	(55)	(26)	(178)	(-232)	(6)
Extended	(3)	(-38)	(-20)	(-43)	(-95)	(38)
Errors and omissions, net	-5	-7	-9	-44	60	4
Overall balance	15	-84	14	13	-42	-17
Change in reserves (- increase)	-15	84	-14	-13	42	17
Memorandum item:						
Forint/SDR (period average)	47.822	47.446	45.967	42.342	40.464	39.263

Sources: National Bank of Hungary; and staff estimates.

Footnotes: See Table 48.

Table 51. Hungary: Trade Indices and Terms of Trade, 1/ 1977-81

(Change from preceding year; in per cent)

	1977	1978	1979	1980	1981	<u>1981</u> <u>Jan.-Mar.</u>	<u>1982</u> <u>Jan.-Mar.</u>
Trade settled in rubles							
Exports							
Value	18.6	0.6	8.1	-7.6	8.9	10.3	1.7
Volume	14.9	1.4	8.8	-1.2	3.9	6.4	-1.7
Price	3.2	-0.8	-0.6	-6.5	4.8	3.9	3.4
Imports							
Value	13.5	10.3	5.9	-5.5	5.3	0.1	4.1
Volume	6.7	8.7	4.7	--	-3.4	-9.3	-3.4
Price	6.4	1.5	1.2	-5.5	9.0	9.4	7.5
Terms of trade	-3.0	-2.3	-1.8	-1.1	-3.9	...	-3.8 <u>2/</u>
Trade settled in currencies other than rubles							
Exports							
Value	14.4	1.2	26.4	5.8	4.7	-7.5	-0.6
Volume	10.5	1.6	15.6	2.1	1.7	9.5	1.6
Price	3.6	-0.4	9.3	3.6	3.0	2.0	-1.9
Imports							
Value	18.6	14.5	--	-0.7	4.4	7.1	1.6
Volume	10.1	15.9	-9.6	-2.6	3.6	8.7	3.5
Price	7.7	-1.2	10.6	2.0	0.8	-1.6	-1.9
Terms of trade	-3.8	0.8	-1.2	1.6	2.2	...	-- <u>2/</u>
Total							
Exports							
Value	16.5	0.9	17.2	-0.4	6.5	7.1	0.3
Volume	12.7	1.5	12.5	0.9	2.6	4.3	-0.1
Price	3.4	-0.6	4.2	-1.3	3.8	2.8	0.4
Imports							
Value	16.2	12.6	2.6	-2.9	4.8	0.1	2.8
Volume	8.6	12.6	-3.3	-1.2	0.2	-3.3	-0.2
Price	7.0	--	6.1	-1.7	4.6	3.4	2.6
Terms of trade	-3.4	-0.6	-1.8	0.4	-0.8	...	-2.1 <u>2/</u>

Source: Statistical Yearbook of Foreign Trade.

1/ Value and price indices in forints.

2/ With January-March 1981 taken as the base period.

Table 52. Hungary: Trade Balance with Socialist and Nonsocialist Countries, According to Currency of Settlement, 1977-1982

(In millions of SDRs)

	1977	1978	1979	1980	1981	Jan.-Apr. 1981	1982
Trade with socialist countries							
settled in rubles						827	903
Exports, f.o.b.	2,513	2,548	2,845	2,854	3,253	-864	-1,085
Imports, c.i.f.	-2,583	-2,872	-3,139	-3,222	-3,550		
Trade balance	-70	-324	-295	-368	-297	-37	-182
Trade with socialist countries settled in currencies other than rubles							
Exports, f.o.b.	581	543	692	804	1,049	322	286
Imports, c.i.f.	-362	-409	-453	-362	-450	-402	-90
Trade balance	219	134	240	442	599	-80	196
Trade with nonsocialist countries							
Exports, f.o.b.	1,896	1,982	2,601	2,979	3,097	838	896
Imports, c.i.f.	-2,645	-3,061	-3,128	-3,499	-3,767	-857	-1,090
Trade balance	-749	-1,079	-528	-519	-670	-19	-194
Trade balance, total							
Exports, f.o.b.	4,989	5,073	6,138	6,637	7,399	1,987	2,085
Imports, c.i.f.	-5,590	-6,443	-6,720	-7,083	-7,767	-2,123	-2,265
Trade balance	-601	-1,269	-583	-446	-368	-136	-180

Source: National Bank of Hungary.

Table 53. Hungary: Export Volumes, by SITC Commodity Groups and Groups of Countries, 1977-1981

(1975 = 100)

	1977	1978	1979	1980	1981
Socialist countries					
Food and live animals	108.0	88.6	102.5	121.6	148.8
Beverages and tobacco	126.0	133.8	145.2	151.6	160.9
Crude materials	114.5	125.6	146.9	125.7	124.0
Mineral fuels and lubricants	129.6	320.6	233.1	142.2	158.1
Animal and vegetable oils and fats	160.1	186.7	218.2	335.1	509.1
Chemicals	178.3	179.8	181.3	181.0	213.1
Manufactured goods	119.5	112.8	103.4	99.2	97.2
Machinery	121.5	124.7	140.1	132.5	128.8
Miscellaneous manufactures	118.1	124.0	122.7	121.5	131.1
Total	120.4	121.0	131.4	129.8	137.5
Nonsocialist countries					
Food and live animals	110.4	124.2	125.2	117.9	113.7
Beverages and tobacco	97.7	106.8	149.3	179.7	197.9
Crude materials	123.5	147.0	134.1	148.1	129.7
Mineral fuels and lubricants	151.9	120.3	162.9	164.0	141.3
Animal and vegetable oils and fats	140.8	164.4	127.0	235.3	293.3
Chemicals	163.0	184.7	222.0	232.6	248.7
Manufactured goods	122.2	107.6	142.2	138.3	131.9
Machinery	105.3	101.3	129.1	146.2	151.1
Miscellaneous manufactures	132.8	143.5	161.6	157.0	156.8
Total	122.7	126.3	148.2	154.1	151.5
All countries					
Food and live animals	109.2	105.7	113.4	120.2	133.0
Beverages and tobacco	121.2	129.2	146.8	158.9	169.8
Crude materials	120.3	139.8	138.7	141.2	127.6
Mineral fuels and lubricants	145.4	156.4	176.7	157.7	139.5
Animal and vegetable oils and fats	146.9	171.6	156.9	267.4	364.3
Chemicals	172.4	182.6	201.4	206.3	230.7
Manufactured goods	121.0	110.3	123.3	119.3	114.9
Machinery	118.1	119.7	137.8	135.8	134.0
Miscellaneous manufactures	123.3	130.8	136.7	134.2	139.9
Total	121.7	123.5	138.9	140.4	143.9

Source: Central Statistical Office.

**Table 54. Hungary: Export Prices by SITC Commodity
Groups and Groups of Countries, 1977-1981**

(1975=100)

	1977	1978	1979	1980	1981
Socialist countries					
Food and live animals	95.7	88.8	95.6	98.1	110.2
Beverages and tobacco	94.2	92.4	92.1	80.2	87.7
Crude materials	102.7	95.1	98.0	103.2	108.8
Mineral fuels and lubricants	103.0	105.3	125.2	176.1	241.0
Animal and vegetable oils and fats	79.9	81.5	88.4	74.3	80.3
Chemicals	84.5	81.2	84.1	83.3	89.2
Manufactured goods	97.9	97.2	105.6	98.9	104.2
Machinery	102.4	104.9	104.7	99.0	102.1
Miscellaneous manufactures	89.9	89.4	89.3	84.5	86.7
Total	98.4	97.1	99.1	95.6	101.4
Nonsocialist countries					
Food and live animals	104.4	102.8	105.6	107.0	111.4
Beverages and tobacco	102.9	111.8	112.5	110.5	109.4
Crude materials	105.2	101.8	110.4	117.4	113.0
Mineral fuels and lubricants	99.9	107.0	139.2	170.9	187.3
Animal and vegetable oils and fats	77.5	68.2	79.2	61.4	64.3
Chemicals	91.7	88.9	109.2	107.1	105.9
Manufactured goods	93.4	98.5	110.5	112.4	105.3
Machinery	111.0	114.3	117.0	115.7	122.4
Miscellaneous manufactures	100.8	104.3	110.2	114.0	115.1
Total	100.2	100.9	109.3	111.0	112.1
All countries					
Food and live animals	99.5	95.1	99.8	101.8	110.8
Beverages and tobacco	95.4	95.1	95.0	84.7	90.6
Crude materials	104.3	99.3	105.7	112.0	111.6
Mineral fuels and lubricants	102.0	107.5	135.3	174.1	205.4
Animal and vegetable oils and fats	78.1	72.3	81.7	65.7	69.8
Chemicals	87.1	84.0	94.0	92.6	95.4
Manufactured goods	95.5	97.7	108.0	106.3	104.5
Machinery	104.1	106.7	107.1	102.2	106.1
Miscellaneous manufactures	93.6	94.6	96.7	95.2	97.0
Total	98.7	98.1	102.2	100.8	104.7

Source: Central Statistical Office.

Table 55. Hungary: Commodity Structure of Imports
by Groups of Countries, 1977-81

(In per cent)

	1977	1978	1979	1980	1981
Socialist countries					
Food and live animals	1.5	1.0	0.8	1.2	1.6
Beverages and tobacco	0.6	0.5	0.5	0.4	0.5
Crude materials	4.7	4.7	4.1	3.9	4.3
Mineral fuels and lubricants	10.9	11.6	13.5	13.1	14.1
Animal and vegetable oils and fats	0.1	--	--	--	--
Chemicals	3.7	3.6	3.4	3.9	4.1
Manufactured goods	9.2	8.3	7.7	7.1	7.5
Machinery	19.5	19.5	20.5	18.2	16.3
Miscellaneous manufactures	2.7	2.6	2.6	2.5	2.7
Miscellaneous transactions	--	--	0.3	0.4	0.4
Total	52.7	51.7	53.4	50.6	51.5
Nonsocialist countries					
Food and live animals	8.5	6.8	6.3	6.2	6.2
Beverages and tobacco	0.3	0.2	0.2	0.3	0.4
Crude materials	4.3	4.3	4.6	5.5	3.8
Mineral fuels and lubricants	1.4	2.0	2.5	3.3	2.5
Animal and vegetable oils and fats	0.1	0.1	0.1	0.1	0.1
Chemicals	9.2	9.3	9.0	9.8	9.7
Manufactured goods	9.4	9.7	9.6	10.6	11.1
Machinery	11.7	13.3	11.9	11.1	11.8
Miscellaneous manufactures	2.1	2.4	2.2	2.5	2.8
Miscellaneous transactions	0.2	0.2	0.2	0.3	0.1
Total	47.3	48.3	46.6	49.4	48.5
All countries					
Food and live animals	10.0	7.8	7.1	7.4	7.8
Beverages and tobacco	0.8	0.7	0.7	0.7	0.9
Crude materials	8.9	9.0	8.8	9.3	8.1
Mineral fuels and lubricants	12.3	13.6	16.0	16.4	16.6
Animal and vegetable oils and fats	0.2	0.1	0.2	0.1	0.1
Chemicals	12.9	12.9	12.4	13.6	13.8
Manufactured goods	18.6	18.0	17.3	17.6	18.6
Machinery	31.2	32.8	32.4	29.2	28.1
Miscellaneous manufactures	4.8	5.0	4.8	4.9	5.5
Miscellaneous transactions	0.2	0.2	0.5	0.4	0.5
Total	100.0	100.0	100.0	100.0	100.0

Source: Central Statistical Office.

Table 56. Hungary: Import Volumes, by SITC Commodity Groups and Groups of Countries, 1977-1981

(1975 = 100)

	1977	1978	1979	1980	1981
Socialist countries					
Food and live animals	89.7	79.4	67.8	98.0	114.0
Beverages and tobacco	131.6	128.8	128.7	118.8	134.1
Crude materials	88.4	97.2	88.8	86.1	89.0
Mineral fuels and lubricants	107.6	116.4	124.1	119.1	112.1
Animal and vegetable oils and fats	53.3	32.0	37.1	--	--
Chemicals	94.6	107.7	106.2	120.8	127.1
Manufactured goods	107.0	109.7	103.3	97.6	100.1
Machinery	106.1	122.1	132.9	122.0	111.7
Miscellaneous manufactures	99.5	104.9	102.2	100.0	109.1
Total	105.7	115.5	118.8	114.3	111.4
Nonsocialist countries					
Food and live animals	125.6	122.2	117.1	113.8	122.8
Beverages and tobacco	152.6	133.3	124.6	152.8	214.8
Crude materials	95.9	113.6	100.0	122.1	89.6
Mineral fuels and lubricants	56.0	81.7	81.8	87.5	63.7
Animal and vegetable oils and fats	103.8	120.7	107.2	118.2	120.9
Chemicals	128.6	196.6	129.8	127.1	139.4
Manufactured goods	115.3	132.1	119.3	125.8	147.4
Machinery	154.3	194.0	171.3	156.1	164.1
Miscellaneous manufactures	174.8	225.9	194.8	196.1	230.2
Total	122.1	141.5	128.6	130.8	135.1
All countries					
Food and live animals	118.1	113.5	107.2	110.3	121.0
Beverages and tobacco	138.3	130.6	128.0	131.0	160.8
Crude materials	91.8	104.6	94.2	103.9	89.4
Mineral fuels and lubricants	94.5	106.1	113.7	113.9	101.7
Animal and vegetable oils and fats	78.6	77.2	72.5	62.7	71.1
Chemicals	117.0	133.2	122.0	124.4	134.8
Manufactured goods	111.1	120.8	111.3	112.0	124.2
Machinery	121.4	144.6	145.3	132.9	128.6
Miscellaneous manufactures	125.3	145.1	133.3	132.3	149.7
Total	112.7	126.9	122.7	121.3	121.5

Source: Central Statistical Office.

Table 57. Hungary: Import Prices by SITC Commodity
Groups and Groups of Countries, 1977-1981 1/

(1975 = 100)

	1977	1978	1979	1980	1981
Socialist countries					
Food and live animals	69.2	59.2	60.9	60.6	67.3
Beverages and tobacco	100.3	108.4	105.8	94.9	111.3
Crude materials	104.0	106.2	106.0	99.9	111.8
Mineral fuels and lubricants	118.3	130.7	146.7	144.3	173.4
Animal and vegetable oils and fats	64.5	65.3	75.0	--	--
Chemicals	100.9	97.5	95.3	92.7	97.1
Manufactured goods	97.1	95.6	97.0	91.6	99.1
Machinery	108.3	106.1	105.1	98.7	101.4
Miscellaneous manufactures	113.4	119.1	123.8	117.1	122.4
Total	102.6	103.7	106.9	102.2	111.8
Nonsocialist countries					
Food and live animals	117.8	108.7	107.7	105.9	104.8
Beverages and tobacco	89.4	87.5	90.5	96.6	102.8
Crude materials	117.7	113.9	141.3	132.7	132.4
Mineral fuels and lubricants	100.9	110.1	139.3	166.5	182.8
Animal and vegetable oils and fats	85.3	75.8	94.2	84.5	80.2
Chemicals	83.7	83.5	93.9	100.9	96.2
Manufactured goods	92.0	93.2	104.4	106.4	99.8
Machinery	86.0	86.9	90.3	89.7	95.1
Miscellaneous manufactures	84.5	81.7	91.7	96.6	97.4
Total	96.5	95.6	104.1	105.5	105.1
All countries					
Food and live animals	104.1	95.0	94.6	93.1	93.9
Beverages and tobacco	96.5	101.1	100.3	94.9	107.6
Crude materials	109.9	109.4	121.2	114.0	120.3
Mineral fuels and lubricants	117.7	130.0	146.4	145.6	173.7
Animal and vegetable oils and fats	76.5	70.5	86.2	77.3	73.8
Chemicals	88.7	87.7	94.7	99.0	97.0
Manufactured goods	94.5	94.4	101.0	99.6	99.2
Machinery	99.7	98.8	99.7	95.6	99.5
Miscellaneous manufactures	100.7	101.8	109.8	109.4	112.3
Total	99.9	99.9	106.0	104.2	109.0

Source: Central Statistical Office.

1/ Measured in forint.

Table 58. Hungary: Direction of Trade, 1977-82

(In per cent)

	1977	1978	1979	1980	1981	1981 Jan.-Mar.	1982
Exports	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Settled in rubles 1/	50.4	50.2	46.3	43.0	44.0	41.7	42.3
Settled in convertible currencies	49.6	49.8	53.7	57.0	56.0	58.3	57.7
Of which:							
Germany, Fed. Rep. of	8.7	8.4	9.4	9.7	8.7	9.0	7.4
Italy	3.8	4.2	5.0	4.5	3.3	4.1	4.9
Austria	3.6	3.3	3.4	4.4	4.4	4.8	4.5
Switzerland	1.3	1.3	1.2	1.6	1.5	1.3	2.0
United Kingdom	1.3	1.5	1.5	1.1	1.0	0.8	0.8
France	1.6	1.6	1.6	1.7	1.6	1.6	1.6
United States	0.9	1.2	1.3	1.3	1.6	1.4	1.6
Japan	0.2	0.2	0.3	0.1	0.2	0.2	0.3
Imports	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Settled in rubles 1/	46.2	45.3	46.7	45.5	45.7	47.2	47.8
Settled in convertible currencies	53.8	54.7	53.3	54.5	54.3	52.8	52.2
Of which:							
Germany, Fed. Rep. of	10.9	12.3	12.1	11.7	11.9	12.1	11.6
Italy	3.4	3.4	3.0	3.1	3.0	2.8	3.5
Austria	4.7	5.1	5.2	5.4	5.0	5.3	5.7
Switzerland	2.5	2.7	2.5	2.8	2.4	2.6	2.7
United Kingdom	2.0	1.9	1.9	2.0	2.3	2.1	1.8
France	2.3	2.4	2.2	2.2	2.5	2.5	2.4
United States	2.2	2.2	1.9	2.7	2.5	2.3	2.3
Japan	1.1	1.1	0.9	1.5	1.4	1.5	1.5

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 59. Hungary: Services and Transfers, 1977-82

(In millions of SDRs)

	1977	1978	1979	1980	1981	1982 Jan.-Mar.
Service receipts	510	566	574	998	1,222	317
Freight and insurance <u>1/</u>	19	17	23	17	33	10
Travel <u>2/</u>	160	196	254	266	341	38
Investment income	79	85	80	378	258	57
Government expenditure	15	18	19	23	26	8
Other	237	250	198	314	564	204
Service payments	713	847	893	1,368	2,055	585
Freight and insurance <u>1/</u>	198	227	227	272	310	81
Travel <u>2/</u>	90	102	115	119	129	10
Investment income	226	297	375	677	1,167	327
Government expenditure	40	45	50	54	63	15
Other	159	176	126	246	386	152
Services (net)	-203	-281	-319	-370	-833	-268
Freight and insurance <u>1/</u>	-179	-210	-204	-255	-277	-71
Travel <u>2/</u>	70	94	139	147	212	28
Investment income	-147	-212	-295	-298	-902	-270
Government expenditure	-25	-26	-31	-31	-38	-7
Other	78	74	72	68	178	52
Transfers (net)	38	79	33	37	41	11
Receipts	62	104	41	42	49	12
Payments	24	25	8	5	8	1

Source: National Bank of Hungary.

1/ Reported figures for freight and insurance include only a portion of actual payments and receipts. Other freight and insurance transactions are included either in other current items (in the case of goods in transit) or in exports and imports which are recorded on a contractual/settlement basis. These two factors, along with the fact that, in the case of intra-CMEA trade, exporters are responsible for transport expenses within their own borders, result in relatively small recorded freight and insurance transactions settled in nonconvertible currencies relative to trade volumes.

2/ Only actual expenditures by tourists in Hungary or expenditures of Hungarian tourists while abroad are recorded under the travel item. Related transportation expenses and receipts are recorded under "other current items."

Table 60. Hungary: Services and Transfers in
Convertible Currencies, 1977-82

(In millions of SDRs)

	1977	1978	1979	1980	1981	1982 Jan.-Mar.
Service receipts	162	247	100	539	642	151
Freight and insurance <u>1/</u>	15	15	18	15	27	9
Travel <u>2/</u>	85	79	122	136	185	25
Investment income	72	81	75	343	238	31
Government expenditure	9	11	12	10	11	3
Other	-19	61	-127	35	181	83
Service payments	519	635	630	1,070	1,675	509
Freight and insurance <u>1/</u>	142	159	163	197	210	59
Travel <u>2/</u>	51	52	66	72	72	6
Investment income	212	282	358	657	1,136	312
Government expenditure	32	37	40	43	51	12
Other	82	105	3	101	206	120
Services (net)	-357	-388	-530	-531	-1,033	-358
Freight and insurance <u>1/</u>	-127	-144	-145	-182	-183	-50
Travel <u>2/</u>	34	27	56	64	113	19
Investment income	-140	-201	-283	-314	-898	-281
Government expenditure	-23	-26	-29	-33	-40	-9
Other	-101	-44	-130	-66	-25	-37
Transfers (net)	19	20	31	35	40	10
Receipts	26	24	36	37	44	11
Payments	8	4	5	2	4	1

Source: National Bank of Hungary.

Footnotes: See Table 59.

Table 61. Hungary: Total Foreign Liabilities, 1977-82

(In millions of SDRs)

	1977	1978	1979	1980	1981	1982 Jan.-Mar.
Total outstanding foreign liabilities						
Financial loans	4,326	5,838	6,272	7,173	7,140	6,216
Trade related credits	123	169	212	248	358	409
Others	305	401	508	666	1,115	1,213
Total	4,754	6,408	6,992	8,087	8,613	7,838
Change in total foreign liabilities	452	1,654	584	1,095	526	-775
Of which:						
Medium- and long-term credits received	558	975	802	726	926	96
Drawings	(...)	(...)	(...)	(...)	(...)	(...)
Repayments	(...)	(...)	(...)	(...)	(...)	(...)
Short-term credits received	-94	677	-193	394	-409	-912
Drawings	(...)	(...)	(...)	(...)	(...)	(...)
Repayments	(...)	(...)	(...)	(...)	(...)	(...)

Sources: National Bank of Hungary; and staff estimates.

Table 62. Hungary: Foreign Liabilities in Convertible Currencies, 1977-82

(In millions of SDRs)

	1977	1978	1979	1980	1981	1982 Jan.-Mar.
Total outstanding foreign liabilities						
Financial loans	4,078	5,574	6,008	6,756	6,916	5,976
Trade related credits	104	143	194	230	345	393
Others	<u>121</u>	<u>106</u>	<u>99</u>	<u>141</u>	<u>212</u>	<u>271</u>
Total	4,303	5,823	6,301	7,127	7,473	6,640
Change in total foreign liabilities	403	1,520	478	826	346	-833
Of which:						
Medium- and long-term credits received	419	898	697	610	523	85
Drawings	(...)	(...)	(...)	(...)	(1,224)	(392)
Repayments	(...)	(...)	(...)	(...)	(-701)	(-307)
Short-term credits received	-16	622	-219	216	-177	-918
Drawings	(...)	(...)	(...)	(...)	(...)	(978)
Repayments	(...)	(...)	(...)	(...)	(...)	(-1,896)

Sources: National Bank of Hungary; and staff estimates.

Table 63. Hungary: Foreign Debt, 1977-82

(In millions of SDRs; end of period)

	1977	1978	1979	1980	1981	1982 March
Total foreign debt	4,754.1	6,407.4	6,991.8	8,087.0	8,613.4	7,837.4
In convertible currencies	4,303.1	5,822.7	6,300.5	7,127.2	7,473.3	6,639.7
By original maturity:						
Short-term	2,005.2	2,627.1	2,407.6	2,624.3	2,447.1	1,529.0
Long-term	2,297.9	3,195.6	3,892.9	4,502.9	5,025.2	5,110.7
By type						
Financial loans ^{1/}	4,077.6	5,573.9	6,008.3	6,755.9	6,916.5	5,976.1
Trade-related credits ^{2/}	104.0	143.4	194.0	229.7	345.2	393.2
Inter-governmental credit	6.7	4.0	0.8	4.6	4.8	5.0
Other ^{3/}	114.9	101.4	97.4	137.0	206.8	265.4
In nonconvertible currencies	451.0	584.7	691.3	959.9	1,140.1	1,197.7
By original maturity:						
Short-term	197.3	253.3	269.2	437.5	209.1	222.9
Long-term	253.7	331.4	422.1	522.4	931.0	974.8
By type:						
Financial loans	248.9	264.3	264.6	416.9	232.2	239.7
Trade-related credits	18.5	25.2	17.4	18.3	13.2	15.6
Inter-governmental credit	172.3	271.6	385.5	497.8	891.6	929.1
Other	11.3	23.7	23.7	27.0	12.1	13.3
Memorandum item:						
Forint/SDR (end of period)	49.317	46.351	46.868	41.084	40.075	38.714

Source. National Bank of Hungary.

^{1/} Syndicated loans, bonds and notes, bank to bank credit and deposits and balances of nonresident banks.

^{2/} Including bankers' acceptances.

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

Table 64. Hungary: Interest Rate and Maturity
Characteristics of Foreign Indebtedness, 1977-81

	1977	1978	1979	1980	1981
Debt denominated in convertible currencies					
Interest rates (per cent)					
Average rate of interest on stock of debt outstanding <u>1/</u>	4.92	4.91	5.87	9.71	14.04
Average rate of interest in loans contracted in year indicated <u>2/</u>	5.15	6.78	8.74	8.57	13.07
Maturity (number of years)					
Average maturity of loans contracted in year indicated <u>2/</u>	5.3	5.7	6.5	6.0	6.1
Debt denominated in rubles					
Interest rates (per cent)					
Average rate of interest on stock of debt outstanding <u>1/</u>	3.37	2.73	2.52	2.52	2.71
Average rate of interest on loans contracted in year indicated <u>2/</u>	2.02	2.02	2.01	2.07	2.38
Maturity (number of years)					
Average maturity of loans contracted in year indicated <u>2/</u>	6.8	9.4	10.4	9.9	9.9

Source: National Bank of Hungary.

1/ Includes short-term debt.

2/ Medium- and long-term debt only.

Table 65. Hungary: Maturity Structure of Medium- and Long-Term Foreign Assets and Liabilities Outstanding at End-March 1982 1/

(In millions of SDRs)

	Convertible Currencies		Nonconvertible Currencies		Total		
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Net
Maturing in:							
1982	120.3	517.8	19.6	78.1	139.9	595.9	-456.0
1983	121.1	818.2	15.5	107.0	136.6	925.2	-788.6
1984	93.6	1,005.5	13.8	103.8	107.4	1,109.3	-1,001.9
1985	82.5	1,016.6	12.6	104.5	95.1	121.1	-1,026.0
1986	61.3	717.7	15.9	118.6	77.2	836.3	-759.1
After 1986	227.2	1,034.9	162.2	462.8	389.4	1,497.7	-1,108.3
Total	706.0	5,110.7	239.6	974.8	945.6	6,085.5	-5,139.9

Source: National Bank of Hungary.

1/ Converted from forint at the end-March 1982 rate of Ft 38.714 = SDR 1. Includes only assets and liabilities with original maturity of more than one year.

Table 66. Hungary: International Reserves and Other Foreign Assets, 1977-82

(In millions of SDRs; end of period)

	1977	1978	1979	1980	1981	1982 March
International reserves						
Gold <u>1/</u>	73.4	97.5	74.7	86.9	58.4	17.0
Foreign exchange						
Convertible currencies	1,187.1	1,306.3	1,248.1	1,477.5	1,398.8	406.4
Official reserves	(1,079.3)	(1,166.9)	(1,152.3)	(1,379.4)	(1,276.8)	(220.1)
Other readily market- able assets <u>2/</u>	(107.8)	(139.4)	(95.8)	(98.1)	(122.0)	(186.3)
Nonconvertible curren- cies	<u>148.1</u>	<u>64.0</u>	<u>77.8</u>	<u>88.5</u>	<u>23.9</u>	<u>5.2</u>
Total	1,408.5	1,467.9	1,400.6	1,652.9	1,481.1	428.6
Other foreign assets						
Convertible currencies	680.6	822.8	878.6	985.2	1,047.7	1,198.4
Liquid assets of the Foreign Trade Bank	(47.4)	(79.9)	(72.9)	(85.5)	) (511.7)	(568.2)
Other short-term assets <u>3/</u>	(412.5)	(476.7)	(453.4)	(452.2)	) (536.0)	(630.2)
Long-term assets	(220.7)	(266.1)	(352.3)	(447.6)	(536.0)	(630.2)
Nonconvertible curren- cies	197.0	251.0	258.2	323.7	438.1	413.3
Short-term	(12.9)	(50.8)	(69.2)	(109.0)	(204.8)	(173.7)
Long-term	<u>(184.1)</u>	<u>(200.2)</u>	<u>(189.0)</u>	<u>(214.7)</u>	<u>(233.3)</u>	<u>(239.6)</u>
Total	877.6	1,073.8	1,136.8	1,308.9	1,485.8	1,611.7
Total international reserves and other foreign assets	2,286.1	2,541.6	2,537.4	2,961.8	2,966.9	2,040.3

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 some working balances of the specialized banks but comprises mainly the 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.

Table 67. Hungary: Balance of Bilateral Accounts
with IMF Member Countries, 1977-1981

(In millions of SDRs)

	1977	1978	1979	1980	1981
Bangladesh	--	-0.8	-2.4	-2.7	-0.4
Brazil	-12.8	-12.2	-55.2	-9.5	-42.9
Colombia	-1.4	-0.1	-5.6	-18.7	-26.6
Ecuador	-18.7	-14.8	-21.8	-21.9	-12.9
Finland	-22.1	-22.4	-15.3	-24.0	-12.1
Iran	4.9	8.1	-9.5	34.9	27.2
Pakistan	0.3	-2.3	--	-1.8	-5.9
Peoples' Republic of China	-2.7	-15.7	-9.6	1.7	-5.7
Total	-52.5	-60.2	-119.4	-111.8	-79.3

Source: National Bank of Hungary.

VI. Exchange and Trade System

A detailed description of Hungary's exchange and trade system is contained in the 1982 Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER). Only jurisdictional issues and recent developments are described in the section.

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

1. The import licensing procedure and related aspects

a. The import licensing procedure

According to the instruction concerning the system of licensing, the import license authorizes the holder to enter and perform a foreign trade contract, to purchase foreign currency needed for the performance of the contract, and to carry out all legal acts required for the implementation of the contract. 1/

The instruction also specifies that in case the quantity of the goods does not exceed the volume fixed in the license, a margin of 5 per cent is allowed in respect of the amount of foreign currency specified without the necessity to modify the license. 2/ Should the margin of 5 per cent be exceeded, the holder of the license has simply to notify the licensing department of the Ministry of Foreign Trade, which would automatically amend the original license. This amendment is not a pre-condition to making the payment, which is made automatically upon receipt of the relevant documents. Thus, in practice, there is only an ex post verification (done twice yearly) of compliance with the terms of the license.

b. The advance import deposit scheme

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 0 per cent since 1971.

At the time when the advance deposit scheme was introduced, domestic importing units were required to deposit 100 per cent of the value of the contemplated imports with the NBH for up to two years. The 100 per cent import deposit applied to all imports; in certain cases, however, part of the deposit could be used to finance the forint cover. Effective January 1, 1971, the domestic currency counterpart under this advance import deposit scheme was set at 0 per cent of the value of the contemplated imports. 3/

1/ Instruction No. 10/1977/Kk.E.14/KkM, Section D5.

2/ Instruction No. 10/1977/Kk.E.14/KkM, Section I6.

3/ NBH's Circular No. 8 of 1970.

c. The forint cover

The forint cover is a deposit requirement, which applies in principle to both import and investment financing. Such a deposit requirement is used by the NBH as a monetary policy instrument to verify that importers (and/or investors) have sufficient funds in domestic currency to finance their imports (and/or investments). The forint cover is a precondition to issuing import licenses in the case of imports of all capital goods.

The forint cover was legally introduced in a decree, which was issued by the Minister of Finance in 1970 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 NBH. Thus, in the case of all imports, domestic importing units are required to deposit a forint cover, i.e., the full domestic currency counterpart of the contemplated imports, 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, an interest rate of 12-13 per cent is charged by the NBH on the borrowed portion of the forint cover.

In the case of imports of goods other than capital goods, the domestic importing units are required to lodge the forint cover with the NBH at least 15 days before the due date for the payment in foreign currency under the import agreement. 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 payment against documents or acceptance. Regulations pertaining to forint cover make it possible for the NBH to exempt domestic importing units from the forint cover requirement. Such exemptions were granted liberally until recently. However, since April 1, 1982 such waivers are no longer granted; in particular, the forint cover requirement has to be met for all imports of noncapital goods before opening a letter of credit. 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.

In the case of imports of capital goods, the domestic importing units are required to lodge the forint cover with the NBH before they can apply 1/ for the contemplated import licenses. Specifically, in order to obtain the required import licenses, the domestic importing units must submit a certificate issued by a bank certifying that they have sufficient forint resources (own or borrowed) to cover the value of the contemplated imports plus customs duties and related expenses. The import license is automatically given upon verification of the forint cover in the case of imports of capital goods to be made in connection with export-oriented investment or approved investment projects. In most of the other cases,

1/ Usually through the foreign trade organizations.

the certificate would be issued only upon completion of a feasibility study by the NBH, which may last for more than one month. The certificate is issued following separation of the necessary funds in a blocked and noninterest-bearing account with the NBH. These funds may be separated from the enterprise's development fund or funds available in the enterprise's current account or be entirely in the form of credits (medium-term working and/or investment from the NBH). The necessary funds are maintained by the NBH on behalf of the domestic importing unit for four to five months before the due date for payment in most cases; in some specific cases, e.g., in cases involving the import of sophisticated capital goods or turnkey plants, such funds may be maintained for up to one year. Such funds are transferred to a special foreign trade organization account at the bank undertaking to make foreign exchange settlement 15 days before the due date for payment.

The use of the forint cover in the case of imports of all capital goods gives rise to a multiple currency practice. Specifically, apart from being a precondition to issuing the import license, staff calculations indicate that the use of the forint cover gives rise to an additional cost falling in a range of 2.5-4.5 per cent in most cases and in a range of 6-11 per cent in the case of imports of certain capital goods (e.g., turnkey plants). This additional cost is to be paid by the importers. ^{1/}

d. Broken cross rates

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 18 convertible currencies 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 per cent. Staff calculations indicate that because broken rates were maintained for more than one week, this

^{1/} The opportunity cost of 2.5 per cent would arise if the importer (1) can finance the full value of the contemplated imports by using funds available either in its current account at its bank or in its development funds; and (2) has the option to place such funds during five months in the form of one year's voluntary deposits earning an annual interest rate of 6 per cent. The opportunity cost of 6 per cent would arise under similar circumstances if the forint cover has to be made for one year. The extra cost of 4.5 per cent would arise if (1) the importer has to finance the full value of the contemplated imports by borrowing the corresponding full amount in the form of a long-term credit at an annual interest rate of 11 per cent from the NBH; and (2) if the forint cover has to be made for five months. The maximum extra cost of 11 per cent would arise under similar circumstances if the forint cover has to be made for one year.

practice in determining the exchange rates for the forint gave rise to multiple currency practices during April-May 1982 1/ and may continue to give rise to such practices in the future.

Specifically, the forint is pegged to a basket of nine currencies. The external value of the forint is adjusted at irregular intervals, on the basis notably of the difference between the domestic and foreign rates of inflation. In the period between such adjustments, the external value of the forint has to be maintained within margins of 1 per cent around the peg. Otherwise, the NBH would have to seek the approval of the Council of Ministers so that the external value of the forint could be changed accordingly. In principle, such approval is given once a year only at the time when the Plan is formally approved. Accordingly, a new external value for the forint in terms of the selected basket that exceeds by 1 per cent the previous external value would be set only at the beginning of a new fiscal year. 2/ In order to maintain the external value of the forint in terms of the selected basket within the 1 per cent margins, the NBH would adjust the forint value of each of the nine currencies included in the basket as well as that of the other 11 quoted convertible currencies only if the cumulative effects of the changes in the forint value of any of the nine currencies included in the basket exceed by one half of 1 per cent the latest new quotation for each of the currencies concerned.

Thus, in practice, the NBH would set the cross rates (in forints) for the nine currencies of the basket at levels virtually identical to the average levels of the cross rates for the same currencies (in U.S. dollars but converted into forint) as quoted on the international foreign exchange markets of Zurich, Frankfurt, and London, say, on April 14, 1982. These cross rates (in forint) would remain unchanged as long as the cumulative effects of the changes in any of the corresponding cross rates quoted (in U.S. dollars but converted into forint) in the three international markets do not exceed by one half of 1 per cent their respective forint value as quoted on April 14, 1982. However, should the cumulative effects exceed one half of 1 per cent, say, on April 20, 1982, the NBH would watch closely exchange rate developments during the next five working days and take the cross rates (in U.S. dollars) of the nine currencies as of April 27, 1982 as a basis to restore the unchanged levels maintained for the cross rates (in forint) during the period April 14-27, 1982. In restoring such levels, the NBH would adjust first the rate for

1/ E.g., the cross rates for the pound sterling against the deutsche mark based on quotations for these two currencies in London on May 18, May 25, June 1, and June 8 exceeded by more than 1 per cent the cross rates for the pound sterling against the deutsche mark based on the NBH quotations for these two currencies in Budapest on the same dates.

2/ The rationale behind the determination of the external value of the forint is that the total value of the export receipts (at constant exchange rates, prices, and volumes) received by Hungarian exporters in the nine convertible currencies included in the selected basket should not exceed 1 per cent between the beginning and the end of a given year and at any other time during the year.

the forint against the U.S. dollar and second but eventually that of the forint against the deutsche mark, because of their relative importance in the basket. 1/ Such adjustments would be made so that the weighted cumulative effects of the changes affecting all the nine currencies of the basket could be virtually eliminated. However, the NBH would not adjust the rates of the currencies which showed a deviation of less than one half of 1 per cent during the April 20-27 period in this particular case.

Quotations (including unchanged quotations from one period to another) are issued weekly (on Tuesday) by the NBH for each of the 18 convertible currencies.

e. Commercial and noncommercial exchange rates
for currencies of 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. 2/ At the same time since there is an explicit exchange rate 3/ 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 per cent could arise 4/ and, thus, give rise to multiple currency practices.

Another aspect of the exchange rate policies of member countries of the CMEA, which may give rise to multiple currency practices, is that the

1/ These two currencies currently account for almost three fifths of the basket.

2/ For example, using end-1981 exchange rates for the Romanian leu and the Hungarian forint relative to the transferable ruble of lei 15 = TR 1 and Ft 26 = TR 1 an effective exchange rate between the leu and the forint of Ft 1.73 = lei 1 can be calculated.

3/ 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.

4/ Prior to November 1981, when the forint was appreciated relative to the transferable ruble from Ft 27 = TR 1 to Ft 26 = TR 1, the difference between the two forint/leu rates was 6 per cent.

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/

f. 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. 2/ A minimum spending/conversion requirement also applies to Polish and Czech tourists.

Yugoslavia was exempted in 1978 from the minimum spending/conversion requirement, along with other countries in the convertible currency area. 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.

g. Bilateral payments agreements

Hungary has bilateral payments agreements with 12 Fund members, of which one (Democratic Kampuchea) has not yet been activated. These bilateral payments agreements are indicated in the detailed description of Hungary's exchange and trade system published in the 1982 AREAER.

h. Implementation of the exchange and trade system

Hungary's exchange and trade system has been applied flexibly until recently. In particular, a number of exceptions have been permitted under the import licensing procedure, including exemptions from the forint cover requirement, especially with regard to imports of noncapital goods. In addition, as indicated earlier, though remaining in force, the advance import deposit system has not been used since January 1, 1971, i.e., the rate has been set to 0 per cent of the value of imports since then. A number of institutions have benefited from duty-free import quotas until recently, and the quota on imports of consumer goods from the convertible currency area was gradually increased during the 1970s.

1/ For example, the rates quoted respectively by Hungary (Ft 34.4297 = US\$1) and Romania (lei 15 = US\$1 commercial, lei 11 = US\$1 noncommercial) at the end of 1981 imply cross rates between the forint and the leu of Ft 2.3 = lei 1 and Ft 3.13 = lei 1, compared to the official rate of Ft 1.7 = lei 1.

2/ Larger travel allowances but no reconversion of forint balances into the national currencies of foreign tourists.

However, as of April 1, 1982, owing to increasingly severe balance of payments constraints, Hungary's exchange and trade system has been implemented more strictly. In particular, control over imports has been strengthened. Administrative measures to restrict imports that have already been taken and are being implemented include (1) a more active use of the forint cover requirement; (2) the postponement of a number of import licenses for certain imports of consumer goods; and (3) a lower (announced) quota for 1982. As mentioned earlier, all importers are now requested to lodge the forint counterpart of the full value of the contemplated imports at banks before opening a letter of credit with the National Bank. All the previous forms of preferential treatment, including a large number of exemptions with respect to the use of the forint cover, were revoked. A number of import licenses have already been postponed until later in the second half of 1982 and, possibly, into 1983; as a result, imports of up to SDR 35 million were not allowed to take place by the end of May 1982. The announced quota was lowered from US\$118 million (SDR 100 million) in 1981 to US\$103 million (SDR 85 million) in 1982; 1/ out of this quota, US\$76 million (SDR 65 million) had already been used by the end of May 1982 according to import licenses issued by that date.

A number of other measures to restrict imports have already been taken but have not yet been fully implemented. Such measures include (1) the revision of current tariff policies, which would involve the reduction and, in some cases, the elimination of tariff exemptions, including duty-free quotas; and (2) a government decision to decrease the foreign exchange quota for those institutions that are financed through budgetary sources.

Existing regulations on payments for and proceeds from invisibles pertaining to nonresidents, were modified in April 1982. 2/ As of April 20, 1982, nonresidents may take out of the country articles (and no longer souvenirs only) not exceeding the value of Ft 3,000 3/ a person without a license from the foreign exchange authority and within this limit articles bought or received as gifts in Hungary not exceeding Ft 1,000. Also, within the limit of Ft 1,000, nonresidents may take out gifts received in Hungary not exceeding the value of Ft 300 a person and articles bought in Hungary up to a limit set at 50 per cent of the amount of foreign exchange brought into Hungary under the official certification of the relevant foreign exchange authority. Nonresidents, who have not brought foreign exchange under the official certification of their

1/ This figure is close to the figure corresponding to the actual use of the 1981 quota.

2/ Decree No. 11/1982/IV.20/ of the Ministry of Finance, which amended and expanded the provisions under paragraphs f and g of Section 24 of the Decree No. 1/1974/I.17 of the Ministry of Finance on the enforcement of the Law Decree No. 1 of 1974 of the Presidential Council of the Hungarian People's Republic (PM) on planned foreign exchange management as modified by Law Decree No. 1 of 1979 of the PM.

3/ In border traffic the value may not exceed Ft 200 once a month unless authorized otherwise under international agreement.

respective foreign exchange authority, may take out gifts received in Hungary not exceeding Ft 300 1/ a person. However, nonresidents may take out freely articles bought by themselves in shops designated for sales in convertible currencies.

Regulations pertaining to travel between Hungary and Czechoslovakia were modified on May 15, 1982. As of May 15, 1982, Hungarian citizens traveling to Czechoslovakia are required to have in their possession Kcs 150 for the first day of their visit and Kcs 90 for any additional day. 2/

1/ Ft 200 in border zone traffic once a month unless authorized otherwise under an international agreement.

2/ The amounts are reduced to Kcs 90 and Kcs 75, respectively, for children of 10 to 15 years of age and no minimum conversion requirement applies to children of less than 10 years of age.

Net Material Product and GDP

Until 1968, national income accounting in Hungary was based on the material product system (MPS) used in socialist countries, which included the value of all final goods and services directly necessary for material production. In 1968, the coverage of the national accounts system was extended to include the value of services such as social, cultural, and health services, public utilities services of financial institutions, public administration, etc. The Appendix table illustrates the derivation of GDP from net material product in 1981. Minor differences still remain between the Hungarian system of national accounts and that of the United Nations (SNA), due mainly to differences in the breakdown of market and nonmarket activities and in the valuation of certain services. The references to plan aggregates are generally based on the material product system since the plans are formulated on that basis.

Table 68. Hungary. Derivation of Gross Domestic Product 1/

(At current market prices)

	1981 <u>1/</u>	
	In billions of forint	In per cent of total
1. Net material product	631.4	81.6
2. Net value added in nonmaterial services	73.6	9.5
3. Value of nonmaterial services used in material production (-)	<u>-28.0</u>	<u>-3.6</u>
4. Net domestic product (1 + 2 + 3)	677.0	87.4
5. Depreciation of fixed capital	<u>97.2</u>	<u>12.6</u>
6. Gross domestic product (4 + 5)	774.2	100.0

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

1/ Preliminary data.

The Regulation of Enterprise Finances

With the shift in emphasis toward market forces initiated by the 1968 economic reforms, profits were expected to become a major indicator of enterprise performance. Both the growth potential of enterprises and the remuneration of employees would be linked to profits. The central authorities would rely more on macro-instruments in order to bring about growth and distribution of incomes, consistent with balanced demand and supply and an efficient allocation of resources. However, the reform of the system was interrupted in the early 1970s with a renewed emphasis on distributional equity and on a return to central direction in the formation of enterprise profits. A major setback to the reform resulted from the decision to protect domestic incomes from the consequences of the sharp deterioration in the terms of trade beginning in 1973. The authorities applied an increasingly complex system of measures (including subsidies, special taxes, and tax exemptions), differentiated between branches, subbranches, and sometimes enterprises, to shield profits and household incomes from changes in world prices.

The system of income determination was adapted again in 1980, in line with the priorities of economic policy foreseen for the next decade. The reform had two key objectives, namely, to increase the efficiency of the income formation system as a means of controlling aggregate demand, and to permit a greater differentiation of incomes so as to induce the desired restructuring of production.

The regulation of enterprise finances 1/

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 26). Production taxes were changed and streamlined in conjunction with the producer price reform of 1980 and the rules guiding budget support to enterprises were modified. A tax reimbursement scheme for exporters comparable to the internationally practiced refund of value-added taxes on exports was established. New legislation governing temporary modernization grants to enterprises made such subsidies contingent on specific performance criteria. 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 funds, the development fund, and the sharing fund. The authorities influence the allocation of resources among these funds through specific rules and financial regulators.

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.

a. Reserve funds

Each enterprise is obliged each year to place a proportion of after tax profits in a compulsory reserve fund until it reaches a certain minimum. For 1980 the contribution rate was lowered from 25 per cent to 15 per cent of after tax profits. The ability to use the compulsory reserve fund is limited by statutory conditions and an obligation of reconstitution. Subject to replacement within five years, an enterprise may draw on the fund to cover losses, or to raise annual profits to a specified proportion of their level in the preceding year, or in some circumstances to transfer resources to the development fund for an increase in working capital. The compulsory reserve fund can also be used to cover payments obligations if the sharing or development funds are inadequate, but must be reconstituted within two years. If an enterprise's reserve funds are insufficient for the statutory uses, it can prefinance them through bank advances.

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.

b. 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 per cent of the enterprises' depreciation allowances on fixed capital, 1/ state investment support, and transfers of development funds from other enterprises. For loss-making enterprises, the calculated depreciation allowances have been reduced by the amount of the losses, thus narrowing the investment potential of such enterprises. Use of the development fund is subject to the following order of priorities: credit repayments to the State and the banks, the financing of increases in working capital, payments obligations to other enterprises, coverage of operating losses, and financing of new investment. Any remaining funds may be lent or transferred to other enterprises or institutions or lent to employees for dwelling construction.

c. Sharing fund

Allocations of profits to the sharing fund are subject to a highly progressive tax. The 1980 reform introduced a tax-free threshold that is higher the more profitable the enterprise; this allows faster development fund formation by more efficient enterprises. The profitability indicator for the purposes of the tax is defined as the ratio of

1/ The remaining 40 per cent accrues to the state budget. Since January 1, 1980, the scope for certain enterprises to retain the full amount of depreciation allowances in their development funds has been reduced.

enterprise profits before profit taxes to the sum of the net assets and the wage bill of enterprises. For enterprises with an average profitability rate of 8-10 per cent, sharing fund formation up to a ratio of 2 per cent is tax free; beyond this the marginal tax rate is highly progressive, reaching a maximum of 800 per cent at sharing fund formation ratios of 14 per cent or more. The tax alleviation for more profitable enterprises introduced in 1980 amounted to raising the tax-free margin of the sharing fund formation ratio by 0.5 percentage point for every 2 percentage point increase in the profitability indicator. The tax-free sharing fund allocation starts at profit rates exceeding 2 per cent, and at rates of 16 per cent or more amounts up to 4 per cent of the wage bill. 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 by various means: they can differentiate among sectors, or vary the tax rates, the rules guiding the formation and uses of funds, and the interest payments on the accumulated resources or advances for the different funds. The system also governs the mechanism for financing enterprise losses. If the use of its own funds is insufficient, the loss-making enterprise is subject to a reorganization procedure. On the basis of recommendations by independent committees, reorganization may be coupled with a rescheduling of the debt of the enterprise, temporary budget support, bank credits granted under a state guarantee, a sale of assets of the enterprise, or damages paid by members of the management proven responsible for such damages; as a last resort, the enterprise may be liquidated.

The Wage Determination System

Approximately two thirds of the total income of the population is work related, 1/ while the remaining one third comes from social benefits in money and kind and a small amount of interest and rental income (see Table 29).

1. The determination of labor income

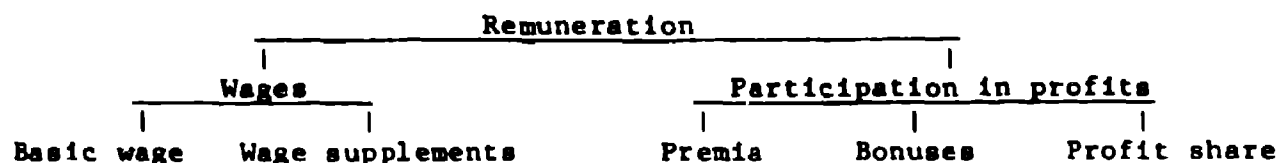
The wage system since the 1968 reforms has aimed to prevent excessive growth in the purchasing power of the population, and at a more efficient use of labor in an environment of greater enterprise autonomy. Wages have been linked in varying degrees to enterprise profits and centrally determined limits of one form or another have been imposed. The system was modified in 1976, based on experience in the first half of the 1970s. In particular, it was considered that there had been a partly unjustifiable differentiation of wage increases due to their close link to profit developments. Since profits were heavily influenced by taxes and subsidies, the wage increases did not necessarily reflect the relative efficiency of enterprises. Moreover, the wage system had not provided adequate stimulus to save labor. The 1976 amendments permitted all enterprises to grant tax-free wage increases of 1.5 per cent (even if not justified by the performance indicators) and they limited tax-free wage increases to 6 per cent for all enterprises (even if the performance indicators would allow higher wage awards). Furthermore, the application of the wage bill regulation, with its built-in inducement toward labor saving, was widened.

The performance of the system with respect to wage differentiation and control of the purchasing power of households was not satisfactory after the 1976 reform. This was mainly due to the buoyancy of enterprise profits, which in turn was partly attributable to higher subsidies. Given the comfortable liquidity position of firms, wage awards were constrained less by performance indicators than by the 6 per cent ceiling. Few enterprises exceeded the tax-free ceiling because of the high marginal progressivity of taxes. The result was a bunching of wage increases at this 6 per cent rate, coupled with an accumulation of unused wage reserves that could be applied to future wage increases. Successive adaptations to the system included a reduction in the scope of wage increases for firms that formerly received preferential treatment, constraints on the use of wage reserves, and cancellation of the guaranteed tax-free wage increase of 1.5 per cent. These measures damped the growth of wages, but brought little improvement to wage differentiation. Against this background, the system of wage determination was adapted further in 1980.

Under the present system, the remuneration of employees 2/ which is subject to no other personal income tax than the 3-10 progressive contribution to social security, essentially consists of the following elements.

1/ Including income from dependent employment, work on household plots or private farms, and activities of self-employed craftsmen or operators of small shops.

2/ Excluding management.

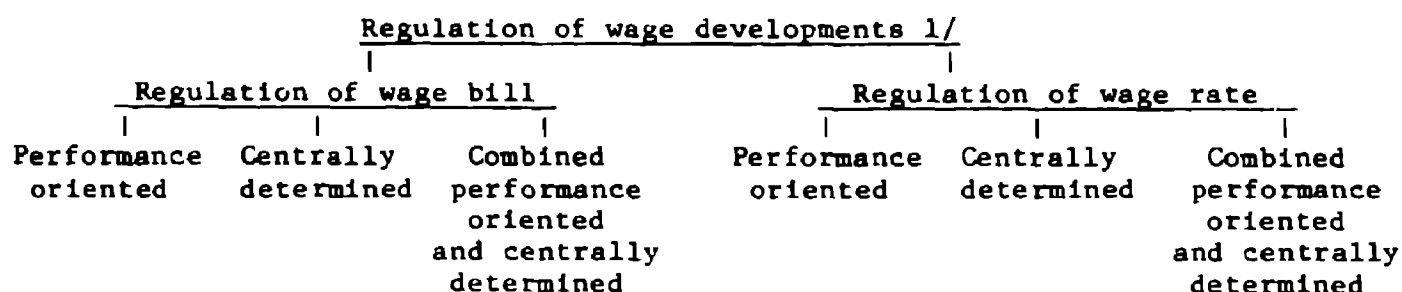


a. Wages

The basic wages paid to white collar employees are differentiated by four grades of training or education and by six categories of experience according to the length of service. For blue collar workers, there is a matrix of wage rates distinguishing between six categories of skills and four categories of working conditions. In each category of wages, a range is provided, with the upper and the lower limits being raised from time to time, in part to account for inflation. The difference between the limits has been widened to 60-80 per cent. The general framework is established by the central authorities; within the ranges, wage rates are negotiated by collective bargaining in the enterprises. Differentiation of the basic wage structure allows for a high wage of seven times the lowest wage for white collar and six times the lowest wage for blue collar employees. Blue and white collar pay scales are markedly egalitarian with the same lowest wage under both schemes.

Wage supplements comprise hardship payments, allowances for shift work and overtime, supplements for language skills, etc. They may be centrally determined or under the competence of enterprises. During 1976-80, wage supplements accounted on average for 5 per cent of total earnings, although they vary greatly between occupations.

The development of basic wages is essentially determined by six alternative schemes:



A common feature of the two basic types of regulation is that the performance-oriented schemes are based on indicators that include enterprise profits, whereas the centrally determined or mixed forms are applied where profits are not considered the appropriate guides. Under the

1/ These apply to activities excluding mainly agriculture, financial institutions, and public administration.

regulation of the wage bill, which applies to about 80-85 per cent of enterprise employees, enterprises can raise wage rates by reducing employment (within limits); the system therefore encourages labor saving. The performance-oriented variant of this scheme, which is used in the majority of enterprises, links the rise in the wage bill to the year-on-year increase in a performance indicator, the definition of which approximates the gross value added 1/ of enterprises. For each percentage increase in the indicator, enterprises may augment their wage bill by a fraction determined by a centrally established coefficient. The coefficient was generally set at 0.3. 2/ The centrally controlled form of wage bill regulation is mainly applied in specified sub-branches of the mining, energy, basic materials, and food industries as well as in cultural, research and development, and administrative services. It entitles enterprises to raise their wage bill up to a limit established by the central authorities (4 per cent). A combination of the two former schemes is applicable mainly in ferrous metallurgy, transportation, and domestic trade. It permits a rise in the wage bill up to a centrally determined rate (3 per cent), supplemented by an increase based on the performance indicator pertaining to the wage bill regulation.

Any increase in the wage bill in excess of the rates permitted by these statutory rules is subject to the tax on wage increases to be paid from the sharing fund according to the following schedule:

<u>Excessive increment in wage bill in per cent of wage bill of previous year</u>	<u>Marginal tax rate in per cent of wage bill increment in particular bracket</u>
0-1	150
1-2	250
more than 2	300

Increases in wage rates in enterprises subject to the wage bill regulation are also limited to 3 per cent over the rise in the wage bill. This provision is aimed at containing the extent at which wage rates can be raised implicitly through a reduction or a lesser increase in staff than in the wage bill. Increases in wage rates beyond this margin are taxed according to the schedule of the tax on increases in wage rates (see below).

The system of wage rate regulation is principally employed in the services sector, where labor saving is not a primary objective. The application of the performance-oriented variant is essentially limited to foreign trade companies. The performance indicator is defined to

1/ The indicator covers wage payments and other assimilated costs, taxes on wages, depreciation allowances, and profits.

2/ For a 1 per cent increase in the performance indicator, the wage bill could be raised by 0.3 per cent.

approximate the net value added per employee, comprising the per capita wage payments and profits of enterprises. The wage coefficient for most enterprises permits a 0.3 per cent increase in wage rates for every 1 percentage point rise in the performance indicator. In specified sub-branches increases in wage rates are subject to a centrally determined limit, or receive a centrally fixed maximum supplemented by increases based on the performance indicator. If wage rate increases exceeded these norms, the following progressive tax schedule applies:

<u>Excessive increment in wage rate in per cent of wage rate of previous year</u>	<u>Marginal tax rate in per cent of wage bill increment in particular bracket</u>
0 -0.5	100
0.5-1	200
1 -1.5	250
1.5-2	300
more than 2	350

Enterprises whose performance indicators would permit a rise in wage rates of less than 2 per cent, are exempted from the tax on wage increases for wage awards within this margin. Moreover, the uniform ceiling on increases in wage rates across all enterprises, irrespective of the wage regulation scheme to which they are assigned, has been maintained. Any rise in wage rates exceeding this ceiling is subject to a tax rate of 150 per cent in addition to the above progressive tax schedules. The ceiling was raised from 6 per cent to 9 per cent in 1980. Similarly, the provision continues to apply under all wage regulation schemes that any unused latitude of tax-free wage increases can be carried over as a wage reserve to be used in future years.

The tax liability on wage increases is settled at the end of the year from the sharing fund on the basis of the wage awards actually granted. The wage increases decided during the year are guided by the estimated development of the respective indicators or the ceilings established in advance by the authorities.

In agriculture, different income determination schemes applied to state farms and cooperatives until a unified system was instituted in 1980. It does not apply performance indicators but subjects the determination of average remuneration ^{1/} to a tax schedule with strongly progressive marginal rates. The tax rates rise with both the rate of increase in average remuneration and the level of average remuneration in

^{1/} Remunerations paid to members of cooperatives during the year according to statutory norms are considered as advances on the members' shares in the annual income of the cooperatives.

the previous year. Farms are entitled to distribute the unused potential of increases in remuneration in the course of the year as a participation in profits at the end of the year, without further taxation.

Enterprises may apply for discretionary wage supplements to be allocated by the central authorities, permitting increases in wages beyond the ranges justified by the above norms. Whereas before the 1980 reform such supplements often accrued to inefficient firms, the new system limits wage preferences to companies in good standing which execute tasks to improve their financial performance or produce favorable external effects for the economy.

b. Participation in profits

Employees are entitled to wage premia relating to specified tasks in addition to basic wages. Bonuses paid during the year depend on the employee's overall performance. These extra payments are drawn from the sharing funds. Any remaining sharing funds at the end of the year are distributed to employees on the basis of rules determined by collective agreement. Incomes from sharing funds represented 5 per cent of total earnings during 1976-80.

c. Remuneration of senior management

The basic wage of managers depends on the importance of the enterprise, in terms of the size of staff, capital stock, etc., and on seniority. In state enterprises and cooperative farms, the salary scale is differentiated by six classes of enterprises and six ranks of seniority from division chief to general manager, with a separate scale applied to middle management irrespective of the size of the firm. The maximum base salary for a manager is about four times the salary of the lowest earning shop floor manager and about ten times the lowest blue collar wage rate. Managers are awarded premia in line with the firm's financial results in the completed year. Moreover, the supervisory authority grants bonuses to managers according to the fulfillment of contractual arrangements concerning the structural development of the enterprise in areas such as adaptation of the structure of production, export performance, or the efficiency of investment. Premia and bonuses to managers, averaging 30-35 per cent of remuneration, are paid out of profits after deduction of allocations to the compulsory reserve fund. Such remuneration payments therefore are only granted if profits are sufficient.

2. Social benefits

Employees and their families also receive social benefits in money and kind from the social security system. The payments in cash are mainly pensions, sick pay, family allowances, child care allowances, scholarships, and housing allowances. The major benefits in kind are the free provision of education and health facilities. In addition, there are sports facilities and cultural and educational services available

at low charges. To finance social benefits provided by enterprises, the latter are required to form a welfare-cultural fund, the size of which is centrally determined.

The Price System

Before the 1968 reform, prices were in general centrally determined and did not normally reflect resource scarcities. Foreign and domestic price differentials were compensated out of special funds, and producer and consumer prices were separated through a wide range of turnover taxes and subsidies. The New Economic Mechanism foresaw a gradual move toward greater freedom in price determination by enterprises in response to market forces. The effort after 1973 to neutralize the impact of sharp rises in world market prices in effect led, however, to a partial reversal toward centralization. Price adjustments were made in 1975-76 and a second major price reform was undertaken in 1979-80.

The 1979-80 reform aimed at rationalizing the use of inputs in the production process, ensuring that profits reflected the relative efficiency of enterprises, and allowing prices to play a more active role in balancing demand and supply. It was recognized that domestic demand would need to be controlled by appropriate incomes and financial policies if the reformed price system was to be fully effective. The price reform included efforts to establish a closer linkage between domestic prices and world market prices, to allow greater flexibility in price formation, to widen the scope for price setting by enterprises, and to create a better relationship between producer and consumer prices.

The reform entailed major changes in the system of price setting and in the development of relative prices. Substantial supervisory control was maintained. About one third of producer prices and more than half of consumer prices have remained subject to regulation by the authorities. Enterprises must notify the Materials and Price Board in advance of increases in prices which can otherwise be freely negotiated between buyer and seller. They must also avoid pricing practices that would produce unfair profits, and must comply with the rules guiding the alignment of domestic prices to world market prices. Within 20 days after such notification, the authorities may object to the price increase or suspend it for up to six months if measures to avert adverse side effects are required. The reform resulted in a set of so-called 'competitive prices,' a set of prices established in relation to the former or to other similar or substitutable products (the principle of "proportionality"), and those set on the basis of the cost-plus pricing rules.

1. Producer prices

Because the domestic market is not sufficiently competitive for genuine market prices to emerge, the set of "competitive prices," which apply to 65-70 per cent of industrial production, is linked to world market prices. Producer prices in the domestic market for energy sources and raw and basic materials are essentially set at their marginal costs, on the basis of "durable" import prices from the convertible currency area. 1/ For metallurgical and aluminum products and certain basic

1/ A price is durable if it prevails for at least one quarter or is incorporated in contracts with such a duration.

chemicals, prices are set on the basis of export prices, because little is imported from the convertible currency area and then mostly under special conditions. In cases where goods are not traded with the convertible currency area, or only in small amounts, expert groups determine the relevant world price. Prices of energy and other basic materials imported from the CMEA area or produced domestically at below world market costs are raised to the "competitive" level by differential producers' turnover taxes. Domestic prices of raw and basic materials are "free," in the sense that enterprises can determine them on the basis of the above criteria, except that energy prices are set by the Government.

Domestic prices charged by most manufacturing enterprises whose convertible currency exports amount to at least 5 per cent of their domestic sales are generally based on domestic 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 allowed to rise more than, and have to decline in line with, export prices. Within the average, an enterprise can set prices of individual products according to the requirements of the market. The only rule governing individual prices stipulates that the domestic price of a product may not exceed the import price of a good of equivalent quality, or may not surpass the import price by more than justified by quality differences. For enterprises whose export sales are below the 5 per cent margin, the adaptation of producer prices to export prices is determined separately by the Materials and Price Board. In general, such enterprises may not set their prices higher than firms producing the same or similar products subject to the competitive pricing scheme.

The rules on competitive pricing were modified in early 1981 and 1982. The changes were made in order to avert two risks: (a) that enterprises might withhold products with a low profitability from export markets in order to maintain or raise the average profit margin on their exports, so as to allow a higher profit margin on domestic sales, and (b) that some firms might withhold exports to avoid reaching the 5 per cent margin which would subject them to the strictures of the competitive pricing scheme. Enterprises with profitable exports to the convertible currency area have been exempted from the obligation to lower their domestic prices if their export profitability or their export prices decline. In addition, certain firms have been authorized exceptionally to raise their domestic prices until their average profit margin on domestic sales reaches that on exports. These modifications apply only to enterprises that record growth rates in their exports in forint terms that attain or exceed specified thresholds. Moreover, the conditions subjecting enterprises to competitive pricing have been adapted so as to give firms the choice of following the statutory rules on export price-oriented domestic price formation or of abiding by separate rules laid down by the Materials and Price Board.

With the price reforms of 1979-80, the authorities raised the share of freely set prices in industry from 71 per cent to 82 per cent. The proportion of prices fixed by the authorities or subject to upper and lower limits or ceilings remained most pronounced in branches affected by the central determination of energy prices (Appendix Table 69).

Producer prices in the construction materials and food processing industries have also been increasingly freed, although in these branches the competitive pricing scheme is applied only to a minor extent.

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 profit markups on products are established on the basis of a "principle of proportionality" designed to bring a demand element into relative farm prices. Major departures from relative world market prices are common, however, because of extensive subsidies on inputs and price premia on outputs. Because of this the 1980 price reform attempted to adjust the structure of farm prices more closely in line with actual costs and to allow a suitable basis for the measurement of profitability of agricultural exports. But the reform did not entail a complete overhaul of the price formation process in agriculture or a linkage to world market prices. Notable increases in prices were undertaken, but farm prices generally remained considerably below both industrial prices and comparable world market prices.

Prices on almost two thirds of agricultural output, excluding the consumption of farm products by producers themselves, are subject to government control (Appendix Table 69). Regulated farm prices are in part centrally fixed. Others are "flexible," which means that they can move up to maximum limits or follow orientation prices within a permissible range. Minimum prices apply to vegetables, fruit, and small animals. Regulated farm prices for each year are established in September of the previous year. For seasonal products, orientation prices are set that follow the seasonal pattern. Representatives of cooperatives, state farms, and the central authorities meet several times a year to negotiate the level of prices within the permissible band. Agricultural products, with the exception of wheat and cattle, may be traded in farm markets at free prices. Where the volume of trading in the free market is substantial, the authorities smooth price movements by intervention sales or purchases involving resources from a special fund.

In the construction industry the share of centrally determined prices remains high, although in 1982 it was reduced from 87 per cent to 70 per cent. The system is based on specified norms for the cost of materials, labor, and profit margins. The 1980 reform introduced more precise definitions of permissible cost overruns under special circumstances.

In transport and telecommunications, there is a unified tariff structure. If costs increase, the sector requests an increase in its tariff from the Materials and Price Board. The small private sector enterprises operating in this sector tend to follow the public sector tariff structure.

Producer prices in trade and other services are determined by the cost-plus principle, including a profit margin of 9-12 per cent of the costs of capital and labor.

2. Consumer prices

One 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 per cent above that of producer prices from a negative differential of 4-6 per cent. In practice the positive differential actually obtained amounted to only 1.5 per cent in 1980, largely because a unanticipated sharp rise in energy prices was not fully passed on to consumers. Owing to a similar development in 1981, overall consumer price subsidies rose again and the differential of consumer over producer prices fell to about 0.5 per cent.

As a matter of social policy, consumer prices continue to be heavily subsidized for household energy, public transportation, and rents, and to a lesser extent food. These prices as well as prices of the chemicals and printing industries remained predominantly fixed or subject to centrally established limits in 1980 when the overall share of freely determined consumer prices was raised by 10 percentage points to 55 per cent in 1980 (Appendix Table 70).

Table 69. Hungary: Distribution of Producer Prices
by Pricing Categories

(In per cent)

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

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 70. Hungary: Distribution of Consumer Prices
by Pricing Categories

(In per cent)

		Fixed prices	Flexible prices within officially set limits	Free prices
Food, beverages, and tobacco	1979	23	52	25
	1980	23	49	28
Clothing	1979	--	20	80
	1980	--	1	99
Ironware, technical, and cultural materials	1979	--	45	55
	1980	--	22	78
Chemicals and petroleum products	1979	46	25	29
	1980	42	26	32
Wood and wood products	1979	--	51	49
	1980	--	15	85
Construction materials	1978	--	72	28
	1980	--	50	50
Glass and ceramics	1979	--	5	95
	1980	--	--	100
Fuels	1979	--	100	0
	1980	--	100	0
Books, periodicals, etc.	1979	50	45	5
	1980	<u>50</u>	<u>40</u>	<u>10</u>
Total retail trade in state and co- operative shops	1979	15	46	39
	1980	15	35	50
Services	1979	33	23	44
	1980	33	11	56
Handicrafts and products from free markets	1979	--	--	100
	1980	--	--	<u>100</u>
Total private consumption	1979	16	39	45
	1980	16	29	55

Source: Data provided by the Hungarian authorities

BIBLIOGRAPHY

Fund sources

International Financial Statistics
Direction of Trade Statistics

Hungarian sources

National Assembly, Act on the Sixth Five-Year Plan of the National Economy (1981-1985)

Hungarian People's Republic, Magyar Közlöny

Ministry of Finance, Pénzügyi Közlöny

National Bank of Hungary, Economic Bulletin

National Bank of Hungary, Market Letter

Central Statistical Office, Statistical Yearbook

Central Statistical Office, Statistical Pocketbook

Central Statistical Office, Népgazdasági Mérlegek

Central Statistical Office, Beruházási-Építőipari Havi Adatok

Central Statistical Office, Monthly Bulletin of Statistics

Gazdasági Szabályozók 1980