Main Problems of the Recent Hungarian Economic Development and Prospects of the Future Economic Growth

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Economic efficiency, external trade and economic development in the Hungarian economy

Following the so called world market price explosion and the recession period of 1974–1975, Hungary entered a critical stage of its economic development. By the end of the 1970s the country's growth rate had been decreased considerably and, for several reasons, there is great probability for a conspicuously modest economic growth rate in the near future too. One direct reason for decelerating the Hungarian economic growth is, undoubtedly, the "hardening" of the conditions of competition in the world market. However, investigating the problems of the Hungarian economy more profoundly, we can say that the slow economic development had deeper reasons and the fast increase of oil and raw material prices in the 1970s only uncovered our weaknesses in the field of economy.

These weaknesses would result–sooner or later–in considerable diminution of our growth rate without an abrupt price explosion too. Deeper reasons for the difficulties in our economic development are the insufficient economic efficiency, the insufficient quality, the lack of "up-to-dateness" of the goods of manufacturing industry and the inelastic accommodation of our production to the permanently changing comparative advantages. An understanding of the difficulties appearing in our present economic growth presupposes a closer investigation of the interrelations among the problems of economic efficiency, external trade and economic development and a deeper analysis of the special weaknesses characterizing the Hungarian economic development in the years past and also in the present.

1. Some characteristic features of the Hungarian economic growth in the period of 1950-1975

The Hungarian economy attained a relatively high growth rate in the period of 1950–1975. Regarding GDP, the average growth rate amounted to 5.7 %. After having introduced the "new economic mechanism" the growth rate of GDP increased to 6.2 % in the period of 1968–1975. The speed of development in manufacturing

industries was higher (7.7 %) and in agriculture it was essentially lower (1.1 %) on the yearly average. It should be stressed, that in the field of agriculture accelerating growth was being effected: in the period of 1950–1975 the growth rate amounted to 1.1 %, however, in that of 1968–1975 it rose to 1.6 % and in the years of the 1970s it reached more than 3 % on the yearly average. The speed of our economic growth was higher than that in most of the Western European capitalist countries and it achieved medium level among the Eastern European socialist countries; the growth rate was higher in Poland, Romania and Bulgaria than in Hungary, but she developed at a faster rate than GDR and Czecho-Slovakia. It should be mentioned that from the 1960s on the Hungarian government (in contrast to some of the other socialist countries) endavoured less and less to accelerate the economic growth; the aim was rather to maintain the growth rate that had been achieved in the previous periods.This feature of our economic policy had a certain role in the fact that, in Hungary, the shortage phenomenons in the sphere of consumption goods were of essentially lower level than that in several other socialist countries.

As regards the economic efficiency, the situation is less favourable. Investments and total capital efficiency may be regarded as weak points of our economic development. When investigating the changes in investment efficiency, we can use the "ICOR" indicator (Incremental Capital-Output Ratio), i. e. the quotient of average gross investment ratio and average growth rate of GDP for a certain period. This ratio directly expresses the gross investment intensity of 1 % growth rate, while it indirectly shows the efficiency of investments too. More clearly: a decreasing number value of ICOR shows increasing efficiency, and its increasing number value decreasing efficiency of investments. Thus in the following table the number value of ICOR was of increasing tendency in the period investigated.

Number value of ICORs in the field of material production, manufacturing industry and production of total GDP (Calculated in 1972 prices. Period: 1950–1975)

	1950–75	1950–60	1961–70	1968–1975
Material prod.	3.53	2.93	3.73	3.62
Manufact. ind.	3.55	3.58	3.91	3.88
Agriculture	13.63	8.33	18.33	15.66
Total GDP	4.60	3.67	4.76	4.77

Calculated on the basis of data obtained from the Hungarian planning Office.

In connection with the above data, the following comments are necessary: a. The deteriorating tendency of investment efficiency was stopped after the economic reform had been introduced in the Hungarian economy. However, fundamental improvement had not ensued. This reveals the problem that our economic reform wasn't consequential one, it had been stopped after few years. (closer investigations of the

problem of investment efficiency prove that in this field great improvements could have been achieved) b. The absolute level of our investment efficiency proved to be relatively low in spite of the fact that the investment funds (as in other soclalist countries) were concentrated mainly into the sphere of material production while the sphere of infrastructure was neglected to a considerable extent. Generally, the tertiary sector absorbs more than 60 % of total investments in the middle developed and developed capitalist countries. In the socialist countries, the proportion of investments carried out in tertiary sector varies between 30 and 50 %. In Hungary, this proportion amounted to 47 %. During the 1970 s, in comparison with other socialist countries, we attained a relatively high investment share in this field; however, the investments directed into the tertiary sector were insufficient. As is commonly known, by concentrating investment funds into the material production, a relatively faster growth rate can be achieved over a relatively longer time. Of course this higher growth rate diminishes the number value of ICOR indicators. On the other hand, the high number value reveals the existence of several factors having an adverse effect on the level of our investment efficiency.

Regarding the changes of total capital output ratio and thus the development of total capital efficiency, a double tendency can be observed in the period of 1950–1975. In the sphere of material production, a significant worsening of capital effectiveness was seen, that is, the total capital output ratio showed a definitely increasing tendency. By contrast, in the tertiary sector and first of all in the sphere of nonmaterial services, the total capital output ratio essentially decreased, i. e., the capital afficiency demonstrated an improving tendency. Taking the whole economy together, the increase of capital efficiency in the tertiary sector counterbalanced the deteriorating efficiency of capital in industry and agriculture; more clearly, the total efficiency of economy increased and the total capital output ratio decreased. However, this improvement was only illusive: in reality, the improvement in the tertiary sector was hardly a favourable phenomenon. The problem can be traced back to the insufficient development of the tertiary sector. Historically, because relatively few capital investments were directed into this area, the amount of total capital invested increased at a slow rate while the demand towards the services of this sector increased at a fast rate. And this rate exceeded the growth rate of the total capital tied up in the tertiary sector. Thus, *the calculated total capital output ratio* showed a falling tendency, which however, revealed even neglecting the nonmaterial sector. In a consequence of these changes, our economy had got to a very contradictory state; even aspecial additional factor in the past contributed to the fast growth of our economy begins to appear as a special hindering factor to growth nowadays: pushing into the background our tertiary sector becomes more and more important obstacle to our economic growth. Backwardness of our communication system, the obsolate

telephone network resulted in waste of working time during certain periods of the day even in the capital city. The backwardness of the transportation network, the relative low level of our roads hinder the increase of productivity as well. The problem of the capacity of services in the field of consumption is one of widely discussed theme sin Hungary. Everyone agrees that a faster development of our tertiary sector is inevitable. This may be reasoned both by the requirements of the further economic growth and by the dependence of the living standard on the tertiary sector. In the near future, we cannot boost the growth rate of our economy by concentrating the investments into the material sector, e. g. into the manufacturing industry. Quite on the contrary, in interest of inevitable faster development of the tertiary sector we have to calculate with relatively slower growth rate of GDP.

In summarizing the problems of economic efficiency, we can say that in the period of 1950–1975 the country achieved relatively fast economic growth rate. However, **it** was accompanied by worsening of capital and investment efficiency in the sphere of material production, and by insufficient development of our tertiary sector. A serious contradiction had ensued between our economic growth and economic efficiency. This contradiction must be resolved, otherwise the economic development will bump into very strong barriers, the contradiction mentioned now must not exist over a longer time. The existence of this contradiction had become of crucial importance after the price explosion in the world market. It forced the country to realize the strong dependence of its economy on the changes of external trade.

In the course of economic development, the value of export and import related to national income and GDP showed powerful increasing tendency. The import elasticity of economic growth was generally more than 1.5 i. e., in the case of balanced external trade the volume of exports grew 1.5 times faster than the national income and/or GDP. In the import–and export proportion a big jump occunred in consequence of the "price explosion", i. e., because of the powerful increase of import prices, and in addition, due to the country's great efforts to accelerate the growth rate of export volume in order to achieve a balanced external trade. By the end of the 1970 s the proportion of import value was more than 44 % of the GDP and amounted to 54 % of the national income. One of the most important characteristics of the Hungarian economy is this extremely strong import–and export sensitivity. Nowadays, the problems of the Hungarian economic growth cannot be understood without taking into consideration this almost unique external trade proportion. (A similar external trade sensitivity can be observed in case of the Netherlands). This share of external trade is extremely high in spite of the fact that Hungary is neither a highly developed country nor an economy which is characterized by mono-

cultural production. The special reasons for the big external trade proportion are the following: (a) Hungary is a smallcountry with a population of 10.5 million by the end of the 1970s, (b) the country is poor in raw materials and energy carriers, (c) the raw material and energy intensity of production is relatively high, essentially higher in Hungary than in the developed Western European countries. This latter factor has a close connection with the low level of economic efficiency, which largely explains the big share of raw materials and energy carriers in our total volume of imports. Owing to the steps taken in the second half of the 1970s in interest of saving with import outlays, the import elasticity of our economic growth had been decreased to 1.2, but (as this indicator shows) the proportion of external trade has still increasing tendency.

The problems of the Hungarian external trade together with the recent and future difficulties of Hungarian economic growth cannot be understood without making a sharp distinction between the two main spheres of foreign trade: (a) external trade continued with other socialist countries, and (b) external trade effected with capitalist countries. The proportions of these two are about fifty-fifty, but there are some very important differences between them.

Perhaps the best approach to investigating these differences is the following formulation: increasing our external trade meets with difficulties in both areas, but in the area of socialist countries, raising our export is mostly limited by the limitations on increasing our imports. It has several reasons. The most important ones for it: (a) In the socialist countries peculiar "shortage economy" exists. Important shortage phenomenons may be experienced mainly in the market of "capital goods", but many times in the market of consumption goods too. In Hungary, after having introduced the new economic mechanism, the intensity of shortage has been moderated, though it has not been removed entirely. Because the shortage economy has strong absorbing effect on the market and on the external market too, increasing the export to the socialist countries doesn't generally bump to serious barriers. And because the Hungarian economy is characterized by the phenomenons of shortage to a less extent (in comparison with the economy of some other socialist countries) the compelling forces to increase the import are generally weaker than the forces having an absorbing effect on our export. This problem is of particular importance mainly under conditions of the bilateral external system, i. e., in the external trade of CMEA countries. (b) Since the first years of the 1970s, the deliveries of raw materials and energy carriers of the Soviet Union was being strongly decelerated. The COMECON integration had mainly been built on the raw material and energy-carrier transportation from the Soviet Union, the other forms of this integration are–for the time being–in a relatively underdeveloped condition. Decelerating the socialist import in real terms results in

decelerating the exports too. Investigations made on the import possibilities which can be effected from the other socialist countries prove, that in the near future Hungary may not expect more than 3–4 % import growth rate in real terms from the COMECON countries. (c) The quality factors and the degree of up-to-dateness of commodities exported by the socialist countries are further hindering factors, these however set obstacles to the growth of both exports and imports in each socialist country. The bilateral character of external trade among the COMECON countries has a similar effect. Because of the strong correlation between the expansion of external trade and the speed of economic growth, the relatively slow increase of imports and exports among the socialist courtries will moderate the growth rate of our production in the near future.

Regarding our external trade effected with the capitalist countries, even the export possibilities set obstacles to the speed of our import growth. In this area Hungary may be regarded as a shortage economy against the capitalist countries. The shortage results in a tendency for creating import surplus e. g. because of its great absorbing effect on the market, and for its unfavourable effect on the development of technique, up-to-dateness of products and on the changes of the structure of production as well. For these very reasons the Hungarian economy has always showed a strong propensity to bringing into existence a considerable sum of *import surplus* in "dollar relation". From time to time restrictive measures have been applied in order to restore the balanced external trade with the developed capitalist countries. Of course, these restrictions had a braking effect on the speed of our economic growth. This propensity to developing an excessive import surplus manifested itself powerfully on the occasion of the world market price explosion, and in the years following this caused abrupt rise of prices. Negative trade balance of enormous amount had ensued, and it is impossible to exaggerate that without investigating the reasons for, and impacts of this negative balance, the recent and future problems of the Hungarian economic growth cannot be understood.

2. External trade and economic growth after the price explosion

In the years of the worldwide–recession of 1974–1975, Hungary's foreign debts rose more than 1 billion (thousand millions) dollars a year, in consequence of the negative balance of external trade. This enormous amount can be explained by two factors: (a) the"terms of trade" index had been deteriorated in the years of 1974–1975; and (b) the growth rate of production which had been achieved during the previous periods (the 5–6% growth rate of GDP on the yearly average) was maintained during years 1974–1975 too, without accommodating the production structure to the fast changing comparative advantages.

It is to be stressed that in the years of 1974–1975 the fall of the "terms of trade" index was not very significant, taking the value of this index as 1973=100, the drop amounted to only 13.5%. This can mainly be explained by the special price calculations, which were applied at that time by the socialist countries. In several capitalist countries (e. g. in Japan) the drop of the "terms of trade index" was essentially faster. Thus the main reason for the fast increase of Hungary's foreign debts and the enormous negative trade balance wasn't the deterioration of the "terms of trade index". *Forcing the growth rate of production attained in the previous years* played more important role. In the years of the worldwide-recession the country was not able to realize sufficiently fast growth in exports, for under conditions of economic crises, increasing the export bumped into strong barriers. However, even in this period, increasing the imports was relatively easy task, and maintaining the growth rate achieved in the earlier periods required a fast import growth rate. Enormous gap had ensued between the import and export growth rates in favour of the import rate and this was the main reason for having taken place the large negative trade balance in the years of 1974–1975.

Seemingly (regarding the data of national income) nothing happened. The growth rate was steady, the country was not affected by the world economic crises. However, there were obvious troubles in the sphere of external trade: the growth rate of exports lagged behind the previous figure and behind the speed of imports. By contrast, in Japan, the changes were of quite different nature. The Japanese export rose by 19% in the years of 1973–1975, and the import volume *fell* by 14.6%. This is the essential difference in external trade between Japan and Hungary: 24% *increase* of imports in Hungary and about 14% *drop* of import in Japan. In the latter, the result was a balanced external trade in spite of the serious fall of the "terms of trade" index. In Hungary, enormous negative trade balance came into being, although here the drop in the terms of trade index was of more moderate degree.

In the efforts to maintain the growth rate of production, some theoretical considerations among others played considerable role.

First: In Hungary, (as in other socialist countries) one of the guiding principles of the economic policy was to exempt the domestic economy from the harmful effects

Changes of indexes of the national income, export and import in Hungary between 1973 and 1975. (1973=100)

	1973	1974	1975
National income	100	105.9	112.5
Export volume	100	103.5	108.5
Import volume	100	117.4	124.1

Source: Statisztikai evkönyv 1979. Központi Statisztikai Hivatal 1979. (Central Statistical Office, Budapest)

of the speculative price changes in the capitalist world market. The prices are to be cleaned from the speculative price movements. And, in Hungary (as was believed in other countries around the world too) a lot of economists were convinced of the temporary character of the high oil and raw material prices. A lot of leading economists asserted that in consequence of the high oil prices the supply of oil will be increased enormously, and its producers will reduce their oil price. The extremely advantageous monopolist position of the oil producers was taken out of consideration, similarly the difficulties of changing the structure of energy consumption were ignored. Convinced of the temporary character of the price explosion, the socialist countries continued their expansive economic policies even during the years of the worldwide recession, and under socialist conditions (for having the state decisive role in the economy) a steady growth rate (*temporarily* of course) can be maintained. (*For a while*, impact of rising import prices could be neutralized by means of the state budget and the external trade monopoly. Enterprises operating under the protection of this monopoly and of the state budget, maybe, failed to notice the events happening in the world market).

Second : Up to this time another guiding principle of the socialist economic policy was that the socialist reproduction was to be characterized—over a longer period too—by steady growth, without stoppings and recessions. The process of economic growth under the conditions of socialism is "exempted from the fluctuations of capitalist production". Investigating the actual economic development in Hungary, we can say that *steady growth* over a long period did not take place in our country, there were several stoppings in the course of production. And theoretically too, exemption from the fluctuations of the capitalist reproduction can be realized only in case of not following intensive external trade with the capitalist countries, i. e., in the case of "closed" economy. In reality, the proportion of exports and imports in trading with the capitalist countries amounts to 25% related to national income (export and import separately achieve a 25% proportion) thus, the exemption from the capitalist economic fluctuations doesn't exist either in theory or in practice.

By the second half of the 1970 s, the situation changed as follows: (a). The growth rate of production showed a decelerating tendency: the relatively high growth rate achieved in the previous period could not be maintained. (b) The average *growth rate* of exports (both in value and in real terms) cought up with that of the imports in consequence of the efforts to accelerate the export, and to decelerate the increase of imports. However, regarding the *level* of import outlays and that of export receipts, the situation had not changed. *A big difference* existed in favour of the import outlays *in dollar relation.* For this reason, the external trade position of Hungary remained essentially the same in the second half of the 1970 s: the amount of foreign debts grew enormously as time passed, and its tempo exceeded the growth

rate of exports, Thus, the so called foreign debt service ratio showed an increasing proportion. By the end of the 1970 s everyone agreed that something must be done to brake the increment of foreign debts. Almost everyone was of the opinion that although increasing the foreign debts could not be stopped at once, at least the amount of its *increment* should be moderated, and a further increase in the foreign debt service ratio should not be allowed. The *minimal* requirement was formulated as follows: at least the proportion of foreign debt service must be stabilized, and as much as possible decreased.

Unfortunately, under the present economic conditions, only braking the increment of foreign debts results in a deceleration of the speed of economic growth and, in addition, we must take into consideration the considerable divergence between the development of GDP produced and GDP realized (disposable GDP). Let us investigate these problems in details.

3. Consequences of braking the increment of foreign debts in the near future

As it had been accentuated in the aboves, although the average growth rate of exports, both in roubles and in dollars caught up with that of the imports, the *level* of import outlays exceeded considerably the level of export receipts *in dollar relation.* This is the reason for increasing the foreign debts later on. Thus, in order to moderate the increment of dollar debts, a faster export growth rate is to be achieved in dollar relation related to the import growth rate (during the period of moderating the increment of dollar debts, or decreasing the amount of these debts). However, under the present economic conditions, we cannot accelerate our export to the capitalist countries (of course in real terms, and also in case of stable prices in value terms too). Conseqently, a surplus in export growth rate related to the speed of import can be realized only by restricting the imports. Considering the degree of increment in foreign debts and the proportion of the foreign debt service, an important gap should be achieved between export and import and import growth rates in favour of export. It requires (in the case of an unchanged export growth rate) strong restrictions in the sphere of imports. In Hungary, there is a very close correlation between the import and GDP growth rate, for a high import proportion related to the national income and GDP exists. Thus, restricting the amount of imports results in decelerating the growth of production too. In addition, during the period of decelerating the increment of foreign debts, the *increment of exports* will exceed the *increment of imports* related to the previous years. This will be repeated *year by year*, during the period mentioned, and for this very reason, the growth rate of *GDP realized* (*disposable GDP*) lags behind the growth rate of *GDP produced.* In other words, in the near future

Changes of exports, imports, GDP produced and foreign debs

Years	GDP Prod.	GDP reali-zed	Growth rate of prod.	Exports	Exp. g. rate in real terms	Import	Imp. g. r. in real terms	Foreign debts	Increment. of for. debts
1.	100			40		40		0	0
2.	105		5	42.4	6	42. 4	6	0	0
3.	110.25		5	44.94	6	53.93	6	8.96	8.99
4.	115.75		5	47.64	6	57.17	6	18.52	9.53
5.	118.65	117. 5	2.5	50.50	6	58.88	6	26.90	8.38

we may increase our investment and consumption only at a lower rate than our production. In order to better understand this problem, let us investigate this process by making use of a simple numerical example.

The suppositions employed in this example are the following: (a) The growth rate of exports between the first and third years is yearly 6%; (b) Import elasticity of economic growth is 1.2 i. e., in the case of the 6% import increase the growth rate of GDP amounts to 5%; (c) In the third year the import prices abruptly increase by 20% while the export prices remain stable; (d) Between the third and fourth year the rate of growth of GDP remains 5%, and the prices in external trade do not change; (e) The government experiencing the enormous increment of foreign debts restricts the imports in the 5-th year and tries to achieve 3% difference in favour of the export growth rate; (f) In consequence of the greater increment of exports than imports as compared to the previous year, the increment of disposable GDP lags behind the GDP produced by the surplus of export increment over the import increments in the fifth year; (g) The proportion of exports and imports is 40% in the first years, and there are not foreign debts at the beginning of the period investigated.

In the fifth year, the *increment* of exports is 2.86 value units and that of the imports is 1.71 value units. In value terms, by 1.15 units more goods flow out of the country than comes into it as compared to the previous year. Consequently, the goods being disposable for internal use, increase by a smaller rate than the growth rate of GDP produced. The amount of disposable GDP is 117.5, only by 1.5% higher than the GDP produced and realized in the previous year. In addition, since the third year in consequence of the price explosion the imports became overvalued against the exports, we may assert that the excess of goods flowing out of the country was even bigger than that of the previous year, and for this very reason the growth rate of disposable income may be even less than 1.5% in the fifth year. It is to be stressed that the growth rate of disposable GDP continues to lag behind that of the GDP produced during the whole period of existing surplus in export increment over import increment, i. e., during the whole period of decelerating the foreign debt increment, or decreasing the amount of foreign debts.

Taking into account the real facts of the Hungarian economy, we can summarize

the development prospects in the following way. In dollar relation we may expect about 6% export growth rate in real terms. In rouble relation (taking into consideration the difficulties to increase the imports), we can calculate an even more moderate export growth rate. It is very likely that the growth rate of total import may not be higher than 3% a year. Otherwise, this gap between the export and import growth rate is necessary for decelerating the increment of our foreign debts. In the last years investigated, the import elasticity of production growth was 1.2 (this decreased value has been effected by several saving measures in the field of import) that is, the growth rate of GDP might achieve a 2.5% rate on the yearly average. Taking into consideration the excess in export increments over the increments of imports, we may get to the conclusion that the growth rate of *disposable* GDP achieves hardly more than 1% on the yearly average in the following (at least) five years. It means that (when calculating an unchaged gross investment ratio) the level of total consumption cannot be raised more than 1% a year. In addition, certain social assignments are to be increased inevitably, e. g., the amount of low pensions and family allowances, and the amount of academic scholarships must be raised. Because of this very reason, the total consumption is immediately increased, i. e., without raising the average level of *real wages*. Looking at the future, we can say that the average growth rate of *real wages* may not be more than zero% in case of the supposition that fundamental changes will not be effected in the field of our economic mechanism. Our Planning Office expects only the increase of *real income* (it includes the changes of the so called "social assignments" too) and the restraint of the average real wages is planned.

However, it is true that seemingly there exists possibility for an important and abrupt increase of personal consumption in spite of the slow increase of GDP produced and realized because of the drop in the growth rate of production. It seems that for this very reason the supposition of unchanged gross investment ratio is not correct. Ceteris paribus (taking the average and marginal capital output ratio constant) the gross investment ratio and the ratio of net investments must be decreased when the growth rate is being moderated, and temporarily, the proportion and level of personal consumption can show an important increasing tendency even in the case of a very slow production growth rate. In Hungary until the middle of the 1970 s the average growth rate was more than 5% for a year. The drop of the average growth rate of production to 2.5% makes a strong fall of net investment ratio possible. Due to the 5% growth rate and nearly 5/1 total capital–output–ratio in the past, the average net investment ratio amounted to 25% as compared to the national income. In case of the constant average and marginal capital output ratio, the proportion of net investments dropped to 12.5%, and the other 12.5% of the national income could be released for increasing the personal consumption. Along with transfor-

ming the production structure in favour of the department of consumption goods, the level of personal consumption and that of real wages could be increased successively. True, there may be only a single occasion for raising the personal consumption, however in the future of hard times this possibility of more than 10% rise in the real wages would have great advantage.

Unfortunately, the above mentioned possibility does not exist since the supposition of unchanged average and marginal capital–output–ratio is not correct. Namely, there are *additional investment requirements* having strong tendency for increasing both the average and marginal capital–output ratio. Of course, the drop in the growth rate of production, ceteris paribus, moderates the magnitude of investment ratio. But in the end, it only counterbalances the effect of the additional investments mentioned above. Practically, the importance of a lowered growth rate does not consist in *reduction* of the net investment ratio. It is real importance that in spite of the existing *additional* investment requirements, a further increment in the investment ratio may be avoided.

4. Special additional factors tending to increase the marginal and average capital-output-ratio

As it has been accentuated, owing to the forced development of industry sector, the so called *tertiary sector*, the sphere of *infrastructure* has got into a backward position. One of the special features of the economic structure of Hungary (like that of other socialist countries) is the relative low share of the tertiary sector in the total employment, and of course, in the total investments as well as in the production of total GDP. Comparing the structure of employment in Hungary with that of the middle developed capitalist countries, we can see that the share of our tertiary sector is ill proportioned. In 1974, the proportion of employment in the tertiary sector was 32.7% while that in Austria was 46.1%, in Italy, 42.5%, and in Spain 39.8%. In the same year this proportion in Japan was 50.8%. In the next 10–15 years faster development of our tertiary sector is inevitable, and for the sphere of tertiary sector has a high capital intensity, it results, in all likelyhood, in increasing both in the marginal and the average capital-output-ratios. Consequently, this will counteract the falling tendency of investment ratio originating from the drop of average growth rate of production.

By contrast, the area of *industry*, and more specifically, the area of *manufacturing industry* has relatively big proportion compared with the developed capitalist countries. Except West Germany, the share of our total industry in the total employment is essentially higher than in the industrially developed countries in Western Europe and in the other parts of the World as well. In the sphere of industry (including the construction industry) the proportion of employment achieved 44% of

the total employment, while this share in the USA was 32.1%, in Japan 36.4 %, and in France 37.4%. Spain, having about the same economic development level as Hungary, showed a share of 37.2% in 1974. Paradoxically, the oversized employment implies even the relatively low technical level of our industry. In Hungary the same volume of industrial product is produced at a great costes by more employees than in a capitalist country having a similar econonic development level to Hungary. The reason for it is that in Hungary the process of industrialization has been constructed on a relatively low technical level. The relatively backward technical level of production involves insufficiences in the "up-to-dateness" of products too, which is one of the main reasons for the insufficient competitiveness of our commodities in the world market.

Another severe problem is that the structure of our manufacturing industry deviates considerably from the comparative advantages. The main reasons for it: (a) The price proportions did not reflect the proportions of inputs, the world market prices and the relative scarcities. Thus, differences between prices and costs did not orientate the producers to the development of comparative advantages. (b) Enterprises were not even compelled to adjust themselves to the comparative advantages because of the system of subsidies and withdrawals employed by the state. When suffering losses, firms could rely on this system, the losses could have been counterbalanced by getting subsidies. When realizing extraprofits, these might have been taxed away by the state. (c) For a long time, the theory of comparative advantages was refused: according to the earlier official opinions, this theory might have applied only under conditions of capitalist interrelations. Therefore a socialist planning system trying to adapt mainly the natural processes couldn't take into consideration the comparative advantages. The inadequacies in this adapting process are another very important reason for the lack of sufficient competitiveness of our exports in the world market.

Summarizing the problems of industry in Hungary, we can establish that the necessary technical development, the necessary development of "up-to-dateness" of commodities, and the structural changes to be carried out inevitably in order to accommodate the structure of outputs better to the comparative advantages, require enormous additional investment expenditures, and at least temporarily raise the marginal capital-output-ratio. Of course, it is a further counteracting factor against the drop of investment ratio deriving from the drop of growth rate of production.

Agricultural production is a strong sector in our economy. Its share in the total employment corresponds to our development level and/or to the proportion of an international average at this development level. Agricultural exports are the most important source of our convertible currency receipts and a further fast increase of agricultural export is expected both in rouble and dollar relations. According to our Planning Office an export growth rate of about 4–5% should be achieved

in dollar relation for the next five years. But, together with the increasing level of our agricultural export to the developed capitalist countries, the role of quality factors will be increased. The amount of export receipts largely depends on the ability of our economy to transport the agricultural goods at times when the development of supply and demand has increasing effect on the prices. The importance of wrapping techniques and avoiding the loss in harvesting the crops will become bigger and bigger. The amount of receipts can essentially be increased through processing the raw products of agriculture, it accentuates the importance of developing the food industry. All these imply that the quality improvement in connection with our agricultural export requires additional investments of great amount: storages, cold storages are to be built, transformation networks and roads are to bo developed, a lot of "approach roads" are to be built between the agricultural enterprises and public roads. Modernized wrapping techniques and the fast development of food industry reguire additional investmemts too. Since agricultural production has bigger capital intensity than that of the most other areas of the economy, the quality development of agriculture will result in an increase in both the marginal and the average capital output ratios on the macroeconomic level.

Considerable transformations are to be carried out in the fleld of *energy production and consumption.* In the past, the proportion of raw-oil based energy production in Hungary increased at a very fast tempo bebause the price of raw oil was moderate and increasing the energy production on raw oil basis had small capital intensity. The import of raw oil from the Soviet Union without paying in convertible currencies could be raised and the increasing share of raw oil in energy supply was advantageous. However, since the first half of the 1970 s the situation has chaged profoundly: the Soviet Union has been unable to promise the fast increase of its raw oil exports since the middle of 1970 s. The prices of raw oil and of other energy carriers have been increased enormously, and we have been compelled to increase the proportion of imported raw oil from the dollar area: the possibilitiy of raising the import of energy carriers without paying convertible currencies has been narrowed.

By the year 1980 the share of oil and natural gas in energy supply amounted to 63% and that of coal was 28% (The share of other sources: wood, hydroelectric stations, wind and others was 9%). By 1985 the share of oil and natural gas should be decreased to 59% and in spite of increasing the energy consumption on domestic coal basis, the proportion of coal energy supply will decrease from 28% to 25%. By contrast, the share of atomic energy will increase considerably from 0% to 7%. Owing to these structural changes, the average cost of one energy-unit may be moderated, and the increase of energy-carrier imports from the dollar area may be decelerated. But, we are to calculate the bigger capital intensity of energy

production and consumption, for the use of coal and atomic energy causes the capital-output-ratio to be raised. The great problem of our economic development in the near future is that we are compelled to make *fast and simultaneous* structural transformations in our manufacturing industries and energy supply and *at the same time*, to develop faster the tertiary sector and to carry out the quality development of agricultue.

In consequence of all these, additional investments of enormous amount are necessary and this is the reason why the total and net investment ratio does not fall in spite of the dropping of tne average growth rate. Moreover, many economists are afraid of the possibility of the net investment ratio's increase in spite of the essentially slower economic growth. This is a very delicate problem, for in the case of slow growth rate and in the case of an even slower growth rate of disposable GDP, even a relatively modest increase of net investment ratio can result in an absolute decrease of personal consumption. In addition, by increasing the social consumption funds, even in the case of a 1% yearly increase of personal consumption, the level of real wages cannot be increased. It means that a very modest increase in the net investment ratio can result in a reduction of the real wages. It would endanger the fulfilment of our medium term plans too, for a drop in real wages would discourage workers from increasing the productivity and the economic efficiency in their own field. Many economists assert that the plan of increasing the production by 2.5% and the disposable GDP by 1% on the yearly average can be discussed for several other reasons too, which so far have not been mentioned here (e. g. because of the strong "demonstration effect" originating from the Western European countries in connection with the foreign tourism, for the important difference in real wages in favour of the Western developed capitalist countries, and the prospects of their faster development than 2–3% in the near future). And, many economists are of the opinion that by improving the *general level* of economic efficiency and the competitiveness of our exports in the dollar market, a more expansive economic policy could be continued and a faster growth rate could be realized. Let us investigate this problem in detail.

5. Main problems of economic efficiency and export dynamics in Hungary

In the near future, the greatest problem of our economic development is that a relative lasting stagnation of the average real wages is plausible. Extrapolating the speed of our export in real terms, calculating the above investigated additional investments, taking into consideration the general level of economic efficiency, and considering the fact that an important surplus is to be achieved in the growth rate of exports related to that of the imports, we can hardly expect even the increase of

the total personal consumption. But the question arises: are the premises of the medium-term plan correct, e. g. cannot the *general level* of economic efficiency be improved, the speed of our economical exports to the advanced capitalist countries be accelerated and the level of the terms of trade index be increased? How is the necessary degree of braking the increment of external debts? By changing the premises, we may get to quite different speeds of economic growth and personal consumption. However, in this case, there is another question to consider. To what extent may we change the premises when investigating the prospects of our economic growth? These are hard problems, but studying the interrelationships more concretely, we may assert that important possibilities for improving the general level of efficiciency do exist, and both the growth of GDP and that of the personal consumption together with our exports and imports may be accelerated. To make these problems more understandable, it is advisable to begin investigating these interrelationships by studying some factors unfavoura bly influencing the developmennt of *economic efficiency.*

In Hungary, like in other socialist countries, there are several special factors which tend to lower the level of investment and total capital efficiency. Perhaps the more important factor is that paradoxically, preferences were and are given to the *individual enterprises over the national economy.* In socialist countries, enterprises enjoyed and enjoy great stability: bankruptcy of the firms is almost entirely unthinkable. Enterprises can hardly get into the condition of insolvency unlike the national economy, but the practical evidences prove that the socialist state itself *may* become insolvent. Socialist firms obtain money relatively easily, e. g. by getting subsidies from the state, by obtaining credits with "soft" conditions, or by increasing their prices relying on the conditions of shortage economy and on their monopolist position. The fundamental reason for this peculiar position is the special connection existing between the socialist state and its enterprises. Janos Kornai, the well known Hungarian economist, tries to characterize the peculiar relationnship between the socialist state and its enterprises by using the notion of "paternalism",* Using this category he stresses that in contemporary and especially in the traditional system of socialism the enterprises have no real autonomy, neither in Hungary nor in other socialist countries. The firms are commanded in the so called centrally planned system, or they are given advices (informal commands) in Hungary by the superior authorities. The state interferes with their affairs in details too. The firms admit these advices (informal commands) for they depend in many ways on these authorities. It is obvious that in every field of economic activity there exists direct dependence of enterprises in the traditional socialist system. However, dependence exists also in

* Janos Kornai: *A hiany*, Közgazdasagi es Jogi Kiado, Budapest, 1980. p. 658 (The Economy of Shortage)

Hungary, even after having introduced the new economic mechanism too, partly because the old guiding organisation remained essentially unchanged, and partly because the enterprises depended on the superior authorities financially further on. The system of subsidies and withdrawals has been widely employed by the state organs in later times too. In the case of realizing higher extraprofits the enterprises were levied by additional taxes and the extraprofits were taxed away by the state budget, and in the opposite case, when suffering losses, the firms were subsidized, and could realize profit of normal account even in case of lacking their economical business activity too. Obviously, the system of subsidies and withdrawals does not compel the enterprises to better utilize the capital tied up in production and to save the new investments. In 1978 for example the net profit of enterprises amounted to Ft 41, 7 billions in the field of industry. In the same year, the amount of subsidies was Ft 31, 1 billions and the sum of "production taxes" which are a special means of taxing away too large or too dispropartionate profits rose to Ft 34 billions. This means that in 1978 *the sum of total net profits* was not changed essentially by this system on the macroeconomic level, but in microeconomy, the distribution of profits *among the individual enerprises depended* first of all on the system of subsidies and withdrawals. It is to be accentuated that in the case of subsidies, the enterprises are individually handled and that the withdrawals are levied *beyond the normal taxes*. The *fundamental* destination of this system is to influence the development of profits in the enterprises *individually*. By the end of the 1970 s this practice resulted in the absurd situation that (considering the enterprises *individually*) on an average 75% of the net profits originated from *getting subsidies*. It means that the distribution of total net profits among the enterprises does not essentially depend on their activities in the *real* sphere (in the field of production and market).

The main harmful consequences of this system are the following:

(a) Enterprises are only weakly interested in the so called real sphere, i. e., in developing the techniques, in saving capital goods, in adjusting themselves to the permanently changing composition of market demand, in producing the "up-to-date" and quality goods. The firms operating uneconomically can obtain the same rate of profits as the firms operating efficiently. Thus, the firms are strongly interested in influencing the superior authorities and in "lobbying" favourable conditions in connection with the system of subsidies and withdrawals. A "clever" firm can many times realize bigger profit by lobbying than by dealing with the problems of the real economic sphere. This phenomenon greatly spoils the level of economic efficiency.

(b) Because the stability of the enterprises is guaranteed by the system of subsidies and withdrawals, and because the firms are able to increase their receipts relatively easily (the so called "budget constraint" of enterprises is "soft" enough), the firms do

not have to bear the responsibility for their investments either. On the contrary, increasing the investments means raising their economic power, their influences, their authority, and in this field the interests of the leaders and workers of the firms are in perfect harmony. By contrast, in the capitalist society, investments always mean a considerable risk for the investors. This is why, in most cases, the capitalist enterprises carefully ponder their own investment claims, and endeavour to save their investment outlays. A certain kind of selection is carried out *by the capitalist enterprises themselves.* This kind of selection cannot be observed on the part of enterprises in the socialist countries. Here an almost unsatisfyable hunger for increasing the investments can be observed. This hunger exists in every part of the economy except in the Central Planning Office and some other central organs which are responsible for taking charge of the economic equilibrium on the macroeconmic level. Of course, the latters cannot controlle the requirements of enterprises effectively: each investment is a special one, there exist no two uniform investments, the investment coefficients are unknown by the central organs, usually the enterprises have an advantage in these debates. The result is that investments on the macroeconomic level repeatedly tend to exceed the increase of investment capacities and a considerable shortage prevails first of all in the market of investment goods, and in consequence of several indirect impacts in the market of consumption goods too. Because of the existence of considerable shortages the socialist market is *usually* and *strongly sellers' market.* This fact has a lot of disadvantageous consequences in the field of technical and quality development, in adjusting to the structural changes of demand, in saving capitals, in changing the prices. Without taking into consideration this sellers' market, a lof of concrete phenomenons cannot be understood in the economic system of socialist countries. For instance, this is a reason why in the case of existing "limited prices" the prices are usually on the upper limits. This is one of the main reasons why the enterprises are not compelled to change their production structure at a fast tempo, to increase the share of new products and to stop producing old, obsolete ones.

(c) Another consequence of the lack of real autonomy of enterprises and of the excessive investment activities is a considerable dissipation of the investment capacities. For existing great eagerness to carry out investments, for example, on the part of enterprises, too much investments are usually started, but of course no more investments can be carried out than the magnitude of the investment capacities. Frittering away the investment capacities they get results of several further disadvantageous consequences. The most important ones are: (i) The average gestation period of investments is essentially prolonged: it impairs the capital efficiency on macroeconomic level. (ii) Because of the long gestation period, the average length of fulfilling the investments

takes at least twice as long in Hungary as in the Western European countries and the new products which are to be produced in the new plants often become obsolate, or in many cases extraprofits are not realised because the new goods do not reach the world market soon enough. It brakes the speed of our economic growth and the growth rate of our exports, and it impairs the level of economic efficiency too. (iii) Because of the long gestation period, the stock of unfinished investments amounts to a very high level. It equals the amount of total gross investments carried out in each year. Of course, unfinished investments should be completed, and their completion ties up a considerable part of the investment funds in each year. This means that the decisions on a great part of investments, which are to bo carried out year by year, were *born in the previous years.* This imposes restrictions on the accommodation to the new requirements of the world market, greatly impairs the elasticity of our economy.

Interestingly, the problem of economic efficiency is closely connected to the price system. In the socialist countries, intereresting discussions have been taken place on the content and the possible application of different price types under conditions of socialism. The essence of these debates is that prices should not be formd in a voluntary way independently of the input proportions (the value and/or production price proportions*). In reality, however, price proportions always have deviated to a considerable extent from the input proportions. In a centrally planned system, when obligatory plan targets are given to the enterprises, most of the prices are determined by the central organs. Under these conditions, the share of free prices is relatively small. However, the centrally determined prices are seldom changed in spite of the permanently changing input proportions; thus deviations between prices and input proportions are generally experienced. Not to mention the problem, that the price authorities do not usually know the real input proportions. For this very reason, in Hungary, on the occasion of introducing the new economic mechanism, everyone thought that by allowing a wide range of *free prices* a fundamental improvement could be achieved: market forces could compel the prices toward the input proportions. Unfortunately, these expectations have not been realized; the price proportions in the domestic market did not adjust themselves either to the input proportions nor to the world market. The reason for it is very simple and easily understandable: market forces drive the prices toward the input proportions only when *competitive market* exists and this market is not characterized basically by a "shortage economy". In Hungary's case the new economic mechanism was not accompanied by a radical ceasing of shortages and the degree of shortages was,

* Production price: average cost of certain kind of products+profits of average ratio in the firms which are of average level in an industrial branch.

to a certain extent, moderated.

To avoid misunderstandings, it should be stressed that price proportions do not have to comply with the input proportions *exactly and permanently*. A perfect congruency would mean that prices could not function effectively. They would not signal the *relative* scarcities in the market and the quality differences of commodities. The exact congruency of input and price proportions essentially would suppose an "imagined" Central Planning Office *operating perfectly*, knowing the development of the demand structure *exactly in advance*, and being able to change the structure of production in such a way that the demand and supply of each commodity could comply perfectly with each other precisely beside such prices which are perfectly congruent with input proportions. Such a Planning Office did not exist and never will exist. In Hungary, when the new economic mechanism was introduced, not a single qualified economist wanted to adjust the price proportions to the input proportions perfectly and permanently. The real trouble is *not the existence of deviations* but the fact that under present conditions these deviations *do not reflect the relative scarcities and quality differences of commodities*: deviations continue in sellers market because of the existence of very strong monopolist positions in production and market and because of shortages in the market. There is no guarantee for increasing the production when the prices are high. Under such conditions the amount and rate of profits realized by the different firms do not sufficiently reflect the level of their economic activities. Consequently, the application of the system of subsidies and withdrawals is inevitable, which discourages in turn the economic efficiency.

All of these mean that the insufficiences of the price system and the lack of autonomy of enterprises can be taken–to a certain extent–as hen and eggs problem: *each one is the cause of each other*. When enterprises lack one's own autonomy, important and irregular deviations in prices are inevitable. These deviations lead to the need for a system of subsidies and withdrawals. In short, sufficient price reform cannot be carried out without a radical reform in the position of the enterprises.

Of course, there are other reasons for the low level of economic efficiency. Among these the neglect of the view points of efficiency in the case of investments iniciated by the central authorities, the tendency of egalitarianism in certain areas of wage system, the separation of the producing enterprises from the external market, the insufficient number of small and middle enterprises, and the exaggerated centralization of enterprises in several branches can be mentioned. But, in my opinion, the position of enterprises, i. e. the lack of their *real autonomy* is of decisive importance. It is key problem in the further development of our economic reform.

As a matter of fact, when investigating the problems of economic efficiency, we deal with also those factors which directly influence the dynamics of external trade.

The shortage economy has close connection with the efficiency of investments, with capital tied up, and with the speed of economical export too. The phenomenon of shortage ensures comfortable position to enterprises in the *domestic market*: profits of high rate can be realized without making efforts to develop the quality of products, and without making efforts to reduce the prime cost of commodities. But entering the competitive external market, the commodities cannot be sold advantageuosly, moreover, their sale may often meet with considerable losses in prices, or they may become unmarketable. The result is: the moderate growth rate of exports in real terms, and the deteriorating tendency of the terms of trade index. We can gain a very instructive picture on the difficulties of our export to the developed countries when we investigate the dynamics of price changes in the individual branches. The essence is that the drop of our "Terms of trade" index in dollar relation can be traced back to *intra-branch price movements* which is contrary to the external trade in rouble relation. In the latter area, the deterioration of our "Terms of trade" index can be explained by interbranch changes of the prices: the price of raw oil and raw materials increased faster than the prices of foods, agricultural products and the products of manufacturing industry. In *dollar* area, the "Terms of trade" index considerably fell *within the individual branches*. In the sphere of "Chemical products" the index of export prices of the developed countries amounted to 207 in 1977 (1970 =100), while the index of Hungarian export prices was only 151. Considering the products of engineering industry, the index numbers were 207 in the case of developed countries and only 147 in Hungary. In other branches the situation was more favourable: our backwardness behind the developed countries was not essential. However these other branches were foods, raw materials, fuels, and "other" goods of manufacturing industry. In these branches the role of "up-to-dateness" is not so important as in the engineering and chemical industries. It is obvious that our disadvantageous position in the external trade with the developed capitalist countries can mainly be traced back to the lack of sufficient "up-to-dateness" of our commodities. In case of the relatively fast improvement of the up-to-dateness considerable acceleration could be achieved in our export receipts. Similar acceleration could be realized in case of faster adjustment to changing comparative advantages. However, these require essential changes in our economic mechanism, first of all, the realization of the real autonomy of enterprises.

No one knows to what extent the total marginal intensity of capital could be decreased and the economic efficiency be improved. But, considering the concrete interrelationships prevailing in our country, we can establish that there are great possibilities for increasing the total and marginal capital efficiencies. True, there are additional investment requirements which increase–ceteris paribus–the marginal capital

intensity. But, through carrying out the economic reform consequently, the *general level* of capital intensity may essentially be decreased. It may result in a drop in the investment ratio in spite of the additional investment requirements. In this case the growth rate of personal consumption could be raised to more than 1% on the yearly average, even if the growth rate of GDP produced does not exceed the 2,5% growth rate a year. In addition, on the basis of improving the efficiency and accelerating the quality development of commodities produced, essentially faster export and import growth rate could be realized. The difference between growth rate of exports and imports could be moderated furthermore. On the basis of faster production growth rate and tightening the gap between the export and import growth rate with somewhat faster import growth a perceptible increase of real wages could be achieved too. The very slow inccrease of production, the extremely modest increase of *disposable GDP* and the stagnation of real wages in spite of the considerable high value of gross and net investment ratio are not fateful, unavoidable consequences of the world market price explosion. Perceptible devlopment and a sizeable raise in the average real wages can be effected in the case of consequent exclusion of the factors responsible for the worsening tendency of economic efficiency*. The most important question is: what are the necessary steps, which are to bo be taken in order to accelerate the economic growth?.

* Troughout this study, the growth rate of exports and imports has been investigated as *a deciding factor* of the economic growth rate of Hungary. The technical development as a determining factor in the sphere of economic growth was mentioned only secondarily. Every growth theory regards technical development as one of the main determining factors in the dynamics of economic growth. Moreover, a great number of economists stress that finally, the dynamics of economic growth has two determining factors *in the long run:* (a) change in number of manpowers, (b) speed of technical development.

As a matter of fact, this study does not assert any different theory. The question is about the bottlenecks of the Hungarian economic growth. The most important direct bottleneck is the limited speed of exports and the necessity to reduce the growth rate of imports temporarily below the growth rate of exports. Over *the middle period*, the dynamics of external trade may become a decisive factor of the growth rate. This connection has already been accentuated by many authors e. g. by M. Kalecki who stressed that the growthrate may be decelerated in the case of unchanged technical development too. If there are serious limits to increasing the exports economically, the growth rate of production must be decreased. If it remains unchanged, i. e., if the rate of production growth effected in the previous years is forced, the export prices will fall, the "terms of trade" index will be deteriorated, and the growth rate of GDP *realized* falls below the rate of GDP *produced*. But, also Kalecki accentuated that over a long time the speed of economic growth depends on two factors. (1) The speed of technical development. (2) The growth rate of employment. The resolution is that in the long run, an accommodation process will be effected: technical development, growth rate of production and speed of external trade will get into harmony with each other. In the case of permanently limited export and import growth rate, technical development will be decreased, or, (this is the favourable case) the growth of economical exports will be decelerated. One of the great problems in Hungary is, which factor will accommodate itself to the other factor!.

6. Consequent economic reform, efficiency and ecomic growth

Consequent further development of the economic reform is of fundamental importance both in improving the economic efficiciency and in accelerating the speed of export and the production growth rate. The main steps to be taken, in my opinion and those of a great number of Hungarian economists, are the following:

1. Real autonomy must be given to enterprises. This means fundamentally two things, (a) Pushing back the system of subsidies and withdrawals radically. Subsidies should be given only for very reasonable cases, and generally with the obligation of enterprises to repay them. Extraprofits based on the efficient operation of enterprises must not be taxed away. Bankruptcies of firms should be allowed to exist under socialist conditions too. (b) Ceasing the detailed interferences with the affairs of enterprises. Informal commands of the superior authorities (ministries, county and municipal authorities and other organs) must be ceased. It should be ensured by carrying out organisational measures too. The system of informal commands permamently disturbed enterprises in their operation, and it hindered the fulfilment of the national economic plans.

2. Consequent price reform should be carried out. Competitive price system is to be effected, where the overwhelming part of prices are *free prices*. In this price system the changing price proportions reflect (besides the changing input and world market price proportions) the relative scarcities in the home market and the quality changes too. However, a fundamental precondition for this is the *ceasing* of *the shortage character of economy*. Otherwise, there is no guarantee that the prices tend towards the input and world market price proportions, and that they will reflect the quality differences and relative scarcities too. The decisive precondition for pushing back the shortage economy is: giving real autonomy to enterprises, pushing back the system of subsidies and withdrawals, and in this way "hardening" the budget constraint of the enterprises.

A very important step in the way of effecting the "competitive" price system was the application of the world price proportions in the manufacturing industry. This system was introduced in 1980, however, for the time being, this price system doesn't rely on the changed production structure already accommodated to our comparative advantages. Adjmtment to the comparative advantages takes time and a lot of investments. Therefore, this system, temporarily tends to incnease the amount of subsidies paid to enterprises, and of course, it has disadvantageous consequences. Days of grace are established for transforming the production structure. It is of great importance that the "world price system" should rely on the transformed production structure and face up to the competition of goods produced by firms in abroad.

3. Consequent transformation of the economic guiding organizations is inevitable. In the opinions of many Hungarian economists, the deficiencies of our economic reform can be traced back first of all to the fact, that the transformation of the guiding organizations did not happen. The basic principles for the reform of the guiding organizations are: (a) Superior organs should be able to comprehend the interrelated processes effecting in the economy, and they should be able to govern or influence them *mainly by the means of economic regulators*. (b) Superior organs must not have too big apparatuses, otherwise, the staff of these apparatuses would try sooner or later to interfere with the affairs of enterprises in details. (c) Legal arrangements are necessary to determine the rights and the sphere of activity of enterprises and those of the superior authorities in the spirit of self reliance of enterprises. Reexamination of the role of the guiding organs is under way in Hungary.

4. In several branches, decentralization of enterprises is necessary. Our economy is characterized by the existance of a lot of big enterprises. However, the number of small and middle enterprises is insufficient. It is a consequence of several centralization waves. The existence of big enterprises was convenient for the central organs. Commanding and controlling big enterprises existing only in relatively moderate number was practical from the viewpoiont of the centrally guiding system. Spontaneous processes played an important role too. Incorporating small enterprises was a suitable way for acquiring additional manpowers, and in this way, the problem of producing semi-products and components could be more easily resolved.

Decentralization of enterprises (of course only in certain branches) would have several advantages: (a) It would strengthen the competition, and push back the sellers' market. (b) Supplying the market with certain goods would essentially be improved. The production of many kind of goods is economical only in small and middle entrprises. (c) The speed of technical development could be accelerated; in the process of technical development, the small and middle enterprises have a very important role. Experimentations with new technques many times happen in these enterprises. (d) By increasing the number of small and middle firms even the shortage phenomenons could be pushed back too. (e) On the basis of wide network of small and middle enterprises "supporting industries" could be developed. Today, cooperation of big and small enterprises is almost missing in Hungary. Big enterprises are compelled to produce for themselves almost all semi-products and components and these many times result in poor quality of semy-products and final products too. More competitive small and middle enterprises would result in improving the quality of our exported products as well. In this sphere, important steps have been taken first of all in the area of textile industry in Hungary in the last few years.

5. Closer contact between the external and the internal markets must be effected.

In this process, a uniform exchange rate has already been introduced, and the separate commercial and tourist rates have been abolished. This was put in force on the lst October 1981. On the basis of the producer and consumer prices reform, the previous double exchange rates were ceased. The uniform foreign exchange rate helps us survey the problems of efficiency in the external maket, and prepare the *possible* introduction of convertibility of Forint in the near future. A further step is to give external trade licences to more of producing enterprises. In this way, the quality, technical up-to-dateness and output structure required by users in the external markets will be directly mediated to the home producers. This measure will make our production more elastic in accommodation to the changes of the foreign market. In the last year many enterprises were given external trade licences. A more advanced connection of the internal and the external markets would be the introduction of convertibility of our national currency. This would be decisive step in pushing back the shortage economy and in strengthening the competition in the internal market. However, the introduation of convertibility has several preconditions, e. g., previously we should carry out the transformation of the production structure of manufacturing industry and among others important changes should be effected in the economic mechanism of other socialist countries too. For the time being, there is no possibility for introducing the convertibility of Forint.

6. Several other steps could be mentioned in connection with improving the efficiency and the increasing speed of our economic growth. It is very likely that new forms of capital flow among the different branches should be applied. This would result in more elastic changes of our production structure. All of the changes or reforms which should be applied, mean strengthening the impact of the market forces and *utilizing them instead of pushing them into the background.* Nevertheless, as everyone agrees, *strengthening planned development is necessary.* This is entirely compatible with utilizing the market forces.

The essence is the following : (a)The elaboration of a *real* national economic plan is necessary. (b) The activity of firms should be directed chiefly by the the means of economic regulators, and of course, these regulators, i. e., credit, money, interest, customs, tax policy, and the ways applying them should be consistent with the national economic plan. (c) The decisive factor of planned development is the economic policy of the government, which, of course, should be in harmony with the national eccnomic plan and with the economic regulators. From the author's point of view it is to be stressed that *on the basis of* the continuation of *the economic reform, a more expansive economic policy could be continued* than the one existing in our country nowadays. A lot of economists asserts that the present economic policy is of excessively restrictive nature. Of course, if the economic conditions and the economic guiding system remain essentially the same, there is no possibility of carrying out a more expansive

economic policy and the speed of our economic growth depends on the development of economic reform to a great extent. Both the acceleration of economic growth and the further development of the economic reform are of great importance. A More expansive policy together with the accomplishment of a consequent economic reform will involve our economy in great difficulties *in short run*, but *over a long time* this is the kind of economic policy which will direct the economy toward the foreign trade quilibriume *and* the higher international competitiveness. In short, this policy means less risk *over* a *longer time*.