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SUB-COMMITTEE ON SOVIET ECONOMIC POLICY

ECONOMIC REVIEW OF INDIVIDUAL EASTERN EUROPEAN COUNTRIES

HUNGARY

Draft Report to the Committee of Economic Advisers

Note by the Chairman

In the series of re-examining sessions(1) a special meeting devoted to Hungary was held on 22nd June, 1967 with the participation of experts(2).

2. The attached Draft Report is based on the results of this meeting, as well as on the detailed note prepared by the United Kingdom authorities(3). It is intended to bring the report submitted to the Council in July 1965(4) up-to-date and it deals in particular with the further development of economic reforms as well as with Hungary's external economic relations. As in the previous report, some conclusions of a more general nature have been drawn.

3. This draft will be put on the agenda of one of the next meetings of the Sub-Committee.

(Signed) A. VINCENT

OTAN/NATO,
Paris, (16e).

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- (1) Czechoslovakia: 7th November, 1966; Bulgaria: 27th April, 1967;
Soviet Zone of Germany: 1st June, 1967.
(2) For a summary see AC/89-D/59.
(3) AC/89-WP/216
(4) C-M(65)57

NATO CONFIDENTIAL

ECONOMIC REVIEW OF EASTERN EUROPEAN COUNTRIESHUNGARYDraft Report to the Committee of Economic Advisers

Hungary is one of the smaller Communist countries with about 10 million inhabitants. It has one of the lowest rates of population increase in Eastern Europe. Although the country is poor in natural resources, its per capita national income is higher than that of Rumania, Bulgaria and Poland.

A. ECONOMIC REFORMS

2. The reforms envisaged for implementation in Hungary en bloc as of 1st January, 1968, are considered to be among the most progressive of Eastern Europe, short of Yugoslavia. But the whole programme is still largely tentative and experimental. The substance of the reforms will become clear only after all the practical measures have been applied, and results will probably not become apparent before the end of the current five-year planning period (1966-70) although drastic changes in the bureaucratic apparatus of the Hungarian capital are already under way.

3. The reform plans were preceded by a number of measures, beginning in 1957, although these were not conveyed as a comprehensive reform programme. Nevertheless, these piecemeal measures should be seen as forming part of a developing process starting with the Hungarian uprising in 1956 and terminating its first stage at the end of 1966. The year 1967 is designed to serve as a preparatory period until, at the beginning of 1968, the fundamental elements of the new economic mechanism are to be introduced.

4. The reforms attempt, in substance, to transfer a sizeable amount of economic decision-making from the government and the different ministries to the competence of the enterprises. In contrast to Czechoslovakia, the Soviet Zone of Germany and Bulgaria, Hungary does not plan to concentrate most of managerial responsibility in industrial or regional monopolies. It is in particular the rôle of enterprises which will undergo a change. Instead of mechanically executing the tasks imposed on them as a result of decisions taken by the planners of the national economy, they will have their own fields of responsibility. The contemplated system of price formation will probably have a great deal in common with the new system already partially implemented in Czechoslovakia. Three categories of prices are being introduced: in the first category prices remain fixed; in the second maximum-minimum limits are established, and in the third, prices should be able to follow market fluctuations. This price reform will be supplemented by the introduction of a new rate of exchange, coupled with a more liberal approach to foreign trade.

B. RECENT ECONOMIC DEVELOPMENTS

5. After a fairly even development over the past five years, the Hungarian economy slowed down in 1965 when national income increased by only 1.1% over the preceding year. The main reason was a steep decline in agricultural output which coincided with a decline in industrial expansion. In addition to this, Hungary's balance of trade position had been deteriorating progressively since 1957.

6. Viewed against this background, it can be said that Hungary staged a full recovery in 1966. Both industry and agriculture expanded by similar rates, and in foreign trade the past deficit on current account turned for the first time since 1956 (with the barely significant exception of 1961) into a small surplus. This coincided with a decrease in Hungary's outstanding credits with NATO countries, some third of which is in credits of over 5 years duration. National income increased by about 6% over 1965, which is 2% more than had been planned.

7. As a result of this favourable development, the 1967 budget is 12% higher than that of 1966. This considerable increase in expected revenue appears to be largely based on an optimistic estimate of enterprise payments brought about by increased productivity. Almost 50% of total expenditure is earmarked for investment (of which: 47% in industry, 17.8% in agriculture, 14% in transport and communication) and growth of reserves. The sum of overt defence expenditure increased in absolute terms, but its share in total expenditure in fact decreased. It is probable, however, that, as in the case of other Communist countries, the real volume of defence expenditure is concealed under other headings in the budget. Moreover, Hungary is receiving military equipment from the Soviet Union and it is not known whether and if so how much she is paying for it. This explains the fact that although the official defence share in the budget had shrunk from 7.4% in 1963 to 5.2% in 1967, the Hungarian Minister of Defence was able to claim in his budgetary report that Hungary has practically completed the construction of modern air defence and considerably increased the number of modern tanks as well as the fire power of the ground troops.

8. As a result of a rapid pace in industrialisation the proportion of the employed population in industry is now higher than that in agriculture. Overall industrial progress has, however, been impeded by the fact that Hungary is not self-sufficient in any industrial raw material except bauxite. In 1966, gross industrial production increased faster than had been planned. The 6.6% growth rate attained, a considerable improvement over the 1965 performance, is due mainly to a rise in labour productivity, which increased at a higher rate (5.5% instead of 3.2-4.8% planned) than in any of the past five years. In particular, the chemical and rubber industries maintained their positions as the fastest growing industrial branches, whereas the growth rates of the mining and food-processing industries lagged considerably behind.

9. In agricultural production there was, in 1966, an increase of some 6% which, however, only compensated for the corresponding decline in 1965. The total bread grain crop was somewhat smaller than in 1965 but it covers the requirements of the country. Rural emigration is becoming a serious problem in Hungary where, since 1960, agricultural manpower has decreased by some 21%. Since housing facilities in cities have become scarce, the tide is said to have been somewhat abated. The problem nevertheless remains very serious, since it is not so much the numerical reduction which causes anxiety but rather the quality of the labour force, especially since the average age of co-operative farm workers is now 63 in "weak" farms.

10. Of particular social and economic importance are household plots, which enter for over 30% in the national income from agriculture. Co-operative farm families derive over 52% of their income from household plots. In view of the different incentive measures the Hungarian government has taken recently, one can assume that household plots will continue to play a very important and officially acknowledged part in agricultural production.

11. In view of the overall recovery of the Hungarian economy but also of its relatively slow progress over the past five years, the growth rates planned for the period 1966-1970 remain more realistic than those of earlier years. National income is expected to rise at an average of 3.5-3.9% as against 6.3% planned and 4.7% achieved in the previous planning period. Per capita real income in general should increase annually by 2.7-3.0% as against 4.1% in the period 1961-65 and that of the agricultural population in particular by only 2.8-3.4% as against 4.7%. Annual growth rates of gross industrial output were 7.9% for the period 1961-65 and are planned at 5.7-6.3% for 1966-70. In agriculture the corresponding figures are 1.8% and 2.5-2.8% with a considerable planned increase in crop output as opposed to the livestock sector.

12. These figures show that in many respects the Hungarian third five-year plan is the most moderate of the plans now being undertaken in Eastern Europe. As a result of this, the economy will probably, after 1970, emerge stronger and somewhat better balanced than before but with a continued weakness in agriculture, with difficulties in the balance of payments and with no striking improvement in the standard of living.

C. EXTERNAL ECONOMIC RELATIONS

13. Hungary ranks fifth amongst Soviet bloc countries in total foreign trade turnover. In terms of foreign trade per head she lies third after Czechoslovakia and the Soviet Zone of Germany. Foreign trade is vital to the growth of Hungary's economy since the country lacks many of the basic raw materials required for the development of its industry. In 1966, exports increased by almost 7% over 1965 whereas the increase in imports was by far slower than planned (3% instead of 8%). Thus Hungary was able to achieve, in 1966, a marginal surplus in her balance of trade, representing only 0.3% of total trade.

14. 67% of Hungary's foreign trade is with Communist countries - over half of it with the Soviet Union alone - and about 23% of the trade turnover is with countries of the industrialised West. In 1966, Hungarian exports to countries in Western Europe - largely processed food, consumer goods, metallic semi-manufactures and telecommunication instruments - increased by 14% against only a 4% increase in exports to COMECON countries which was mainly due to a stagnation in exports of machinery. Hungary has also been active in co-operating with Western firms either by purchasing the right to manufacture under license or by agreements for industrial and technological collaboration, including joint marketing in third countries.

15. In November 1966, Hungary was granted the status of observer with GATT but according to the Hungarians themselves, it will take several more years until Hungary might apply for full membership. On the other hand Hungary is rather active in her enquiries about establishing relations with the Common Market.

D. CONCLUSIONS

16. The conclusions contained in the last report(1) remain on the whole valid. The Hungarian economy has experienced, in the past five years, a steady decline in the growth of national income which was scheduled to increase by 6.3% annually but actually grew by 4.7%. An increase of less than 4% is foreseen for the period 1966-70. Within this abating rhythm of economic expansion the 1966 performance must have been reassuring for the Hungarian planners.

17. In foreign trade, Hungary is likely to continue to be dependent to a large degree on trade with the Soviet Union, which it is planned to increase even further. The rate of growth of trade with other Eastern European countries is, on the other hand, likely to continue its downward trend. Trade relations with the industrialised West will probably be expanded because of Hungary's need for up-to-date machinery and equipment. The economic reforms could lead eventually to Hungary's exports becoming more competitive on world markets which would help to finance the expected expansion of imports from the West. The Hungarian planners have come to realise that only with increased contacts with the West can they find the capital goods vital for the growth of their economy which they are unable to obtain through COMECON trade.

18. By promoting joint economic ventures, granting most favoured nation treatment and opening up their own markets to Hungarian goods, the West should, without damaging the legitimate commercial interests of other countries, especially those of the free world which are still in the course of development, continue to help Hungary in asserting its own national interests. NATO countries should maintain an economic policy flexible enough to be able to take advantage of the opportunities that further developments in Hungary's foreign economic relations might offer and for this purpose they should follow closely such developments.

(1) C-M(65)57.