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Subject: Poland and Hungary - Economic Conditions, Reform and Financing

Summary and Conclusions

1. Poland

Being faced with a situation of rapid economic deterioration, the new Polish government under Prime Minister Tadeusz Mazowiecki intends to transform Poland's largely socialised economy (75% of GDP) into a market system. Current economic conditions are the result of a series of economic crises, and the failure of previous reform efforts to address the economy's fundamental weaknesses early on. While internal adjustment has been largely delayed, external adjustment has mainly taken the form of import compression, thereby limiting future growth prospects for production and exports. Acknowledging that the observed economic imbalances reflect severe and deeply rooted micro- and macroeconomic distortions, the Polish government is determined to implement a comprehensive framework of structural economic reform.

Stabilisation of the macro-economy is the main short-run policy objective. The necessary reform measures, as for example the immediate need for tackling Poland's distorted structure of relative prices, have to be supported by foreign financial assistance. This implies two things: First, an infusion of foreign exchange, and second, offering external debt relief to Poland. However, Poland's long-run growth prospects can only be improved by addressing the country's large and persisting structural problems. Industrial restructuring is the key to improving Poland's economy. While the Polish industry accounts for roughly half of GNP, the sector is currently unable to meet domestic demand for almost all types of industrial products. Industrial production costs are high because of inefficient use of inputs, and the quality of much of the output is poor. As a result, Poland is largely uncompetitive in export markets.

The necessary investments have to reflect the need for efficiency enhancing restructuring of much of the Polish industrial sector (including the energy sector). Structural reforms in other sectors (as for example financial intermediation, transport, telecommunications, human resource development, and environmental protection) will play key roles for the success of the overall reform effort. Given both the magnitude and the urgency of the problem, and considering the interlinked character of the various components of Poland's economic reform, it is important for individual measures to be well sequenced, and to be incorporated into an overall policy framework that addresses the fundamental problems of the Polish economy.

2. Hungary

The Hungarian government, faced with upcoming free elections, intends to transform Hungary's largely socialised economy (85% of GDP) into a market system.

Hungary's current economic situation is extremely precarious with an urgent need for austerity measures to cope with the huge problem of a rising balance of payments deficit (-1.5 bn USD in 1989 versus a planned -600 million). IMF renegotiations of the standby agreed early in 1989 are under way. The Hungarian economy is characterised by:

- (i) an overemphasis on heavy industry and energy, with large subsidies draining the government budget, and low productivity limiting the country's export potential and its ability to service its foreign debt;
- (ii) a high degree of monopolisation and vertical integration;
- (iii) administrative restrictions on investment and imports having the objective of achieving external adjustment through compressing imports;
- (iv) a neglected infrastructure with an inadequate telecommunications system;
- (v) a weak agricultural sector that, with input cost increases exceeding sales price increases, has accrued mounting losses.

Even though the rapid political developments of the recent weeks (the transformation of the Hungarian Communist Party into a Western style socialist party, and the symbol-laden declaration of the Hungarian Republic) tend to deflect attention from Hungary's growing economic crisis in the short run, the deeply-seated structural problems that are reflected in the country's current economic situation need immediate attention.

Still, the economy's fundamental weaknesses run so deep that a difficult transition period of several years appears unavoidable. Industrial restructuring is the centrepiece of Hungary's medium-term structural adjustment programme, but it is also important to carry out well coordinated supportive reforms in the financial sector, the energy sector, the transport sector, and in the agricultural sector. The failure of reforms over the last 20 years demonstrates the importance of clearly concentrating on fundamental issues. It is thus essential to improve technical and managerial skills of economic agents, so as to increase labour productivity, and to accelerate the behavioural changes that are needed to shift to a modern market economy.

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POLAND

Background

1. Poland is a medium size (population 37.5 million (1987)) economy with a per capita GDP of about USD 1,920. An environment of rapid economic deterioration, characterised by galloping inflation, consumer goods shortages, and large internal and external imbalances, contributed to the forming of the first non-communist Eastern Bloc government under Prime Minister Tadeusz Mazowiecki. The new Polish government intends to transform Poland's largely socialised economy (75% of GDP) into an efficient market system. The Polish government's economic reform plan, for which principle agreement has been reached with the IMF, calls for wideranging economic reforms. In order to put current economic reform efforts into perspective, the proposed reform package has to be analysed on the basis of the country's history of economic problems and previous reform efforts.

The Economic Crisis of the 1980s

2. In the beginning of the 1980s Poland suffered a severe economic crisis. Aggregate output fell by one quarter, investment was halved, and consumption fell by about 15 percent. In 1981, the Polish government proposed to overcome the crisis by a sweeping economic programme that had three interrelated elements:

- (i) economic reform geared toward increasing efficiency and responsiveness through a decentralisation of output, pricing and investment decisions to autonomous and self-managed enterprises;
- (ii) internal adjustment, focused on reducing shortages through improved resource allocation patterns, and improving the quality and the efficiency of the investment programme;
- (iii) external adjustment.

3. The programme was only partially implemented. Even though the reform efforts led to indicative rather than compulsory production targets, the Polish economy remained essentially centrally planned. The allocative influence of market forces was severely restricted by the central allocation of roughly half of fuels and major materials (including imports), a system of price controls, licenses (including imports), and other formal and informal mechanisms of central control. Similarly, the economic reforms did not tackle the excessive use of export retention quotas, differentiation of interest rates, fiscal rebates and other subsidies, that were largely enterprise specific rather than being applied on a national level. Together with consumer subsidies (housing, food), these subsidies not only posed a heavy fiscal burden but also suppressed market signals.

4. Although the reform efforts led to a greater decentralisation of investment decisions, reluctance to abandon pre-reform projects and pressures from established enterprises to invest, continued to lead to greater than planned investment outlays. However, as only a small amount of investment funds was directed to new projects, fewer new investment projects were completed. While Poland significantly reduced its convertible currency current account deficit from over 9% of GDP in 1975 to roughly 1% in 1986, external adjustment has largely taken the form of

import compression. This has led to a shortage of badly needed inputs, spare parts, and repair services, thus limiting future growth prospects for production and exports. Exports did actually fall, causing Poland's external debt to convertible currency export ratio to be among the highest in the world, even though Poland's debt to GDP ratio remained fairly low (about 0.5), reflecting the small share of convertible currency exports in GDP. Debt service payments owed significantly exceeded the availability of convertible currency resources for most of the 1980s.

Current Economic Trends

5. Poland's current economic problems reflect severe and deeply rooted micro- and macro-economic distortions, structural imbalances, and the failure of previous reform efforts to implement corrective measures early on.

6. Annual inflation for 1989 is now projected to be in the range of 800%-1000%. Combined with consumer goods shortages, the price developments have led to foreign currency hoarding, giving the Polish economy a high level of excess liquidity. With private sector holdings of foreign currencies only legalised since early 1989, the private sector currently holds about USD 5.0 billion in foreign currency accounts with state banks and an unknown amount (variously estimated between USD 4.5 and USD 8.0 billion) in dollar notes. While the second half of 1988 saw a 22% real appreciation of the Polish currency (zloty), the zloty has been officially devalued about 15 times since the beginning of the year, but still remains seriously overvalued. Even though the current practice of stepwise devaluations of the official zloty/dollar exchange rate does not constitute a viable medium term policy option, the Polish government has been reluctant to tackle the dual exchange rate regime where the zloty is overvalued according to the official rate and undervalued and subject to large fluctuations in the black market.

7. Industrial output fell by 5.9% between September 1988 and September 1989, largely due to strikes and shortages of input materials. Agricultural production currently faces input price increases that significantly exceed output price rises, which is likely to increase shortages particularly of meat and meat products.

8. For the January to July 1989 period, the central government budget deficit was roughly 17% of National Income, and 55% of total government revenues. With tax payments being delayed by tax payers, the real value of tax revenues is rapidly evaporating. To finance government spending, the nominal money supply grew by about 60% between January and May 1989.

9. Poland's convertible currency trade surplus amounted to USD 842 million in 1988, the lowest in five years. In 1988, the servicing of medium and long term debt obligations absorbed about 75% of the trade balance (1987: 65%). As the trade surplus was too small to allow debt service payments in full, roughly 80% of all convertible currency debt repayments due had to be rescheduled. In an attempt to reduce excess demand, Poland's decomposition of convertible currency imports changed drastically in the first quarter of 1989, when, compared to the first quarter of 1988, imports of investment goods dropped by 21.7%, while imports of consumption goods increased by 29.0%. Poland's trade surplus is

expected to disappear this year. Continued balance of payment problems have caused Poland's level of convertible currency reserves to drop to roughly two weeks of imports.

10. The reform proposal of the Polish government that has won approval by the IMF in principle, emphasises economic reform and stabilisation objectives for the short run, and focuses on improvements of the economy's growth prospects for the long run. A review of the key issues of economic reform and stabilisation in Poland follows.

The Short Run: Reform and Stabilisation

11. In order to begin to address the severe distortions that characterise the Polish economy, the structure of relative prices needs immediate attention. Reform efforts will include price deregulation and cuts in government subsidies, which in 1988 represented 33.2% (1987: 42.1%) of the government budget. As an initial step, the Polish government singled out energy prices, and increased coal prices by 100% and electricity prices by 140% on November 1. While this will lead to production cost increases, and therefore generate additional inflationary pressures, the relative price of energy in Poland is still very low compared to international standards.

12. A unification of Poland's dual exchange rate regime needs to be implemented fairly soon. While the Polish government has argued in the past that full convertibility of the zloty will have to wait until Poland's balance of payments situation is stabilised, it is likely that the yet to be formalised IMF adjustment programme will emphasise drastic exchange rate reforms.

13. The Polish government is expected to attempt to reduce the budget deficit by cutting some key subsidies, closing energy inefficient companies, and beginning to select some chronically loss making state companies to be privatised. In addition, the government signaled its intention to reduce military and police spending and initiated reorganisations and cuts in the military and interior ministries. The government has also started to sell treasury bonds. There are currently two types of bonds, one type of bonds is a zero coupon bond that is convertible into cash on presentation after six months from the date of issue, the other type of bonds is price indexed and convertible into stock of the companies which the government intends to sell in the future. into ownership shares. At the end of this year a new privatisation law that intends to gradually transform much of the state sector (2,300 enterprises and 94% of non-agricultural output) into joint-stock companies owned by both Poles and foreign investors will be introduced. The Polish government is aware that forcing firms to operate efficiently is likely to increase unemployment in the short run.

14. Initial nominal wage restraint is important for the success of the reform programme. While the Polish government is weary to be seen as directly interfering with the wage-setting process, it plans to carry out a fundamental fiscal reform in 1991, aimed at taxing company profits, personal incomes, and value added. However, increased taxes and cuts of government subsidies will lead to reductions of real wages, creating a potentially explosive situation.

15. The immediate requirement is for foreign financial assistance to support the stabilisation efforts of the Polish government. This implies two things: First, an infusion of foreign exchange, and second, offering external debt relief to Poland. The Polish government has called upon its Western counterparts to provide a stabilisation loan of USD 1 billion. In addition, it is looking to the International Monetary Fund (IMF) to provide USD 700 million worth of funds under a 12 months standby programme in 1990, and hopes to receive a minimum of USD 500 million worth of funds from the World Bank in 1990. Poland's hard currency debt currently amounts to USD 38.9 billion, the highest level of all Eastern European countries. USD 26 billion is owed to Paris Club creditor governments, USD 9 billion to commercial banks, and USD 4 billion to other creditors, a group that includes CMEA governments. While Poland successfully negotiated a multi-year (1988-93) rescheduling with commercial banks, it also wants to negotiate a suspension of interest and capital repayments on external debt to Paris Club countries up to the end of 1992. This would mean granting preferential treatment to Poland and thereby setting a precedence. Other middle income debtors would surely demand equality of treatment.

The Long Run: Investment and Growth

16. Poland's long-run growth prospects must be improved by addressing the country's large and persisting structural problems. The slower the supply side is to adjust, the more painful the country's adjustment process will be. This implies that sectoral problems need to be clearly identified. However, in order to devise specific Western financial assistance measures, the interlinked character of the various components of the necessary economic reform needs to be taken into account. This implies that individual financial assistance measures need to be well sequenced, and to be incorporated into an overall lending policy framework that addresses the fundamental weaknesses of the Polish economy.

17. While industrial restructuring (including the energy sector) is the key to Poland's economic recovery in the long run, significant structural reforms in a number of economic sectors (agriculture, environmental protection, financial intermediation, health care, human resource development, telecommunications, and transport) will play key roles for the success of the country's overall economic reform effort. The various elements of the necessary reform can be thought of as falling into two categories. First, there are sectoral reform measures that help to integrate Poland into the World economy by increasing the degree of openness of the Polish economy and/or by diversifying the country's export base. Second, there are sectoral reform measures that increase the economic efficiency of individual production processes.

18. Industry: Poland's industrial sector employs about 29% of the labour force and produces about 50% of GDP. The sector is currently unable to meet domestic demand for almost all types of industrial products. Industrial production costs are high because of inefficient use of inputs, and the quality of much of the output is poor. As a result, Poland is largely uncompetitive in export markets. Industrial production is concentrated in energy and heavy industry, with enterprises employing over 1,000 workers accounting for over two-thirds of industrial employment and output. The sector is dominated by state enterprises, with private enterprises (mostly small scale operations that until 1989 were constrained to a 50-workers-per-shift ceiling) contributing only 6% of non-agricultural

output. While Poland is the world's fourth largest producer of hard coal, it is no longer a net energy exporter. Coal accounts for 16-18% of Poland's convertible currency export earnings and for 76% of its primary energy consumption, making Poland one of the most coal-dependent countries in the world. Polish factories on average use 2.5 times as much fuel and power per unit of output as do their Western counterparts. This implies that the needed efficiency enhancing technical overhaul of much of the country's industrial sector should emphasise energy efficiency and energy conservation, which seem essential both to lower domestic production costs and to free hard coal for export.

19. Agriculture: Poland's agricultural sector accounts for only 13% of national income and employs about 28% of the labour force. About 80% of Poland's agricultural lands are privately held. Agriculture (mainly agro-processing) provides about 12% of total export earnings. While Poland's level of modern input use and mechanisation compares favourably with its Eastern European neighbours, its agricultural productivity is low and stagnant. The most important constraints are institutional difficulties (extension, credit, marketing, pricing), insufficient state investment in agricultural infrastructure, and agro-processing, i.e. the lack of storage facilities, and the low levels of efficiency, lack of capacity, and poor quality performance of existing processing facilities.

20. Environment: Poland's environment is rapidly deteriorating. Sulphur dioxide generated by burning low-quality coal is the single worst pollutant. Out-of-date technology, especially in the chemicals, petrochemical and fertiliser subsectors, result in air, water, and soil pollution levels that pose a threat to crop production, health, water supplies, buildings, and forests. Investments to reduce sulphur dioxide emissions, combustion gases dedusting, sewage treatment, and solid waste disposal facilities need to be considered.

21. Financial Intermediation: In the past, financing decisions have tended to be made in conjunction with other centralised decisions. Real interest rates remained significantly negative. As financial reforms facilitate reforms in other sectors of the economy, regulatory reforms, the achieving of positive real interest rates, the creation of capital markets, and with at least one new bank with the participation of foreign private commercial seem of primary importance. It is expected that a stock exchange will start its operations in the near future.

22. Transport: Road, rail, air and maritime transportation facilities are frequently strained, causing delays and expensive and inefficient operations. The potential role of the transport sector in convertible currency trade might increase the motivation of Western financial assistance. While rail transport investments should probably focus on cost reduction and rationalisation rather than capacity expansion, air, maritime and road transportation are in need of capacity increases through selective network expansions and upgrading of existing facilities.

23. Telecommunications: Poland's telecommunications network is severely underdeveloped and supply constrained relative to the needs of an industrialised society. It is estimated that approximately 3.6 million new telephone connections are needed. Having a well trained workforce, the

focus of telecommunication investments has to be on expanding the domestic network and integrating Poland into the world network.

24. Construction: Technology in the construction industry is badly outdated, particularly in housing construction. Institutional innovations should concentrate on stimulating market mechanisms like competitive bidding. Construction investments should emphasise technological modernisation, such as increasing the use of electrically powered tools and modern finishing materials.

25. Housing: The keywords are shortage and subsidies. In 1980, Poland ranked last among 28 European countries in terms of the number of housing units per household, having 18% more households than housing units. In 1985, housing subsidies made up 13% of the government budget. Subsidies need to be reduced and the private construction sector expanded. In addition, increased resource allocation to housing related infrastructure (water, sanitation, heating etc.), and investments into the production of building materials seem important.

26. Health: Poland's healthcare system has problems with providing access to treatment, and faces shortages of pharmaceuticals. In addition, significant increases in the incidence of cancers and heart- and circulatory diseases, have resulted in a decrease in life expectancy. Investments into preventive medicine and efficiency-oriented structural reforms of the healthcare system seem more important than a quantitative expansion of clinical resources. The health implications of investments in other sectors need to be analysed.

27. Human Resource Development: Poland's transition to a market economy will result in a significant increase of the demand for managerial training and international exchange of information and know-how.

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HUNGARY

Background

28. Hungary is a small (population: 10.7 million), upper-middle income country (GNP per capita: USD 2,240 in 1987). Even though moves towards market mechanisms date back to 1968, the scope of the current reform efforts is unprecedented. The transformation of Hungary from a "People's Republic" to a "Republic" on October 23, as well as that of the Hungarian Communist Party into a Western-style Socialist Party that has to compete with other parties in free national elections next year, the first of this type since 1948, are expressions of the government's commitment to a complete overhaul of the Hungarian society and its largely socialised economy (1986: 85% of GDP). However, the Hungarian leadership has been reluctant to impose overly strong reform measures that could lower the standard of living or create unemployment during the pre-election period.

The Economy: Recent Developments and Structural Weaknesses

29. Economic performance over the last 4 years was poor, with persistent budgetary and balance of payments deficits, a slowdown of growth and rising inflation. Despite an improvement in the convertible currency trade balance (to a surplus of 600 million dollars in 1988 and 1989), the convertible currency current account deficit still persisted (600 million dollars in 1988 and around 1.5 billion in 1989), due to Hungarian tourist expenditure following total liberalisation of travel restrictions and tax exemption. The government budget deficit was also substantially higher than planned, due to an overrun in social security payments and subsidies to enterprises relating to CMEA trade. Consumer prices rose by 15.5% in 1988 (8 percentage points reflecting the introduction of VAT), and are expected to reach 18% to 20% in 1989. GDP is estimated to have remained constant in 1988 and 1989.

30. The current deterioration of Hungary's economy has forced the authorities to urgently seek external resources, either through the IMF renegotiation and/or support loans by other multilateral agencies or through foreign government agencies, but also through direct access to financial markets. The aim would be to reduce the weight of austerity measures, requested by the IMF as a condition to a renewed agreement, during the period up to the next legislative elections in March 1990.

31. The economy's current troubles are not new. Over the last 10 years, a sluggish growth, an increasingly obsolescent and uncompetitive industrial base and a rising foreign debt burden, which stem from deep seated structural problems, have characterised the Hungarian economy :

- (i) Overemphasis on heavy industry and energy, with large subsidies draining the budget and low productivity limiting export potential and ability to service foreign debt.
- (ii) High degree of monopolisation and unnecessary vertical integration.
- (iii) A neglected infrastructure with, in particular, a completely deficient telecommunications system.
- (iv) Low technological development, which relies on centralised R & D institutes and a tendency to focus on fundamental rather than applied research.
- (v) Weaknesses in the agricultural sector, which has accrued mounting losses due to input costs rising faster than sales prices.

32. Other factors have played an important role in the deterioration of the economic situation, among which the slackening of modernisation efforts in the manufacturing sector as a result of administrative restrictions on investment and imports, during the '80s, to cope with the external problem. Then, because export industries were uncompetitive, payment imbalances soon re-emerged. Also, an insufficient understanding of how a market economy functions has left the essential features of the centrally planned economy largely intact and failed to create adequate incentives to promote industrial restructuring. In the absence of genuine markets, the authorities have moved from setting plan targets to creating a set of "regulators", including subsidies, wage and price rules and taxes, designed to simulate the workings of a market. However, since the same bargaining as before between enterprises and the state has continued over the regulators, their effectiveness has been undermined. In addition, tax

breaks and subsidies to ailing enterprises, which should have been closed, have conflicted with a more efficient resource allocation.

Economic Reform: Past Experience and Prospects

33. To address the shortcomings of previous reform efforts and lay the basis for improved economic performance, the Hungarian government has been trying to increase market forces in the economy since late 1986. The stabilisation and adjustment programme further developed in 1988 contains an ambitious set of reforms: reorganisation of the financial sector, reduction in enterprise subsidies, restructuring of major loss-making sectors (coal-mining, metallurgy), reduction of non-tariff barriers to imports, further reduction of administrative price intervention, transfer to autonomous enterprise management, introduction of bankruptcy procedures.

34. The government reorganised the banking system in 1987, establishing a two-tier banking system composed of a central bank and independent competing commercial banks. Additional steps have been taken in 1989 to increase competition between banks, with the elimination of restrictions on deposit taking and credit activities. The founding of other financial institutions has also been encouraged, including a joint Hungarian-foreign bank, which have actively supported joint ventures and foreign companies participating in World Bank projects. New financial instruments, such as bonds and stocks, have been introduced. Nevertheless, small capital base, a shortage of skilled bank managers, inadequate telecommunications and a high proportion of loans to insolvent companies supported by the State are major constraints on the modernisation and liberalisation process of the banking sector.

35. Heavy subsidisation (no less than 20% of GDP) of industry, agriculture and consumer prices, which in turn necessitates excessive taxation, is at the heart of the economy's structural problems. Recognising the need to reduce corporate taxation and state involvement in the economy, the government has called for a further reform of the budget after the introduction of VAT and personal income tax in 1988. The intention is that the budgetary redistribution of incomes should be reduced from the current 60% of GDP to 40-45% by 1992, and subsidies level cut by a factor of 2 (from current Ft 200 bn to about Ft 100 bn). Such a major cut will be difficult, given the pressing need to modernise Hungary's infrastructure and the growing demands for social welfare.

36. The private sector, accounting for 14.3% of GDP in 1988 on an official basis (while unreported economic activity may equal the same level) received a significant boost in January 1989 with the introduction of a new enterprise law. This law allows for foreign ownership liberalisation, reduces discrimination against the private sector with a more favourable corporate tax system and liberalises foreign investment. The conversion of state enterprises to joint stock companies, authorised in May 1989, was a further step to encourage the private sector, even if many difficulties could prove hard to solve, such as the basic problem of monopoly and collusion, as well as the assets valuation. This new climate has nevertheless induced an increasing number of foreigners to establish joint ventures, whose total number was about 300 by end-1988, with more than 300 million dollars in paid-in capital.

37. Further reforms are obviously necessary to move towards a market economy. The Hungarian authorities are in some doubt, however, as to how far and how fast to proceed with reforms and how to balance macroeconomic goals. The most recent assessment of this problem by the government, set out in a document sent to the Group of 24 in autumn 1989, seems to have opted to accept stagnation and strong austerity measures during the next 2-3 years to lay the basis for an economic recovery through a selective growth strategy. The economy's fundamental weaknesses are so deeply seated that a difficult transition period of no less than several years is, in any case, unavoidable. In the meantime, new reforms aim to improve technical and managerial skills of economic agents, allowing for a rise in labour productivity as well as helping the behavioural modification needed to shift to modern market mechanisms.

Foreign Debt and External Constraints

38. Hungary's total external convertible currency liabilities rose from USD 8.8 billion in 1984 to USD 16.6 billion in 1988, with about half of the increase being due to exchange rate movements. During the same time period, Hungary's debt/export ratio increased from 1.43 to 2.10, and its debt/GDP ratio from 0.43 to 0.60. World Bank estimates show that in order to roll over maturing long-term debt, and to be able to finance its current account deficit, Hungary will require USD 2.0 billion annually during the 1989-1990 time period. Thereafter, Hungary's external debt situation is expected to be largely dependent on the results of the implementation of the reform programme, and the response by international capital markets.

39. Largely because it has given top priority to servicing its external debt in the past, Hungary currently enjoys better access to commercial credits than Poland. Each year it has been able to roll over most of its maturing principal payments. Nonetheless, with debt service payments exceeding 40% of the country's convertible currency goods and service earnings through 1992, investment funds are severely limited. In the past, exports were often pushed to the West, even at the cost of subsidising unprofitable exporters. Hungary has been trying to shift from trading with the Soviet Union, its largest trading partner with 30% of total trade, to hard currency trade at world prices.

Economic Sectors: Main Current Problems

40. Industry: In 1987, industry, almost entirely socialised, accounted for about 36% of GDP, 31% of employment, 35% of gross fixed investment, and 85% of total exports. Energy and basic materials accounted for 25% of industrial production; manufacturing industries (machinery and engineering products, building materials, chemicals, light industry and food processing) are fairly developed. With the help of the World Bank, Hungary is currently pursuing an ambitious industrial restructuring programme that emphasises those areas which are most likely to have an immediate impact on the country's macro-economic performance and on the realisation of the main objectives of the general reform programme in the industrial sector (financial discipline, enhancement of competition, and resource mobility). Hence, the greatest attention is given to: (i) further reduction in budgetary support to inefficient enterprises and subsectors, and stringent application of the liquidation framework; (ii) import liberalisation and strengthened incentives for convertible currency exports; (iii) facilitation

of entry of new enterprises and private entrepreneurship; (iv) further reform of taxation, pricing, and wage systems; and (v) reduction in producer and consumer subsidies.

41. Agriculture: In 1988, agriculture accounted for 14.4% of GDP, 19% of employment, and 26% of convertible currency export earnings. It comprises equal value shares for livestock (pigs, cattle, poultry) and crops (wheat, corn, fruits and vegetables). Two thirds of employment are dedicated to primary agriculture, and one third to ancillary non-agricultural activities. Many large farms are diversified enterprises. Small farms account for only 14% of the cultivated area but for 50% of the agricultural value added. Agriculture performed well until 1983, when difficulties (weather, external demand slowdown, domestic economic stagnation) drew attention to several unresolved issues such as the impact of often contradictory policies and programmes, the sector's needs for restructuring in order to improve efficiency and export performance, and the extent, emphasis and rate of future investment in the primary agriculture and food processing subsectors.

42. Transport: Hungary has a diversified transport network to integrate its 93,000 square kilometres of territory, and to serve the needs of its 10.7 million inhabitants. The transport system consists of about 8,000 km of rail, 30,000 km of national roads, 1,300 km of navigable rivers and canals, one international airport and a fairly large oil and gas pipeline network. Railways and roads are the backbone of the transport system and together carry about 70% of total freight traffic and more than 95% of passenger traffic. Future efforts need to concentrate on energy conservation and efficiency improvements through increased competition between transport agencies. Investments should target electrification and rationalisation of the rail network, and improved maintenance and selective extensions of the highway network. The World Bank currently finances two comprehensive projects in the transport sector.

43. Energy: Hungary's economy is relatively energy intensive, in spite of a modest domestic resource base. Over the past 15 years, energy has accounted for up to 15% of total national investment, for about half of national investment in industrial plant and equipment, and for about two-thirds of the total investment financed by the government budget. Despite the high levels of energy investments, Hungary has had to rely on imports for a large share of its energy needs. Government policy has begun to shift towards more effective demand management, including significantly higher prices for some energy carriers. Government objectives focus on effective utilisation of existing resources, and increasing investment efficiency. It is currently working on: (i) improving the policy and institutional framework of the energy sector, including the development of pricing strategies, subsidy elimination, restructuring of the coal mining sector, and improved power investment planning; (ii) developing the oil and gas sector through gradual restructuring of the national oil and gas company, opening the sector to foreign investment, and financing high priority investments; (iii) preparing an energy conservation programme, and financing related investments.

44. Telecommunications: Similar to the case of Poland, Hungary's telecommunications network remains severely under-developed. Large investments are necessary to alleviate some of the constraints thus imposed on other sectors.

POLAND - SELECTED ECONOMIC INDICATORS

(Population: 37.5 million)

1. Shares of Gross Domestic Product (from Current Price Data)

	<u>1980</u>	<u>1987</u>
Net Indirect Taxes	0.0	0.0
Agriculture	13.2	10.8
Industry	53.8	50.2
Services	33.0	39.0
Resource Balance	-2.9	1.4
- Exports	28.1	20.1
- Imports	31.1	18.7
Total Domestic Expenditures	102.4	98.6
- Total Consumption	76.1	72.4
- Private Consumption	66.9	60.1
- Government Consumption	9.2	12.3
- Gross Domestic Investment	26.3	26.2
- Fixed Investment	24.7	18.6
- Changes in Stocks	1.6	7.6
- Gross Domestic Saving	23.4	27.6

Source: World Bank**2. Growth Rates (% per year)**

	<u>1986</u>	<u>1987</u>	<u>1988</u>
GDP	4.2	2.0	4.5
Private Consumption	5.0	3.0	3.0
Fixed Investment	5.9	5.0	5.7

Source: World Bank**3. Convertible Currency Balance of Payments**

	<u>1986</u>	<u>1987</u>	<u>1988</u>
Net Exports of Goods and non-factor Services	948	989	842
Current Account Balance	-665	-417	-580

Source: World Bank**4. Convertible Currency External Debt and Debt Burden Ratios**

	<u>1982</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Total External Debt (USD bn)	26.5	33.5	39.7	38.9
Debt/GDP ratio		0.45	0.57	0.55
Debt/Export ratio	5.8	5.9	5.9	

Source: IMF

HUNGARY - SELECTED ECONOMIC INDICATORS

(population: 10.7 million)

1. **Shares of Gross Domestic Product (from current price data)**

	<u>1980</u>	<u>1988</u>
Net indirect taxes	10.5	14.7
Agriculture	17.1	14.4
Industry	41.2	36.9
Services	31.2	34.0
Total consumption	71.5	72.5
- private	61.2	61.4
- government	10.3	11.1
Gross investment	30.7	24.9
- fixed	28.8	21.7
- changes in stocks	1.9	3.2
Gross domestic savings	28.5	27.5

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2. **Growth rates (percent per year)**

	<u>1987</u>	<u>1988</u>
GDP	3.4	0.5
Private consumption	2.8	-4.3
Fixed investment	5.5	-5.7
Inflation (consumption price deflator)	9.0	15.7

3. **Convertible Currency Balance of Payments (USD million in current prices)**

	<u>1986</u>	<u>1987</u>	<u>1988</u>
Balance of goods and NFS	-664	-25	342
Current account balance	-1419	-847	-592

4. **Convertible Currency External Debt and Debt Burden Ratios**

	<u>1980</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Total public and publicly guaranteed LT debt (USD bn)	6.4	12.5	15.7	14.62
IMF Credit (USD bn)		1.03	0.81	0.44
LT Debt/GDP ratio	0.26	0.49	0.57	0.51
LT Debt service/Export ratio	0.14	0.52	0.40	0.36

Source: World Bank