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GENERAL AGREEMENT ON TARIFFS AND TRADE

Committee on Balance-of-Payments Restrictions

REPORT ON THE 1983 CONSULTATION WITH HUNGARY

1. The Committee consulted with Hungary in accordance with its terms of reference and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205). The consultation was held on 8 March 1983 under the Chairmanship of Mr. J.N. Feij (Netherlands). The International Monetary Fund was invited to participate in the consultation pursuant to Article XV of the General Agreement.

2. The Committee had the following documents before it:

Basic Document	(BOP/231)
Secretariat Background Paper	(BOP/W/66)
IMF Recent Economic Developments, dated 14 September 1982	

Opening Statement by the representative of Hungary

3. In his introductory statement the representative of Hungary said that his authorities had introduced on 1 September 1982 restrictive import measures to safeguard Hungary's external financial position and had so notified the CONTRACTING PARTIES in document L/5363 and Add.1. Hungary's reserve position had suddenly worsened in 1982. In the trade field, Hungary had to face the cumulative effects of the worldwide recession, protectionist measures stemming from this recession, discriminatory measures, a rise in raw material prices and a deterioration of the terms-of-trade. In the financial sphere, problems had arisen as a result of important withdrawals of deposits held by the National Bank of Hungary, high interest rates and hence also high costs of debt servicing, as well as reduced possibilities of access to foreign capital markets. In these circumstances, Hungary, to maintain its ability to service and repay its debts, had to achieve a positive trade balance. This could only be achieved by both increasing exports and reducing imports. However, given Hungary's dependence on imports, its interest was to keep its market open. Hungary therefore took a series of internal measures to reduce domestic demand. The interest rates for credits given for investment purposes had been increased in 1982 by 3 to 4 per cent. New investments were charged with a special fee of 25 per cent. Consumer goods prices were allowed to rise by 8 per cent, which had been a heavy burden on the Hungarian population. Moreover, the forint had been devalued in July 1982 by 7 per cent and in November and December 1982 by a further 4 per cent. As a result of all these measures, the internal demand in 1982 had decreased by 2 per cent with an increase of the GNP by 1.5 per cent. The trade balance had shown a surplus of \$766 million on a cash flow basis; however, there was still a current account deficit of \$160 million.

4. The representative of Hungary closed his statement by pointing out that, though the burden of adjustment was on Hungary, its possibilities to resolve its problems were not independent of external circumstances. Some of these external circumstances were not created by market situations but by trade policy measures. It was essential that Hungary's own adjustment efforts not be impeded unnecessarily by other countries' policies. It was Hungary's desire to continue to contribute in every possible way to restoring a normal situation without any disturbance to international economic and financial relations, to full application of the international rules and standards in force, and it would endeavour, also in the future, to achieve closer integration in the international division of labour.

Statement by the representative of the International Monetary Fund

5. At the invitation of the Committee, the representative of the International Monetary Fund made a statement, the full text of which is reproduced in the Annex.

Balance-of-Payments position and prospects - alternative measures to restore equilibrium

6. Several members of the Committee expressed their comprehension for the difficult payments situation that Hungary was experiencing. Though regretting that Hungary had felt it necessary to take trade measures to redress its payments situation, they said that Hungary's invocation of Article XII and its readiness to consult promptly in the Committee were to be regarded positively.

7. One member said that he could not agree with the analysis presented by the Hungarian authorities in document BOP/231 regarding the effect of the trade policies of other countries on the Hungarian payments situation. The representative of Hungary replied that the trade policies of Hungary's trading partners were no doubt one among the causes for Hungary's difficult payments situation but that his intention was not to discuss these policies in detail at this meeting.

8. Some members noted that the forint's trade-weighted exchange rate had recorded a significant appreciation in 1980 and 1981 and that in spite of emerging balance-of-payments problems this trend had only been reversed in 1982 when the forint was devalued twice. One member asked whether the devaluation had been intended to have specific trade effects and, if so, whether these had been achieved. He also wondered whether the resort to trade measures could not have been avoided through a more active exchange rate policy. The representative of Hungary replied that the purpose of the appreciation of the forint had been to avoid an importation of inflation from abroad. However, the appreciation had had undesirable side-effects on the competitive position of exporting and import-competing enterprises in Hungary. The purpose of the devaluations had been to restore their competitive position. He added that exchange rate policies could only have a positive effect on Hungary's trade balance if market access was not limited by trade policy and other economic measures.

9. One member asked whether it was true, as had been claimed in a publication of the World Bank, that certain features of the Hungarian competitive pricing scheme adversely affected Hungary's export performance. The representative of Hungary replied that the rules on competitive pricing had been changed in early 1981 and 1982 to avert two risks: (a) that enterprises might withhold products with a low profitability from export markets in order to maintain or raise the average

profit margin on their exports so as to allow a higher profit margin on domestic sales, and (b) that some firms might withhold exports to avoid reaching the 5 per cent margin which would subject them to the strictures of the competitive pricing scheme. The changes introduced had resolved the problems to which the World Bank publication had referred.

System, method and effect of the restrictive import measures

10. Several questions were asked about the quota on consumer goods. One member wondered what the legal basis for the reduction of the quota was under the GATT, and another asked whether there was a target date for the removal of the quota. The representative of Hungary answered that the restrictions on consumer goods had been applied by Hungary already at the time of its accession to GATT and had been discussed in the Working Party on Trade with Hungary. They constituted a residual element in Hungary's import regime. In the Tokyo Round negotiations, Hungary had expressed its intention to remove the quota during the course of its 1981/85 plan. The quota served balance-of-payments purposes and Hungary could invoke Article XII to justify them, although it had so far not done so. It was, however, not excluded that Hungary might in the future invoke Article XII in respect of the quota if it could not meet the target date for its removal.

11. In reply to a question about the forint cover the representative of Hungary said that the forint cover was a deposit requirement which applied to both import and domestic investment financing. The forint cover was used by the National Bank of Hungary to ensure that importers and investors had sufficient funds in domestic currency to finance their imports and investments. It was not used as a trade policy instrument but to dampen the growing investment demand. The representative of Hungary confirmed that his authorities intended to eliminate the link between the forint cover and the import licensing for capital goods within a reasonable period of time. One member suggested that the link be eliminated immediately with regard to those import categories bound in Hungary's GATT schedule.

12. Several members expressed concern that the quotas imposed in September 1982 only applied to imports paid in convertible currencies and therefore had particularly adverse effects on OECD countries. One member said that the group of countries he represented was the major supplier of practically all goods included in the quota scheme and that the product selection appeared to discriminate against this group of countries.

13. The representative of Hungary stressed in his reply that the quota scheme did not involve any geographic discrimination because it did not distinguish between countries as sources of supply but between forms of settlement. That distinction applied also to imports from the countries listed in Annex A of Hungary's Protocol of Accession; if imports from these countries were paid in convertible currency they were also subject to the quota restrictions. It was in the nature of all trade measures that they affected different countries differently. Such different effects, by themselves, could not be considered "discrimination" within the meaning of the most-favoured-nation rules of the General Agreement. It was quite natural that Hungary's main trading partners would be most affected by Hungary's efforts to improve its trade balance.

14. Several members said that the effect of the scheme was to create a particularly heavy burden for imports from convertible currency sources and they expressed doubt whether this conformed to Hungary's obligations under Article XIII of the GATT. One member said that a final determination on this issue could only

be made if Hungary provided statistics showing for each of the restricted product categories the origin of the imports and the form of settlement, and he urged Hungary to provide such statistics. The representative of Hungary replied that, the legal basis for the distinction between imports according to the form of settlement (convertible and non-convertible currencies) was Article XIV of the General Agreement. This Article permitted Hungary to apply restrictions in a manner having equivalent effect to restrictions on payments which Hungary applied in accordance with Article XIV of the Articles of Agreement of the International Monetary Fund. This provision of the Fund Agreement gave Hungary the right to maintain and adapt to changing circumstances the restrictions on payments and transfers for current international transactions that were in effect on the date on which it became a Fund member. The distinction as to the form of settlement had been in existence at the time when Hungary became a member of the International Monetary Fund, that is on 6 May 1982.

15. One member said that he had serious doubts as to whether Article XIV of the General Agreement could justify deviations from the non-discrimination principle in the administration of the quotas introduced in September 1982, inter alia, because his understanding was that Article XIV of the Fund Agreement did not apply to measures imposed after Hungary's accession to the Fund.

16. In reply to questions about Hungary's licensing practices the representative of Hungary recalled that, in the Working Party which had examined Hungary's application to accede to the General Agreement, Hungary had declared its intention to carry on a liberal licensing practice provided that balance-of-payments considerations would not hinder this practice and provided that no discriminatory quantitative restrictions would be applied against Hungary. The present licensing practices were designed to bring the flow of imports in line with Hungary's payments constraints, while permitting the imports needed for the normal production process. Licences were issued taking into account the foreseeable liquidity position.

17. In response to several questions on the 20 per cent surcharge on imports of components the representative of Hungary explained that the surcharge was applied to imports paid in convertible currency; no distinctions were made as to the origin of the imports. The purpose of the surcharge was to counter the very high propensity by Hungarian enterprises to import components and parts. The latest statistics however showed that imports were so far not reduced in spite of the surcharge. This might partly have been due to the fact that imported components often constituted only a very small portion of the value of the final product, in which case higher prices for imported components did not effectively deter enterprises from importing. One member noted that there were price regulations which prevented enterprises from passing on the costs of the surcharge to the final consumer and he asked whether these regulations did not constitute internal measures discriminating against imported products. The representative of Hungary stated in reply that the regulations were necessary to make the surcharge effective. They were not intended to be trade restrictive by themselves.

18. Several members were concerned that Hungary had not announced a time-schedule for the removal of the quotas and the surcharge, as provided for under paragraph 1(c) of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes, and urged Hungary to do so as soon as possible. The representative of Hungary said that his government regarded these measures as temporary and would make every effort to remove them as soon as possible but it could not responsibly announce a time-schedule at this point given the uncertainties as regards both the

result of the internal adjustment efforts and the external environment. One member regretted that, at least with respect to some import categories, quota restrictions and the surcharge were applied simultaneously, which was contrary to the principle enunciated in paragraph 1(b) of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes. The representative of Hungary answered that there was only one import category, namely tyres, for which a simultaneous application of the two measures had been found inevitable and for which, moreover, the size of the quota was greater than actual imports in 1981.

Conclusions

19. The Committee noted that Hungary's balance-of-payments situation had deteriorated sharply in the early part of 1982 against the background of worsening external economic conditions, adverse trade policy measures, increased difficulties in foreign borrowing, the withdrawal of short-term funds by some lenders, and domestic demand policies that were less effective than expected. The Committee further noted that the Hungarian authorities had decided in the latter part of 1982 to strengthen their adjustment efforts by adopting further measures of demand management, structural reforms and more active exchange rate policies, and to temporarily introduce measures to reduce imports paid in convertible currency by imposing quotas on several primary products and a 20 per cent surcharge on imports of components.

20. The Committee recognized that Hungary had serious balance-of-payments problems which had led to the invocation of Article XII. The Committee noted, however, that Hungary, in responding to these problems, had introduced measures interfering with imports of particular products settled in convertible currencies, and regretted that Hungary did not rely solely on measures and policies of a more general nature. The Committee welcomed the temporary nature of the restrictive import measures taken and their relaxation in early 1983, but it regretted that Hungary did not consider it possible at this time to announce a time schedule for the removal of the quotas and the surcharge as provided for in paragraph 1(c) of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes. The Committee requested Hungary to pursue its adjustment effort, announce a timetable for the removal of the quotas and the surcharge as soon as possible and gradually withdraw the restrictive import measures as the balance-of-payments situation improves.

ANNEX

Statement by the Representative of the
International Monetary Fund

The progress made by Hungary in 1979 and 1980 toward restoring a sustainable balance of payments position faltered in 1981 and the early part of 1982, as external economic conditions became more difficult and domestic demand policies were less effective than intended. The sharp increase in the external current account deficit that ensued was particularly unfortunate as it coincided with a drying-up of medium-term foreign loans and with withdrawals of short-term funds by some foreign lenders. Together, these developments produced massive losses in reserves in the first quarter of 1982.

In the light of the liquidity crisis, corrective measures decided on by the authorities in the latter part of 1981 were reinforced considerably in the course of 1982. Financial policies were tightened, the latitude of enterprises to raise wages and to utilize their investible resources was constrained, and various increases were announced in consumer prices. In the allocation of investment funds, priority was given more strictly to projects designed to strengthen exports to the convertible currency area and to lead to savings in imports of energy and raw materials. In a further effort to bolster the balance of payments, temporary import restrictions were introduced and the forint was depreciated twice during the second half of 1982.

Reflecting the tightening of demand policies, the deficit of the state budget in 1982 was kept below the level foreseen in the initial budget plan and the stock of outstanding investment credits to enterprises declined, while that of working capital credits grew by about one half of the amount envisaged in the Plan. All told, domestic absorption in real terms is estimated to have fallen by 2 per cent in 1982 (on a net material product basis), with the volume of fixed investment in the socialist sector declining, the rate of stockbuilding slowing down markedly, and real private consumption rising only moderately. The curtailment of domestic demand, together with other measures to improve the external accounts, and exceptionally favorable crops, led to an important strengthening in the trade balance in 1982, notwithstanding the continued weakness of export markets and a further deterioration in the terms of trade. Thus, the surplus on total trade (convertible and nonconvertible) rose from SDR 33 million in 1981 to SDR 460 million in 1982, with the trade surplus in convertible currencies increasing from SDR 377 million to SDR 694 million. The current account in convertible currencies, meanwhile, moved into surplus in the second half of 1982 and the deficit for the year as a whole is estimated to have been reduced to the order of SDR 150 million from SDR 618 million in 1981. With the improvement in the real foreign balance, economic growth is estimated to have remained positive in 1982, at 1 1/2-2 per cent. At the same time, the strengthening of the current account permitted a moderate recovery in official reserves during the last three quarters of the year.

However, the external liquidity position remained very tight. In view of this, and taking into account the relatively large share of short-term maturities in the outstanding foreign debt in convertible currencies, the authorities decided in the latter part of 1982 to strengthen their adjustment efforts further. A package of policies designed to achieve a sizable current account surplus in convertible currencies in 1983, while at the same time permitting a gradual dismantling of the import restrictions introduced in 1982, was supported by a 13-month stand-by arrangement for SDR 475 million with the Fund, which was approved by the Executive Board on December 8, 1982. The program includes measures of demand management, structural reform, and exchange rate policy.

Under the program, domestic absorption is projected to fall by 3-4 per cent in volume terms in 1983. Real private consumption is to be reduced through curbs on wage increases, higher taxes, cuts in consumer subsidies, a further quickening in price increases, and new measures to stimulate private savings. A similarly wide array of measures is being directed to curtailing the volume and raising the efficiency of fixed investment and to containing stockbuilding. These encompass further cuts in state investment outlays, including investment grants to enterprises; the freezing in compulsory reserve funds and the taxing away of a part of the earnings withheld by enterprises for investment purposes; higher interest rates on investment and working capital credits; early redemptions of certain outstanding loans to enterprises; and tighter conditions for the disbursement of new credits. In addition, government current expenditures are slated to decline in real terms. Nonetheless, a further marked improvement in the real foreign balance is expected to prevent a decline in overall economic activity in 1983.

The foregoing measures, aimed at securing an immediate further improvement in the balance of payments, are being accompanied by structural policies to strengthen the efficiency of the economy and the external balance in the medium term. A new wage system is designed to permit greater flexibility of wage formation in enterprises. To promote competition and to enhance the mobility of production factors, new legislation facilitates the creation of new enterprises, including small private businesses, compels inefficient firms to contract and to release capital and labor for more efficient uses, diversifies the channels of financial intermediation, and widens the independence and responsibility of management in state enterprises. Enterprises are also now permitted some latitude to increase wages according to their performance in increasing exports to the convertible currency area or achieving savings in imports from this area.

As an integral part of the adjustment effort, the authorities have adopted a more active exchange rate policy vis-a-vis the convertible currency area, geared to promoting a more rational use of imports and to raising the profitability of exports. The forint was depreciated against a basket of currencies by some 11 per cent during the second half of 1982, reversing part of the real appreciation in the previous two years. Incentives for investments aimed at expanding export capacities toward the convertible currency area were strengthened by a rise in the interest rebate. At the same time, the period in which export earnings from the new projects must exceed the value of the investment was shortened.

While these measures and the tightening of demand management take effect, temporary recourse has been made to measures to restrict imports. As of September 1, 1982, imports from the nonruble area of several primary products were subjected to quantitative restrictions and a 20 per cent surcharge was imposed on imports of component parts. The products affected by these restrictions accounted for about 30 per cent of 1981 imports from the nonruble area. Valued at 1981 prices, the quotas announced for 1982 were about US\$60 million below 1981 imports. Import licensing was also tightened in 1982, involving both trade and payments restrictions.

The authorities have indicated that the import restrictions introduced in 1982 are temporary. Early progress toward their removal includes a reduction (by about 20 per cent) in the trade coverage of import quotas announced for 1983. In addition, simplified import licensing procedures were adopted from the beginning of 1983: quarterly limits relative to 1981 imports were introduced for all large and frequent importers, below which individual licenses will be automatically granted. This simplification did not apply to imports of capital goods, for which licenses remained subject to individual approval. The Fund believes that the projected improvement in the external current balance and the expected availability of financing from official and private sources as confidence on the part of foreign private lenders recovers should make it possible to increase holdings of reserves, while permitting the removal of the import restrictions introduced in 1982.