

---

**EMBARGO:**

NOT FOR PUBLICATION BEFORE 1300 HOURS GMT THURSDAY 18 APRIL 1991

---

GATT/1506  
4 April 1991

GATT TRADE POLICY REVIEW

**HUNGARY**

On 17-18 April 1991, the GATT Council will conduct a comprehensive examination of the trade policies of Hungary. The examination will be based on reports prepared by Hungary and the GATT Secretariat.

The reports cover all aspects of Hungary's trade policy, including domestic laws and regulations; the institutional framework; bilateral, regional and other preferential agreements; and wider economic questions.

The trade policy review mechanism (TPRM) was launched in December 1989 as one of the early results of the Uruguay Round to enable a regular collective evaluation by the GATT council of the full range of trade policies of individual GATT members.

Attached are summary extracts of the reports prepared respectively by the GATT Secretariat and Hungary. Full reports are available for journalists from the GATT Secretariat on request.

The complete trade policy review of Hungary, including these two reports together with a record of the Council's discussion and of the Chairman's summing-up, will be published later in 1991, and will be available from the GATT Secretariat, Centre William Rappard, 154 rue de Lausanne, 1211 Geneva 21, Switzerland.

Since December 1989, reviews of the following countries have been completed and are available from the GATT Secretariat: Australia, Canada, Colombia, Hong Kong, Japan, Morocco, New Zealand, Sweden and the United States.

TRADE POLICY REVIEW

HUNGARY

Report by the GATT Secretariat - Summary Observations

As part of the sweeping liberalization in central and eastern Europe, Hungary's political and economic life has been changing fundamentally since 1989. The former one-party régime has been replaced by a democratic multi-party system. A new Government was formed in May 1990. It intends, as a major objective, to transform Hungary's economy into "a modern European social market economy integrated into the world economy, and built on the priority of private property".

This undertaking benefits from a history of economic reforms in Hungary since 1968, when Hungary abolished its mandatory planning system. However, unlike earlier efforts, the reforms introduced since 1989 affect all economic policy areas and basic institutions such as the system of property ownership.

The new approach towards reform has been launched during a period of major economic problems in Hungary, including a persistent decline in real GDP since 1988, high and accelerating inflation and the threat of large-scale unemployment. The Government's scope for action is constrained by a substantial budget deficit and high foreign indebtedness.

(1) Hungary in World Trade

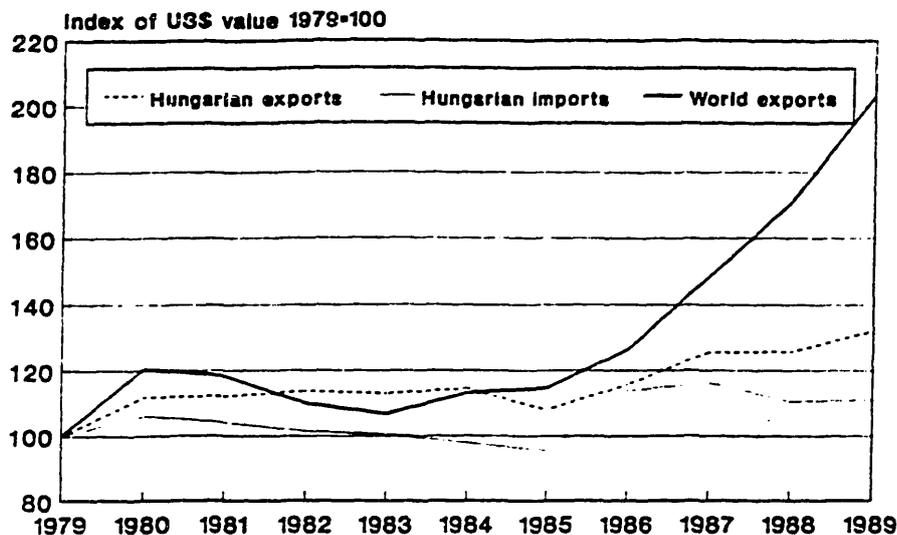
Within current efforts to raise economic efficiency as a key to resolving Hungary's economic difficulties, trade policy reform is an important element. As a small economy with relatively poor raw material and energy resources, Hungary is heavily dependent on foreign trade. In 1989, its merchandise exports and imports each corresponded to about one-third of GDP.

In global terms, Hungary belongs to the smaller trading nations. In 1989, the country ranked 47th among world exporters and 49th among world importers. Its share in world merchandise trade was 0.3 per cent, down from 0.45 per cent in 1980. The decline in world market share is related to the framework in which part of Hungary's trade was conducted until the end of 1990, and in particular to the way in which this framework developed in the 1980s.

As a result of the geopolitical changes after World War II, a centrally planned economy was introduced in Hungary and the country became a member of the Council of Mutual Economic Cooperation (CMEA) in 1949. Within the CMEA, Hungary developed a range of manufacturing industries. Manufactures made in Hungary, in particular machinery, transport equipment and other capital goods were exchanged against energy and raw materials produced by other CMEA members, mainly the Soviet Union. By contrast, Hungary's merchandise exports to market economies were mainly limited to raw materials, semi-finished products and food, whose world market demand was expanding relatively slowly during the 1980s.

MORE

## Hungary and world merchandise trade, 1979-89



Source: GATT Secretariat.

For almost four decades, CMEA countries accounted for well over one-half of Hungary's merchandise trade. Except for a minor part, this trade was settled in non-convertible currency (transferable rouble accounting). Hungarian companies engaged in bilateral CMEA trade were not exposed to competition, as trade was based on bilateral annual delivery obligations at fixed quantities and prices. Poor product quality resulted, adding to Hungary's difficulties in increasing exports settled in convertible currencies.

Following several years of weak trade performance, the volumes of Hungary's merchandise exports and imports declined by more than 5 per cent in 1990. An estimated 27 per cent drop in exports settled in non-convertible currencies more than offset the estimated increase of 13 per cent in the volume of convertible currency exports. The volume of imports from convertible currency sources increased by an estimated 4 per cent in 1990, while import volume from non-convertible currency sources is estimated to have declined by 18 per cent.

The forint value of Hungary's trade increased by an estimated 6 per cent in 1990, with convertible currency trade increasing substantially and non-convertible currency trade contracting strongly. As a result, the share of the Soviet Union and other CMEA countries in Hungary's trade, on a declining trend since 1986, was reduced further to less than one-third in 1990. At the same time, Hungary's trade with developed market economies increased to about 60 per cent of its total merchandise trade. Developing countries continued to account for about 7 per cent of merchandise trade.

Several factors have contributed to this major change in Hungary's trade patterns. Successive real devaluations of the forint vis-à-vis convertible currencies (since 1985), coupled with the weak Hungarian market and, more recently, plummeting demand for Hungary's exports to the CMEA area, stimulated exports to the developed market economies. Imports from CMEA members to be paid in hard currencies were also reduced. This trend is expected to continue in the years to come.

MORE

Since the beginning of 1990, exports to market economies have also been facilitated by trade policy measures introduced by Hungary's western trading partners. In particular, GSP treatment for Hungarian exports was introduced, quotas established by the EC under voluntary export restraint agreements were increased, and specific quantitative restrictions maintained by the EC on Hungarian exports were eliminated. In 1990, Hungary achieved a record surplus of almost US\$1 billion in its trade settled in convertible currencies.

Hungary's trade and current account balance in non-convertible currencies was in substantial surplus from 1985 to 1990. However, these surpluses were tantamount to an interest-free loan by Hungary to other CMEA members, because, under CMEA arrangements, they could not be liquidated.

(2) Institutional Framework

The last few years have seen important changes in Hungary's policies relating to the planning system, the functioning of enterprises, the system of prices, the application of exchange controls and the process of trade policy formulation. The details of developments in trade policies are dealt with in greater length in Section (3) below.

(i) Planning

In 1968, the earlier system of mandatory planning was replaced by a system of macro-economic planning, under which targets were set for economic variables such as the growth of gross domestic product and of convertible currency exports and imports. These targets were binding for the Government agencies involved in their implementation, but were neither product- nor enterprise-specific. They were to be achieved by way of economic regulators, for example credit policy, taxation, subsidies, and exchange rate policy.

The system of macro-economic planning was abolished in early 1990, together with the Planning Office. Since then, the Ministry of Finance has been responsible for working out macro-economic strategies to be adopted by the Government.

(ii) Enterprises

Until recently, the vast majority of enterprises were State-owned. Their freedom to conduct foreign trade was restricted through the State monopolies on foreign trade, foreign exchange and credit. Enterprises were expected to be profit-oriented, but many enjoyed special privileges such as tax exemptions, subsidies and freedom from bankruptcy procedures ("soft budget constraints"). State intervention in individual business decisions was widespread.

Since 1985, about three-quarters of the total of some 1,000 State-owned enterprises have operated under a system of "enterprise self-management". In this system, enterprise collectives decide all economic and personnel affairs. However, the State can change the status of these enterprises, putting them under "administrative direction".

MORE

About one-quarter of State-owned enterprises have remained under administrative direction, with the State retaining a great deal of supervisory control. This includes the appointment of the director by the Government. State-owned enterprises under administrative direction are active in areas such as energy production, public utilities, basic raw materials and defence-related sectors.

Many State enterprises are insolvent. This is of particular concern, because, for lack of a well-functioning capital market, long credit chains have developed among enterprises. Bankruptcy procedures have recently been initiated against a number of larger State-owned enterprises.

In agriculture, co-operatives dominate. They operate under a system of self-management. They also enjoyed State support in various forms such as concessional credits and tax privileges.

A privatization programme began in 1990. The objective of the programme is to privatize, within three years, the production of some 50 per cent of national output, excluding basic social services and public utilities. However, by the end of the year about 90 per cent of national output was still produced by State-owned enterprises and co-operatives.

Following first steps towards developing a capital market in the early 1980s, a two-tier banking system was established in 1987. By the end of 1990, 28 commercial banks operated in Hungary. In 1990, the Budapest Stock Exchange was officially reopened. A new law is in preparation on the National Bank with the objective of making it independent from the Government.

To promote the restructuring of the Hungarian economy, stimulate the transfer of technology and management techniques, and increase capital inflows in the face of a high debt burden, foreign direct investment regulations have been liberalized. As a result, the number of Hungarian joint ventures with foreign participation has increased from about 200 in 1988 to about 5,000 at the beginning of 1991. However, the value of foreign investment has remained relatively low.

In 1988, all economic organizations in Hungary were accorded the right to conduct foreign trade settled in convertible currencies. The State monopoly of foreign trade was formally abolished in 1990. The number of companies listed in the foreign trading company register increased from 350 in 1987 to about 10,000 by the end of 1990. However, State-owned enterprises continued to dominate Hungary's international trade. Trade in some products such as fuels, precious metals, waste paper, some pharmaceuticals and military items, remained subject to specific authorisation. By 1991, three foreign trade enterprises, dealing with products which are subject to specific authorisation such as military goods and energy carriers, remained under administrative direction. Five other foreign trade export-import enterprises under administrative direction trade in products which are not subject to specific authorisation.

(iii) Price system

In Hungary, the share of free prices for consumer goods has progressively increased in recent years, to reach 77 per cent in 1990 (measured in terms of 1987 turnover of consumer goods). In parallel, consumer subsidies (excluding the housing sector) were reduced from 61 billion forints in 1987 to an estimated 48 billion forints for each of the years 1988-90, and producer subsidies from 120 billion forints to an estimated 88 billion forints in 1990. In 1988, the complex system of turnover taxes was replaced by a value added tax, with rates of 0, 15 and 25 per cent. This tax is refunded on exports.

As from January 1991, producer and consumer prices are, in principle, freely determined. Administered prices, allowed only in exceptional cases, cover some 10 per cent of all goods sold, including maximum prices for milk, white bread, school text books, household energy, water, transport and postal services and profit limitations on medicines. The Ministry of Agriculture can establish minimum prices for wheat, maize, cattle and pigs for slaughter. Advance notice on price increases is required for printing paper, red pepper grist, sunflower oil and margarine. In administrative price setting, no distinction is made between domestic and imported goods.

(iv) Foreign trade-related exchange controls

Hungary introduced unified exchange rates for convertible currencies and the transferable rouble in 1968. In order to avoid major price increases for imported goods, the forint was fixed at an overvalued level vis-à-vis convertible currencies. In this situation, the ability to earn the foreign exchange required to finance imports from convertible currency sources depended on subsidies for many export products, in particular food items and other agricultural commodities. Administrative import controls additionally served to secure the balance of payments in the face of attractive imports (at the overvalued exchange rate). Since 1986, Hungary has followed an active policy of real devaluation of the forint vis-à-vis convertible currencies which has diminished the pressure for both export subsidies and administrative import controls.

There are no foreign exchange plans. For imports of goods, import licenses also serve as foreign exchange licenses. Since 1991, all merchandise subject to licensing is enumerated ("positive list").

Since 1989, importers of all products have been obliged to provide forward forint cover for each import transaction in a blocked bank account.

(v) Trade policy formulation and implementation

Hungary's basic trade law dates back to 1974. While the most-outdated regulations have been abrogated, its provisions include wide discretionary competence for the Government in trade-related matters, and a strict separation between foreign and domestic trade. Its provisions still reflect the outstanding importance which was attached to trade relations with CMEA members.

Until the recent political changes, the powers of the ruling party and the State were not clearly distinguished. Major political and economic decisions, including decisions on trade-related policies, were taken by the Party. State institutions, especially Parliament, played a secondary rôle. The bureaucracies of the Party, the State and the big State-owned enterprises were closely intertwined. Bargaining between the State administration and the large State enterprises over support and other interventions was a regular feature of the system.

Since 1989, the Government has assumed sole responsibility for formulating trade policy within the framework set by law. Political parties do not intervene directly in business matters. Within the Government, the Ministry of International Economic Relations (MIER) is the central body responsible for international economic affairs. It formulates, and submits to the Government for approval, the principles of trade policy and regulations in individual policy areas. Trade policy is implemented by a number of Government agencies, including the Ministry of Finance, the Ministry of Industry and Trade, and the Ministry of Agriculture.

In trade policy matters, the Government consults with the business sector through organisations such as Chambers of Commerce and industrial and agricultural federations. In response to recent decentralization and privatization, their number and activity has been rapidly increasing. Along with Government officials and academics, the business sector is also represented in an Advisory Group to the Minister of International Economic Relations.

While recent changes have made the process and results of trade policy formulation more transparent, Hungarian legislation continues to give wide discretion to State authorities. A recent Government decree provides the authority to introduce trade restrictions under a variety of circumstances, including under international agreements or decisions accepted by the Hungarian Government, and the possibility of retaliation if discriminatory practices on the part of a trading partner cannot be resolved through GATT dispute settlement procedures. For many trade-related areas, criteria or guidelines for decisions by the authorities are either missing or have remained somewhat opaque. As a rule, administrative decisions cannot be challenged before courts.

In Hungary, there is no independent statutory body which carries out regular public reviews of trade policies.

### (3) Trade Policy Features and Trends

#### (i) Recent evolution

During the first two decades following World War II, Hungary's trade policy was determined by a rigid system of central planning, the country's close relationship with the Soviet Union and its participation in the CMEA. Economic reform efforts between 1968 and 1988 opened up the Hungarian market to some extent, but were not accompanied by political reforms. The economy remained largely divided into three economic spheres, relating to

MORE

the domestic market; CMEA-related activities; and relations with market economies. Each of these areas was governed by different rules and institutions. Virtually all imports were administratively controlled.

In 1972, Hungary introduced a scheme of tariff preferences in favour of developing countries, excluding such products as meat, meat preparations, fish, dairy products, aluminium and aluminium products. Since 1978, Hungary has accorded duty free-treatment to imports originating in least developed countries.

In 1973, Hungary acceded to the GATT on the basis of tariff concessions. However, its Protocol of Accession contains a number of specific provisions which reflect the fact that the country was not a market economy. Hungary has frequently emphasized its interest in a well functioning multilateral trading system. It has signed all Tokyo Round Codes, except for the Agreements on Subsidies, Government Procurement and Civil Aircraft. It has been a signatory to the MFA since 1974. Hungary has been an active participant in the Uruguay Round, both individually and as a member of the Cairns Group, reflecting its major concern to improve conditions of competition in world agricultural trade.

With one exception, Hungary's trade with market economies has been conducted on an m.f.n. basis. In 1974, Hungary concluded a free trade area agreement with Finland, affecting a relatively small volume of trade. Recently, Hungary has started negotiations on an association agreement with the EC, seen by the authorities as an important step towards the more distant objective of joining the Communities. The Government also intends to conclude free trade agreements with the EFTA countries. Hungary's exports benefit from GSP treatment in most developed countries.

Until January 1991, trade among CMEA countries was based on co-ordinated plans and bilateral intergovernmental trade agreements which included fixed prices, mandatory export-import quotas and certain other conditions which restricted the economic freedom of enterprises. Hungary did not apply its customs tariff to imports settled in non-convertible currencies, nor was the m.f.n. principle applicable in CMEA trade. Price-related measures, such as special taxes, subsidies and levies, a wide range of formal and informal administrative measures, and ad hoc interventions were used to bridge the gap between pricing within the CMEA trading system and the Hungarian economy.

Despite ongoing economic reform attempts, the economic situation of the country deteriorated in the course of the 1980s. Hungary's industrial products were not competitive in the world market, overall economic performance fell markedly behind that of the developed market economies, and, in the face of weak export performance and energy-price related terms-of-trade losses (until 1987), gross foreign debt increased to almost US\$21 billion (end of 1989). By 1989, it was recognized that fundamental changes were needed in both the political and the economic sphere. Following the reform of the political system, the reform of the economy is the priority objective of the new Government.

Between 1989 and 1991, a series of unilateral import liberalization programmes were launched by the Hungarian Government. Along with these steps towards reducing border measures, reforms in other trade-related policy areas were started or accentuated.

From 1 January 1991, the two-tier nature of Hungary's trade policy régime has been largely replaced by a unified system. In principle, Hungary's trade with CMEA countries, China, the Democratic Republic of Korea and Viet Nam (countries covered in "Annex A" of Hungary's Protocol of Accession to the GATT) is now also conducted in convertible currencies on the basis of world market prices, and general rules, including the m.f.n. clause, also apply to trade with these countries. In the short term, this change may cause a deterioration in Hungary's terms of trade, as prices for fuel and raw materials from CMEA sources have increased to world market levels.

In view of the difficulties associated with the change to convertible currency trade, it is likely that trade with the Soviet Union and other "Annex A" countries will preserve some elements of barter trade for a transitional period. New bilateral trade agreements have been concluded with several of these countries and negotiations are under way with others. The Soviet-Hungarian trade agreement, signed in 1990, contains an indicative export-import list.

(ii) Type and incidence of trade policy instruments

Until recently, price-related border measures had a modest impact on Hungarian trade flows. While customs tariffs were applied to imports settled in convertible currencies, their main impact was to generate government revenue. Trade with market economies was largely regulated by comprehensive non-automatic import licensing, trade-related State monopolies, and other instruments, including a sophisticated system of formal and informal State and Party interventions in enterprise decisions affecting foreign trade. Domestic prices for many goods were fixed, with consumer subsidies bridging the gap between domestic prices and domestic production costs for a variety of products. Competition between domestic and imported products was very limited.

Up to 1989, all imports were subject to non-automatic licensing. Licensing criteria or guidelines were neither published nor notified to the GATT. Large exporters appear to have enjoyed more stability in obtaining import licences than small importers. For balance of payments reasons, imports from non-convertible sources appear to have been favoured. Licensing for imports from these sources served mainly to monitor the fulfilment of bilateral trade agreements.

In 1989, Hungary began to implement an import liberalization programme, followed by further reductions in licensing requirements in 1990 and January 1991. Substantial liberalization appears to have been achieved to date. The precise degree of liberalization is difficult to assess because information on the number of tariff items freed from licensing requirements, and their share in all tariff items, has not been available

for this report. It is known, however, that a wide range of products continues to be subject to licensing, such as certain industrial raw materials, coal, precious metals, transport equipment, telecommunications equipment, pharmaceuticals, chemicals, and many consumer goods, including furniture, travel goods, footwear, textiles, clothing and food items.

Imports of liberalized items have increased at a time when domestic demand has been weak.

Since its accession to the GATT, Hungary has maintained, for reasons related to balance-of-payments considerations, a specific quota on consumer goods imported from market economies. This so-called global quota on consumer goods has protected Hungarian producers of a wide range of products, including several food items, wine, cosmetics, household chemicals, photographic films, clothing, leather, footwear, some electrical consumer goods and furniture. Between 1985 and 1990, the value of the quota was increased from US\$100 million to US\$200 million, while the product coverage of the quota was reduced. For the first six months of 1991, a further increase of the quota to US\$302 million has been announced. This amount, however, includes imports which were previously settled in non-convertible currencies and thus not part of the quota.

With effect from 1 January 1991, the administration of the quota has been reformed. The global quota on imports of consumer goods is divided into fifteen product groups, with group-specific and, in some cases, country-specific ceiling values. It is administered through licences, which, according to the Hungarian Government, are allocated on a first come-first served basis.

With the reduction in the scope of import licensing, tariffs are gaining in importance in shaping the level and pattern of imports. Hungary operates a system of ad valorem tariffs, classified under the Harmonized System since 1 January 1991. The simple average tariff is 16 per cent, exceeding levels in most developed countries. A tariff reduction package to be implemented in 1991 is expected to reduce the average tariff to 13 per cent. In the Uruguay Round, Hungary has conditionally offered to cut tariffs by about one-third on average.

Currently, tariffs are particularly high for items such as electric machinery, investment goods, transport equipment, textiles, clothing and agricultural commodities. For a broad range of products, tariffs escalate with increasing stages of processing. However, tariff escalation is less pronounced than in many developed countries because Hungary's tariffs on industrial raw materials are generally higher. The share of bound items in total tariff lines is 93 per cent for industrial products, but only 23 per cent for agricultural products. Hungary's conditional offer in the Uruguay Round includes an increase in tariff bindings.

A particular feature of Hungary's customs tariff is that high tariffs are in place for several products not made in Hungary. The items involved include some mechanical machinery, electrical machines, passenger cars and a wide range of other transport equipment. This tariff structure partly

reflects fiscal considerations in determining duty levels. However, it also served to protect merchandise imported duty-free from CMEA sources against potentially competing imports from market economies.

The specific nature of trade with CMEA countries provided protection for several Hungarian sectors by way of guaranteed outlets, in particular for commercial vehicles, telecommunication equipment, engineering, textiles, clothing, footwear and a range of agricultural products. With import liberalization and the shift to convertible currency accounting in CMEA trade, these sectors are now being exposed to international competition. The Hungarian authorities have indicated that, in the light of developments, there may be a need to review sectoral protection policies. A new import régime for agricultural products is in preparation.

Largely for developmental or industrial policy purposes, Hungary provides tariff relief for a number of items such as components for the production of refrigerators (tariff quotas), certain inputs for semi-conductor production (concessional tariffs) or computer-assisted design and manufacturing systems (tariff suspensions). These relief measures, which also cover certain other items, are taken on an m.f.n. basis.

Levies and charges on imports other than tariffs are substantial. All imports settled in convertible currencies are subject to a 2 per cent customs clearance fee. In addition, a 3 per cent statistical fee is charged and, for items subject to import licensing, a 1 per cent fee applies.

In CMEA trade, a special support and levy scheme was in place, as a buffer between the accounting prices applied in this trade and the domestic price system. This scheme lapsed on 1 January 1991.

Consumer taxes are levied on a range of products at item-specific rates. Domestic and imported products are treated equally. An earlier discriminatory treatment of cigarettes imported from market economies, or produced under foreign licence, was eliminated in January 1991.

Hungary applies sanitary and phytosanitary controls to imports of many plants, plant products, live animals and animal products. The authorities have made efforts to bring Hungarian measures into line with international norms.

A large number of industrial standards also exist, with CMEA standards still playing a substantial rôle, in particular in the engineering sector. Reflecting Hungary's objective to open its economy and join Western European integration, participation in CMEA standardization activities has been terminated and efforts to base national standards on international norms have been increased. Standardization bodies are soon to become independent from the Government.

Hungary has no specific legal regulations for Government procurement. While some guidelines on tendering procedures exist, there is little

MORE

transparency about the policies, criteria and instruments used in this area.

Present Hungarian legislation also fails to give a clear picture of the extent to which State-owned enterprises are independent from State authorities in their economic decisions. According to the Government, State-trading in the sense of Article XVII does not exist in Hungary. However, even after a reform of the law on State-owned enterprises in 1985, about one-quarter of these enterprises have remained under administrative management, with the State retaining a great deal of supervisory control. These enterprises include some export-import enterprises. Recently, the number of enterprises enjoying exclusive export and import rights has been reduced.

There are no export prohibitions in Hungary, but up to the end of 1990 all export transactions were subject to licensing. Exports against non-convertible currencies were allowed only within bilateral quotas. Licenses for exports to convertible currency destinations mainly served the purpose of verifying that exports were only undertaken by authorized enterprises. Licensing has also been used for the implementation of export restraint agreements concluded by Hungary with the EC (steel, textiles, sheep and sheepmeat, goat and goatmeat), the United States (steel, textiles), Canada (textiles), Norway (textiles) and Sweden (textiles and footwear).

In January 1991, Hungary reduced the scope of export licensing substantially. Despite these reductions, a wide range of products remains under licensing, including certain fuels, steel products, non-ferrous metal products, machinery and transport equipment, chemicals, textiles, clothing, food items, forestry products and weapons. Licensing is maintained to control exports of products covered by specific non-commercial regulations, to regulate exports of military items and to implement export restraint agreements.

Export levies can be imposed on certain agricultural products such as rabbits for slaughter and live pigs. Minimum export prices apply to dairy products in the framework of the International Dairy Arrangement, and to steel and certain pigmeat, cheese and wine exported to the EC.

Hungary operates a duty drawback scheme for imported products used in export production.

Exports of a wide range of agricultural items are promoted by way of subsidies. In 1990, export subsidies amounted to an estimated forint 23.5 billion (equivalent to around US\$370 million), down from forint 29.5 billion in 1989. According to the Hungarian Government, there are no other export subsidies.

Export assistance is also provided within the framework of special funds such as the Export Development Programme and the Trade Promotion Fund. Assistance includes profit tax preferences, refund of the value added tax paid on export-oriented investment, research and development

support, promotion of market research and participation in fairs and exhibitions abroad. Data on the total assistance involved and the distribution of support across economic sectors have not been available for this report.

Guidelines for medium- and long-term export credits appear to follow OECD practice closely. The National Bank refinances short-term export credits. Efforts to establish a new export credit guarantee and insurance system are under way.

(iii) Temporary measures

In 1982, Hungary introduced specific import restrictions for balance of payments reasons under Article XII of GATT. These measures were terminated in 1984.

Hungary has never taken recourse to temporary protection under Article XIX of GATT. A new Hungarian safeguard regulation has come into force on 1 January 1991. The regulation contains a sunset clause, terminating measures after a maximum period of one year.

To date, Hungary has never resorted to anti-dumping or countervailing duty actions. Recently, a Government decree was approved on the application of anti-dumping measures. Duties may be imposed for a maximum period of five years.

(iv) New Initiatives

In September 1990, Hungary's new Government, in office since May 1990, outlined a comprehensive political and economic reform programme to be implemented in the period 1991-93 (Programme for National Renewal). The basic economic objective of the programme is to establish the foundations of a market economy by the end of 1993. Major features of the programme include privatization; price and wage liberalisation; making the currency convertible; opening up the economy; intensifying links with Western Europe; and promoting foreign investment.

Concerning trade-related policies and institutions, specific items of the programme include the negotiation of an association agreement with the EC and free trade agreement with the EFTA countries; the preservation of Hungary's interests in Eastern European and Soviet markets; promotion of trade relations with the United States, Japan and with some newly industrialized countries; freeing of almost all imports from import licensing by 1992-93; reduction in the average level of tariffs to 8 per cent; the pursuit of an exchange rate policy primarily based on the country's export interests; a continuation of support for agricultural exports; and the achievement of an increase of 30 per cent in exports settled in convertible currencies in order to maintain the country's solvency. Efforts to streamline the administration of foreign trade are also underway.

In support of the economic reform programme, the Hungarian authorities intend to keep monetary policy tight in order to curb inflation, which reached a rate of 30 per cent by the end of 1990. Tax reform and a further cut-back in subsidies are envisaged to rationalize the fiscal system and to reduce the budget deficit. These measures are to help bring about internal and external balance in the economy.

The Government is aware that successful implementation of the reform programme depends on social consensus. It encourages the development of institutions representing the interests of all economic groups, including consumers, which could facilitate the dialogue between the Hungarian population and its Government.

#### (4) Trade Policies and Foreign Trading Partners

With the change in the political system and the progress of market-oriented reforms, Hungary is becoming a more attractive place for its trading partners to do business. The move towards price-related trade measures and other steps in the direction of liberalizing the economy are rendering Hungary's trading environment more transparent. However, many changes still need to be made before Hungary becomes a fully open economy with predictable and stable conditions for the conduct of trade.

Temporary uncertainty about import, export and investment regulations is inherent in a reform process as fundamental as the one currently underway in Hungary. By regularly providing information on the state, pace and pattern of trade-related reforms, the Government would help to keep such uncertainty at a minimum. Transparency is needed with respect to all aspects of Hungary's new trade policy orientation, including Hungary's future trade relations with its CMEA partners.

Rapid implementation of a rule-oriented, open trade régime would require further clarification of the discretionary powers of the administration and of new rules in a number of areas such as government procurement or State-trading. Swift implementation of privatization and a clear definition of the future rôle of State-owned enterprises would boost foreign trading partners' confidence in Hungary's reform programme. Relatively high tariffs, the general import cover requirement, and the continuing presence of non-automatic import licensing and the consumer goods quota protecting substantial sectors of Hungary's economy are factors which weaken, if not prevent, competition in many areas of the Hungarian economy. The issue of currency convertibility is also of major concern to foreign traders in conducting business with Hungary.

For the progress and success of Hungary's reforms, a supportive external environment is crucial. Despite the recent improvements in access to western markets, in particular the EC, a number of major Hungarian export products like steel, textiles, clothing and several other consumer goods continue to be subject to major barriers to entry abroad. Hungary's agricultural exports face serious problems of market access in Europe and elsewhere. Massive export subsidies by certain trading partners are also

hurting Hungary's agricultural exports through their depressive effects on world market prices.

Hungary needs increasing foreign exchange not only to satisfy the aspiration of its population of having more access to foreign consumer goods, but, perhaps even more importantly, to finance imports of technological, management and marketing know-how, of capital goods and of other inputs which are necessary in promoting the restructuring of its economy. Foreign exchange earnings through export expansion will have to be the main vehicle as Hungary's foreign debt is already high, with debt service having exceeded 50 per cent of the value of its convertible currency exports in 1989. Hungary's ability to pursue structural adjustment while honouring its debt-servicing obligations depends on an expanding world economy, improvements in market access for Hungary's exports, and the business certainty ensured by stable, predictable rules governing world trade.

The changes introduced in the last few years, in particular since 1989, indicate that Hungary is in the midst of a comprehensive and far-reaching economic reform affecting, along with other economic policy areas, a wide range of trade-related policies and aiming at a substantial transformation of the economic structure. These reforms, which are only at the early stage of their implementation, will evidently take time to work their way through the economy. Their full implementation would make Hungary's economic system, including its trade régime, largely compatible with that of developed market economies. At the same time, the new economic system would provide a promising foundation for realizing Hungary's objective of integrating itself more closely into the GATT system and the expanding world economy, including participation in Western European integration and a renewal of Eastern European cooperation on the basis of market principles.

TRADE POLICY REVIEW

Report by the Government of the Republic of Hungary

Summary extracts

1. GENERAL OVERVIEW

After World War II, the directions of Hungary's development had largely been determined by political considerations. It resulted in copying not only the one (communist) party political system, but also the Stalinist autarchic economic model. Tense East-West political relations in the so called "cold war" period also had a large impact in pushing Hungary towards overly ambitious self-reliance and one-sided economic co-operation within the CMEA. After the repression of the 1956 Hungarian revolution, which was a major attempt to break free of the political and economic system forced on the country, Hungary remained to be affected for a long time by trade restrictions applied by industrialized countries.

As it became increasingly obvious throughout the 1960s that the potential of economic growth through extensive industrialization had been exhausted and centralized economic management proved to be ineffective, the need for reforms intensified. This led to the elaboration and introduction of an economic reform programme in 1968. Its basic aim was the decentralization of economic management and the introduction of certain market elements. As a result, plan directives, obligatory to enterprises were abolished and profit orientation became an important factor of companies' operations. Changes were effected in the foreign trade régime to create the necessary linkages between the national economy and international markets. Nevertheless, these reforms were limited only to certain areas of economic management without attacking the basic characteristics of the socialist economic model.

The Hungarian economic reform slowed down in the 1970s, due to unfavourable external political and economic conditions and internal - mostly political - pressures. The dramatic increase in oil prices and the neglect of its impacts adversely affected the development of the Hungarian economy. The period was marked by the accumulation of foreign debt, reaching \$US 10 billion by the end of the decade.

The reform process gained new momentum in the early 1980s. Measures have been taken to promote structural adjustment of the economy by introducing market economy mechanisms and institutions. Improving economic and trade performance led decision makers in the mid-1980s to setting ambitious and contradictory growth and development objectives. Since these policies were based on false premises, severe repercussions soon manifested. The external indebtedness rose sharply, reaching about \$US 21 billion by 1987. Deficit in the current account in convertible currencies increased, the trade balance deteriorated.

MORE

Following 1988, economic policies concentrated on preventing the further increase of indebtedness and restoring macro-economic equilibrium. In order to strengthen market orientation in the economy, new structures and legal frameworks compatible with those of market economies were created. The process of economic and trade liberalization has been carried forward.

In spite of the partial results, after two decades of economic reforms it became apparent that the economic model followed so far can not be made viable by way of limited reforms. Ideological considerations prevented the addressing of such fundamental problems as the overwhelming rôle of state ownership in the economy and the limitations on private initiative. It has also been recognized that the desired economic changes can not be implemented without the synergy of correspondent changes in the political system. The close interrelationship between democratic political structures and an open market economy has been the cornerstone of systemic changes in Hungary.

The process of changing the political structures and institutions through peaceful transition to a democratic parliamentary system was characterized by broad-based national consensus. It culminated in free, multi-party elections in the spring of 1990. As a result, a new coalition government has been formed.

The Government elaborated its three-year action programme, called the "Programme of National Renewal". The programme covers all the major facets of political, economic and social life and outlines the directions and priority areas for action.

As far as economic policy is concerned, the Hungarian Government intends to complete the setting up of the necessary framework for a well-functioning market economy, based on entrepreneurial freedom, private initiative and social responsibility. Economic competition in the sphere of goods, services, capital and labour is to play a full rôle.

Privatization is considered as a basic pillar of the process of economic transformation. The Government set the goal of decreasing the share of state property below 50 per cent in the competition sphere of the economy by the end of 1993.

In order to implement these policy objectives, a wide range of important legislations have been elaborated and adopted in the course of 1990. Some of the relevant regulations are discussed in part A and B of the document. In addition to the establishment of a transparent legal base for economic activities, the Government has put in place an array of concrete measures to accelerate economic transition which have already produced some encouraging early results.

The Government is, at the same time, aware of the difficulties of economic transformation. The room of manoeuvre for economic policies is limited by internal and external factors. Growing inflation, decreasing GDP and living standards put serious strains on economic development. The



dramatic collapse of CMEA trade has already caused serious problems, inter alia, through reductions in supplies of energy carriers and deterioration of export opportunities in traditional markets. Some other unfavourable developments in the external environment (such as the effects of the Gulf crisis) added to the difficulties.

Under these circumstances, resolute efforts are needed to stabilize the external payment situation of the country. Strict monetary and financial policies are followed to combat inflation, reduce the budget deficit and meet debt servicing obligations.

Hungary remains fully committed to comply with its debt servicing obligations though they constitute a drastic outflow of resources, hindering the achievement of objectives to modernize economy, upgrade infrastructure and advance structural adjustment. Foreign direct investments should play a crucial rôle in easing these constraints. The inflow of these resources for development is facilitated by the necessary guarantees and favourable conditions to investors, already in place.

In spite of all these difficulties, the process of structural adjustment should be speeded up in order to establish the basis for sustainable economic growth in the medium term. Intensified foreign economic relations should make an important contribution to this process.

## 2. TRADE POLICIES AND PRACTICES

### (i) Objectives of trade policies

The objectives of trade policies are determined against the above outlined background and stemming from the changing of the political system and the economic model. For Hungary, as a small country of 93.000 sq. kilometers with a population of 10.4 million, foreign economic relations are of crucial importance in the process of economic development. This can be demonstrated by indicators such as the ratio of exports to GDP (over 30 per cent) or exports per capita. Given the small size and the trade dependence of the economy, economic progress is directly linked to the trade performance of the country and its integration in the world economy.

In view of the openness of the Hungarian economy and its high exposure to changes in international markets, economic transition should be underpinned by a renewed, carefully elaborated strategy for foreign economic relations. As far as the main directions of the current Hungarian trade policies are concerned, the emphasis is on the full integration in the network of world trade, through:

- continued economic and trade liberalization as a means of promoting structural adjustment;
- improved market access conditions and possibilities for Hungarian exports;

MORE

- market reorientation;
- changing the centre of gravity in foreign economic relations.

In achieving these goals the Government attaches great importance to the evolution and maintenance of a supportive external economic environment which includes multilaterally agreed norms and principles. In this context Hungary, also as a small country, attaches special importance to a well-functioning multilateral trading system and to the success of the Uruguay Round negotiations.

Agriculture is a priority area for Hungary in the Round. The importance of the agrarian sector in the economy and in exports explains the keen interest of Hungary in putting an end to the international competition in subsidization and in a substantial reduction of market access barriers. To this end Hungary takes an active part in the negotiations and co-operates - on the basis of similar interests - with other countries of the Cairns Group.

As a result of market access negotiations Hungary expects meaningful reduction of tariff and non-tariff barriers. Hungary tabled a conditional offer for tariff reductions and bindings which would decrease by one third its average tariff level. The offer covers all product groups, including agricultural, tropical and natural resource-based products. As a contribution to the mid-term review results, Hungary extended GSP treatment for tropical products not covered so far and reduced GSP rates for some 90 tropical products. Hungary is also interested in pursuing liberalization in the clothing and textiles sector.

Success of negotiations in the rule-making area would result in strengthened and predictable multilateral trading rules which could also be supportive to the ongoing major restructuring of the Hungarian economy.

The extension of multilateral disciplines to such areas as services, trade related investment measures and trade related aspects of intellectual property rights is also supported by Hungary. The active participation at these negotiations is aimed at elaborating appropriate rules and in case of certain service sectors, the achievement of improved market access possibilities.

Hungary also aims to rely on new or improved bilateral frameworks as a means of enhanced integration into the world economy. It is the Government's intention to fully reinstate the historic economic and cultural ties with European partners abruptly cut some forty years ago. This process is marked by the ongoing negotiations with the EC and EFTA aiming at substantial improvements in economic and trade co-operation. At the same time, trade policies put an emphasis also on the establishment of closer links with the US, Japan and other OECD countries. Trade and economic relations with developing countries are to be intensified through exploring new avenues for co-operation. Due to the systemic changes in Central and Eastern Europe, the former CMEA trade is placed on market

economy rules and mechanisms. Hungary is interested in the development of mutually beneficial economic and trade co-operation adapted to the changing conditions with a view to avoid the disruption of these trade relations.

In industrial development structural adjustment plays a central rôle. As a result of shrinking internal demand the share of exports in the total sales of industry is expected to grow. This process, however, is likely to encounter major difficulties. A number of traditional industries developed production structures based on the demand in CMEA markets. Trade opportunities with these countries are reduced due to the economic difficulties of the partners. The shift to convertible currency trading in this region will cause marketing problems to companies whose medium-quality products or high prices may not stand the competition with the goods of other suppliers. Also, the process of trade liberalization exposes Hungarian producers to international competition in the domestic market.

These challenges can be met if access to modern technologies is not hindered and there is a steadily increasing inflow of foreign investments. Trade policies are to contribute to the necessary market reorientation, both in exports and imports.

Concerning agriculture, the major aim of trade policies is to improve the terms of access for Hungarian products both to traditional and new markets. While there are efforts to increase the share of higher value-added products in Hungarian exports, in the short term there are only limited possibilities for a substantial shift of production and export patterns. The worsening state of international agricultural markets requires appropriate flexibility in shaping domestic agricultural policies. The Agricultural Marketing Co-ordination Committee has the task of formulating production and trade policies and measures in order to provide the necessary conditions for a well-functioning agricultural market in Hungary.

(ii) The export-import system

All economic operators (state owned or private companies, business associations, co-operatives, single entrepreneurs) may directly deal with foreign trading as a result of the abolition of the state monopoly of foreign trade. Fully or partially foreign-owned companies domiciled in Hungary are granted national treatment in the field of foreign trade.

The main instruments of foreign trade regulation are the tariffs and the exchange rate. Tariffs are imposed on all imports regardless of their sources. However, under the Hungarian scheme of Generalized System of Preferences most products imported from beneficiary developing countries are subject to GSP tariffs, substantially lower than m.f.n. rates. In addition, imports from Finland under the bilateral free-trade agreement and all imports from the least developed countries are exempted from customs duties.

No foreign exchange restrictions are applied nor permissions are needed for obtaining foreign currencies for imports. Importers, when

opening a letter-of-credit, have to deposit the forint equivalent of the transaction value in a blocked account at their banks. The reason for this regulation is to ensure that importers have, in fact, at their disposal the necessary amount of the local currency to finance imports.

For a limited number of products (energy carriers, hazardous products, precious metals and stones, military and nuclear goods etc.) exports or imports may be carried out by companies possessing specific authorization on the basis of meeting certain pre-set criteria.

The list of products subject to export and import licensing is annexed to the relevant Government decree. Export licensing covers some 30 per cent of exports, while the share of licenced imports remains under 10 per cent. As a consequence of import liberalization, the major part of the domestic industrial production is fully exposed to foreign competition.

Imports of certain consumer goods are subject to a global quota. The quota is announced for six-month periods and may contain individual ceiling values. Allocation of the quota is made on an order of arrival basis.

In order to partially offset the adverse effects of the seriously distorted international markets and to avoid further loss of market shares Hungary is compelled to provide export subsidies to a number of agricultural products. However, the overall level of support, including producer subsidies has been constantly decreased in recent years.

Until the end of 1990, trade under the intergovernmental agreements with CMEA countries was subject to special regulations (fixed delivery quotas and prices, domestic price equalization schemes, etc.).

### 3. Wider economic and developmental needs, policies and objectives

The central objective of the Hungarian economic policy is an early transition to a market economy. The cornerstones of the economic transformation are the stimulation of entrepreneurial activity, the speeding up of privatization, the promotion of structural adjustment in industry and agriculture, the development of the services industry and infrastructure. At the same time the Government intends to curb the external indebtedness and inflation, to keep within acceptable limits the decrease of production and to provide a social safety net for easing the inevitable social tensions. The process of transformation must be coupled with concerted actions to preserve the functioning of the economy, to reduce macro-economic imbalances and to lay the foundations of sustainable economic growth for the future. This requires the pursuance of mutually reinforcing economic, financial and social policies.