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THE AGGREGATE DEMAND MANAGEMENT IN HUNGARY

It is known to everyone that the evergreen subject of aggregate demand management arises with particular emphasis in every country since the mid-seventies. Every economy strives after the full exploitation of resources. Within this, it wants to avoid unemployment, and to maintain the stability of the value of the money, or at least to avoid galloping inflation.

Hungary can record laudable successes in these fields. There is no unemployment and the rise of prices, though not insignificant, yet has never transgressed the one digit mark; the average annual price rise of 6.2 percent between 1975-1983 was practically under the unambiguous control of the government. In this respect we have been lagging behind only in comparison to the results achieved by a part of the centrally planned economies. In our country plan directives were not issued during this period and buyers were much less dependent on sellers than in the other centrally planned economies.

Hungary thus avoided unemployment and uncontrolled inflation. The growth in the quantity of money essentially corresponded to the growth of production and to the inflation planned by the government. Although the procedures devised for this purpose proved successful in avoiding unemployment and enterprise failures, as well as in controlling inflation, yet they did not entail unambiguously advantageous results. The unfavourable phenomena of 1979-1983 may be summed up in the following:

In the period of the stagnating indebtedness, the government slowed down the growth of production; under the impact of these measures the domestic use of the national income fell back: investment in 1983 was 15 per cent lower, gross accumulation 30 per cent lower than in the peak year of 1978, and

personal consumption increased between 1979-1983 by only 1.3 per cent p.a. much more slowly than the 5.1 per cent p.a. between 1965-1974 or the 3.8 per cent between 1975-1978.

How did the Hungarian economy achieve between 1979-1983, in harmony with the declared political objectives, that economic efforts should be concentrated on improving the balance of payments in convertible currencies at the expense of domestic consumption and the trade with the 'rouble area'; within domestic consumption personal consumption should enjoy preference over investment.<sup>1</sup> In the course of this successful policy many unfavourable side-effects have appeared. Namely, unexploited capacities have considerably increased, while this has not shaken the financial stability of firms and has not ended shortage of labour. In this context the difficult situation emerging has not mobilized the economy for greater efforts and this resulted, in an undesirable manner, in a general decline of Hungary's share in the Western export markets and somewhat again increased the unfavourable phenomena of shortage economy which had considerably improved after 1968. Thus what we have to analyse is whether it was correct to apply this combination of economic policy instruments, and reflect what conclusions have to be drawn from the above analysis for the future.

### 1. Consolidation policy between 1979-1983

#### The dilemma

- 1/ After those years when the domestic consumption had exceeded the domestically available national income the continuation of the old trend became impossible.
- 2/ The further raising of the stock of accumulated credits amounting about to \$ 8 bn in 1978 would have not only lacked every economic rationality, but it became impossible because of the changed conditions on the credit market. The real rate of interest on credits /the nominal credit lending rate divided by the index of Hungarian export prices/ which had been frequently negative up to 1978, considerably increased by 1981-82 and, on short-term credits, it rose for some time essentially above 10 per cent. In consequence,

a particular bottleneck came about in the development of the Hungarian economy: the balance of payments with Western countries.

The task was not simply to eliminate the 8 per cent difference in 1978 between the creation and use of the national income and to attain a saving of 2 per cent by 1982, but it also had to be achieved that the 27 per cent deficit in the balance of foreign exchange in convertible currencies of 1978 should be replaced by a 12 per cent surplus. This would have allowed a modest reduction of debts in convertible currencies and to cover the interest burden of debts.

The problem might have been handled - in a manner obvious to economists - by braking aggregate demand and devaluating the forint. If this strategy had been accepted the question would have remained open whether the devaluation of the forint and the restriction of demand could be so concerted as not to release inflation moreover whether the drastic devaluation of the forint provided sufficient stimulation for the desired boosting of exports and the substitution for imports, thus whether the desired improvement in the balance of payments actually occurred. It would also have remained unclear how many establishments had to be closed down in consequence of the change in production structure owing to reduced domestic demand, and whether the released labour could be successfully regrouped towards export activities and those substituting for imports. And, finally, it was doubtful whether the workers, highly irritated by the emerging inflation and at best slowly rising nominal wages in consequence of falling demand, deprived from the accustomed job safety, would adjust to the changes without open resistance.

Obviously, each of these uncertainties is a considerable risk factor. Their unfavourable development would not only have annihilated the promise of easing the tension of the balance of payments and avoidance of the related acute danger situation, and also that the transitory halt of growth should provide the foundations for a later smooth development, but it would also have made unavoidable an upsetting of the social peace, with the economic consequences involved.

It was certainly not only adherence to the established political, institutional and organizational conditions and the lack of new requirements indispensable for the policy of reducing aggregate demand but also the above considerations that have contributed to the government reaction that not aggregate demand should be restricted but a complicated strategy be devised for fighting the difficult situation.

The short-term strategy consisted in renewing market regulations and in expanding the possibilities of private initiative, according to Hungarian terminology those of enterprising. Here belong the promising initiatives related to the competitive price system and those relating to the modification of enterprise wage control<sup>2</sup> as well as the creation of new forms for small-scale ventures.<sup>3</sup> The press devoted great attention to both strategic elements.

The long-term strategy was aimed at a revision of the general control methods of the economy brought into equilibrium by 1984-85. Also this effort was given much publicity. Although it became clear already at the end of 1982 that the political leadership did not want to go into a thorough critical analysis of the processes after 1966-1968 and did not want to introduce the necessary changes as a new epoch of control, it did not turn a deaf ear to further changes in the financial regulators and in the institutional system of the economy that would consider the requirements of a market economy. Thus, it wanted to eliminate the discriminatory methods of curbing money circulation and to restrict considerably the dependence of enterprises on party and state administration. The latter tendencies led to the resolution of the CC, HSWP in April, 1984.

## 2. The policy of discriminatory financial regulation

In practice instead of shifting to a policy of regulating aggregate demand a discriminatory financial policy individually regulating details was introduced. The armory of the policy here employed is not unknown in Western economic literature, either. In manifestations of critics unsatisfied with the presently prevailing economic policy, considered conservative by many, a lot of similar elements are mentioned.<sup>4</sup>

It may be called a particular feature of the Hungarian economic policy that, after the abolition of plan instructions, it employed, instead of aggregate demand management, mainly four methods:

1. Regulation of earnings,
2. Import restrictions,
3. The systems of price controls and market surveillance,
4. Regular discriminatory taxation of enterprise incomes.

These methods, which had been employed even earlier, regulated not only the quantity of money issued, but beginning with 1979 they successfully contributed to restoring the equilibrium of the balance of payments. This was also promoted by the effort to put into the fore equilibrium instead of the growth of production. With this the Hungarian economic leadership took upon itself tasks similar to those applied in the leading industrial countries in the sixties, called fine tuning and deriving from the then fashionable neoclassical synthesis, but they were even more ambitious. From among them, it could successfully attain full employment, controlled inflation and equilibrium in the balance of payments. But it could not sufficiently amalgamate the results with the elimination of insufficiencies left over from the practice of plan instructions of the Hungarian economy, which had been only eased but not finally corrected, as e.g. a better exploitation of factors of production, continuous adjustment to demand etc.

Even more important is the insufficiency that, although the economy has muddled through the troubles of 1981-1983, it has not yet shifted to a development path of qualitatively higher performances without administrative interference. Instead of a policy restricting the issue of money, based on the creativity of economic agents, the main method of economic control was to make it clear for the state and cooperative enterprise leaders acting as functionaries of the central hierarchy that their tasks in the future would not be to increase production, but only to develop exports to the West and to correspond to the requirements of an import restricting policy.<sup>5</sup> The individual instruments of financial control can be evaluated on the basis of the declared economic policy background, built

upon the institutional system of relations. From among them, I shall first briefly discuss the problems of earnings and import regulation, and market surveillance, and then analyse at some length the control of enterprise income.

### 2.1. Regulation of earnings

The government devotes particular attention to the regulation of a partial market, to the harmony between the purchasing power of the population and the available stock of commodities. This is partly the most successful instrument of government policy in recent decades, but also one causing the gravest functional disturbances. This success may be measured by the fact that the outflow of wages and personal incomes has not broken away from the value of the consumer goods made available to the population /considering the planned changes in prices/. Nor did the growth of consumption play a determinative role in the growth of the domestic use of national income exceeding resources. At the same time, the rigid prescriptions regulating earnings involved several unfavourable consequences. On the one hand, the value of wage increment has been too much "labelled" for the enterprise. This is the "most valuable money" for the enterprise, the saving of which is highly important. This frequently prevents the stimulation of additional performances and is a constant obstacle to the rational differentiation of incomes. At the same time, the effort at avoiding the raising of wages may make necessary inputs that are otherwise unjustified. On the other hand, the earlier paid wage, the so-called basic wage, is of low value. The result is that the substitution of labour in the long run, is neglected even in justified cases. After 1980, the wage control regulations allowed for enterprises to choose, in agreement with government authorities, from among several kinds of wage control. This provided the possibility for enterprises reckoning with economic difficulties, thus, with a reduction of output and employment, to choose a form of wage control which rewards staff reduction. Thus that the coercion to modify the structure of production owing to diminishing domestic demand became mostly neutralized. The enterprises were able

to survive the deteriorating business without major efforts even in the for them most sensitive respect, i.e. wages.

It clearly follows from the above that all kind of wage control diminishes substantially the control function of money. This is such type of cost and an element of control, operating in a manner differentiated by enterprises, which, beyond the unfavourable impact on efficiency, also entails that workers can achieve a higher wage income only by leaving the firm or through increased participation in the second economy.

## 2.2. Import control

In 1968 when the partial insulation of Hungarian firms from the external markets was ended by the introduction of the rate of exchange, also the principle was stated that he who has the money to cover import costs also has to obtain the foreign exchange necessary for the purchase. This principle has never been fully asserted in practice. Gradually a semi-administrative control technique based on the self-restraint of enterprises became established.<sup>6</sup>

At the time of the balance-of-payments-crisis, in the course of 1982, this was replaced by an unsurveyable maze of rude administrative interventions. Finally, beginning with 1983, the productive enterprises were given an "import reference limit" which is a technically bearable system of administrative control, and is efficient for the central control of import processes.<sup>7</sup>

The important requirement of economic policy that the economy should prefer equilibrium on the convertible-currency-markets to the domestic commodity supply could be achieved first of all by the administrative reduction of imports, particularly the imports paid for in convertible currency. But the administrative bargains, the acquisition of import possibilities is still the most important task of enterprise managers, for the success of which first of all good contact with the administrative bodies is needed. The time seems to be still far away when the control of imports will be exercised by solvent demand and the exchange rate.

### 2.3. Market surveillance

At the time of bridging over the balance-of-payments crisis the avoiding of crisis phenomena on the internal commodity market remained an important objective, although this had not been formulated among the declared objectives of economic policy.

The notion of market surveillance has been introduced. The resolution No. 1061/1980 of the Council of Ministers lays down what should be meant by market surveillance: the continuous, organized observation and evaluation of factors affecting the domestic market, particularly demand and supply as well as process in the short-term, and promotion of the smooth assertion of market processes on this basis. The task of market surveillance follows from the above: it has to supervise the actually prevailing market regulations, develop the market and cut off the wildlings. Market regulation has two spheres of activity: market control and market organization. While market organization means the promotion of a healthy market order and the restriction or elimination of monopolies, according to one of the leaders of the government body responsible for market surveillance, the National Office for Materials and Prices, by market control it should be meant, to put it simply, that attempts are made to bring about market equilibrium with indirect and direct instruments when it cannot be created through preliminary planning, organizational or general regulatory instruments. The price formation of enterprises is influenced, official prices are fixed, proposals are made to the government to establish trade quotas, the inventory management and cooperation of the enterprises are channelled.<sup>8</sup>

It needs no separate mentioning that there is a possibility for similar interventions in the case of unsatisfactory export performance or exaggerated imports.

### 2.4. Differentiated taxation of enterprise incomes

One of the important elements of the general practice of economic regulation - and one having impacts opposed to the

declared principles - is the individual taxation of enterprise incomes. The practice of discriminatory taxation spread particularly after 1972, in the period of hidden recentralization.<sup>9</sup> This practice was further affirmed under the economic compulsion even after the end of this period in 1979. In the rhetoric after 1979 a new notion was introduced: the so-called "normative" regulation. By the term normative a uniform regulation asserted in the whole economy was meant. But the real situation was different.

The views on the uniform regulation that would be thus not differentiated by branches and also would exclude further bargaining are contradictory. In general, the expediency of such regulatory system is acknowledged from the viewpoint of efficiency, but many think that its impact on the income differentiation of enterprises and individuals is supportable.<sup>10</sup>

Let us now have a closer look at the not unique, but perhaps most important case of differentiation of regulation, that of differentiating the accumulating ability of enterprises.

Since the income-creative ability of the enterprises was regulated already in a non-uniform manner /regulation of exchange rates, subsidies, credit controls/, and differentiated obligations were prescribed for tax payments, formation of the development fund and the accounting of depreciation, the use of the profit due to the enterprise /net profit/ for development were separately regulated. In this respect the discriminatory practice after 1968 could only be caught redhanded in credit granting. The enterprises the development of which had not been provided for in the central plan to an extent allowed by the means there accumulating could not obtain credit for development or only with difficulty, and they could not finance with credit even the increment of their circulating assets.

Beginning with 1980 the practice of discriminatory taxation became even more widespread. In the eighties namely about 10-26 per cent of the enterprise development means were annually taxed away. It was in this period that so-called normative regulations<sup>11</sup> were issued as levies for the use of the development fund, the meeting of credit repayment obligations,

the settlement of losses, the size of own assets necessary for meeting credit conditions, the liability to building tax in the case of investment projects, as well as for the exemptions. The circulating funds of the Budapest enterprises obliged to move out were blocked and the payment of interest was prescribed on investment projects not put into operation. Further regulations were: the obligatory cession of circulating funds against interest, the obligatory building up of reserve funds, the general taxation of enterprise assets with an impact afflicting practically mainly the efficient enterprises and thus of highly differentiating effects, prescription of the obligatory rate of reserve building and, particularly, the taxing away of the remainder of reserve funds built up before 1980. Also the payments to the technological development fund and centralization of depreciation allowance were obligatorily prescribed.

Out of the 39 rules examined 36 per cent had expressly levelling effects and 36 per cent differentiating ones. In the first group.<sup>12</sup>

The here reviewed so-called normative events of regulating development may be complemented by the fact that the Ministry of Finance issues alone ordinances affecting enterprises in a number between 1200 and 2500 annually. These ordinances are complemented by other supreme authorities, thus e.g. by the National Bank of Hungary also exercising the rights of supreme authority, by the sectoral ministries exercising supervisory rights and, not infrequently, by the party organizations of territorial political control.

About the control through ordinances by the Ministry of Finance it is known that 50 per cent of them are characterized by being retroactive, that is, they modify taxes on incomes originating in the past. The ordinances frequently modify regulations within a year. 5 per cent of the ordinances are initiated generally by the supervisory organs, without any justification. The majority of ordinances formulate an exception to some general uniform rule.<sup>13</sup>

There are also many well known marks of the practice of individual crediting. In spite of the fact that, allegedly,

the National Bank of Hungary considers the return requirements as primary, it can be proven that in the case of bigger firms with lower profitability the number of credits is growing to larger extent after the fall in profitability than in the case of smaller but profitable enterprises.<sup>14</sup>

The above characterized armory of individual fiscal and monetary instruments had an active role in that the spending of enterprise incomes coming about between 1980-1983 should not disturb the political idea that the financial equilibrium has to come about not by a general reduction of domestic consumption, but exclusively by a fall in accumulation /investment/.

Thus the enterprises were unable to formulate their development concepts in harmony with the financial conditions. The hectic, unsurveyable and unpredictable changes in financial regulations did not stimulate enterprise managers to increase their efforts in adjustment to the market and financial conditions as objective criteria, but prompted them to maintain good connections with the authorities and thus be in a good bargaining position in the interest of the successful implementation of a technical-technological concept promising to be good.

### 3. The possibility of aggregate demand management

After all this the question arises whether the Hungarian economic management - because of the negative effects is ready to break off with the discriminatory financial control - and is switching over to aggregate demand management or not.

The substance of the new methods declared in 1984 are as follows:

#### 3.1. Changes in the organizational system of state-owned firms

Two new forms of enterprise will be introduced, beside the enterprises further controlled by state administration: enterprises managed by an enterprise council /larger firms/ and enterprises managed by an elected collective /firms with less than 500 employees/. The freedom of enterprises to enter into

### 3.2. Changes in the National Bank of Hungary and in the flow of capital

The functions of the bank of issue will be separated organizationally within the Bank from the credit banking functions. The Bank intends to make practical use in the future of the right of pledge.

It is intended to allow enterprises to grant commercial credit; the bill of exchange and, of course, the discounting of bills of exchange will be introduced. The recently licensed practice of issuing investment bonds will be extended.

It is not impossible that shares will be issued and negotiated.

### 3.3. Financial regulations

Even without a detailed review of changes it may be said that important reliefs are planned for enterprises in the regulation of wages, earnings, prices and imports.

All these important changes may be a promising beginning in the spreading of an approach in which enterprises will be judged first of all and mainly on the basis of the expectable financial situation and where the state - instead of regulating economic processes in detail - only wishes to keep in harmony the size of aggregate demand with the performance, leaving free room to the regulated processes.

But the question has not yet been decided whether the new conditions only mean changes in the methods for the central control of enterprises or amount to essential progress towards socialist market relations.

The declarations of economic policy makers are ambiguous. The president of the Hungarian National Bank /HNB/ is rejecting the argument about the separation of the central bank from the business banks because of the costs of transformation. More over he does emphasize that the abundance of money cannot be expected from institutional changes.<sup>15</sup> Top managers of HNB are making statements that differentiated credit lending for fixed and circulating assets cannot be changed.<sup>16</sup> Other genuine de-

clarations are made about new less rigid but still strict methods of income - and wage regulation.<sup>17</sup> Thus so far the introduction of publicly controlled aggregate demand management, free flow of money among the economic actors will not take place. The market pressure upon the economy will not significantly strengthened.

Some important indicators of the development of the  
Hungarian economy

Table 1

	1979	1980	1981	1982	1983	1983/ 1978=100
	annual growth, per cent					
Gross Domestic Product						
- at current prices	10,5	9,1	7,6	9,9	8,7	155,0
- at constant prices	1,5	0,1	2,9	2,8	0,8	108,3
Personal consumption	2,4	0,6	2,9	1,2	0,4	107,7
Gross accumulation	-16,7	-3,4	-2,2	-3,5	-7,4	70,3
Implicit price index	8,9	9,1	4,6	6,9	7,8	143,1
Growth of money Supply money and quasi-money	8,2	10,7	6,7	6,2	5,1	142,7

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9. For this practice see: Antal, L.: Fejlődés kitérővel. Development with Some Digression. Acta Oeconomica 23 /3-4./ 1979. pp 257-274.
10. The two opinions are well reflected by two manifestations of István Hetenyi, Minister of Finance. First he takes a stand for the uniformity of regulation. In the second case, however, he not only thinks that incomes should be progressively taxed, but also says that it is necessary to judge the origin of incomes from the point of view or the conditions, under which they were attained.

11. In this particular field as in quite many others the so-called normative rules meant rules generally differentiated by branches, from which further concessions could be attained through bargaining.  
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## Kierowanie globalnym popytem na Węgrzech

M. Tardos podejmuje ocenę polityki gospodarczej Węgier w latach 1979-83 na tle wzrostu zadłużenia tego kraju w krajach zachodnich. Autor wykazuje, że w drodze szczegółowego regulowania wynagrodzeń, importu, kontroli cen i rynku, opodatkowania przedsiębiorstw osiągnięto równowagę bilansu płatniczego. Była to jednak polityka hędująca równowadze a nie wzrostowi gospodarczemu. W końcowej części opracowania rozpatrywana jest możliwość prowadzenia w miejsce szczegółowego regulowania procesów ekonomicznych prowadzenie polityki utrzymywania harmonii między ogólnym popytem a efektywnością gospodarczą z pozostawieniem szerokiego pola dla samoregulacji. Takie podejście zdaniem Autora bardziej sprzyjałoby wzrostowi gospodarczemu. M. Tardos nie widzi obecnie możliwości takiej zmiany polityki gospodarczej.