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Macroeconomic Policy, Liberalization and Transition: Hungary's Case

by

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I. Introduction

While during 1990-1992, Hungary was generally considered to have been in the best macroeconomic position among East-European transition economies and was regarded to have had the best and closest prospects for becoming a market economy, in 1993 increasing disillusion and scepticism can be observed on the part of foreign analysts concerning this country`s political, economic performance and outlook. This is partly explained by the disappointing external economic performance of the country in 1993. The paper concentrates on economic developments; it does not treat issues related to domestic and foreign policy. It may well be the case that in the latter fields the trends are not encouraging, but these problems are beyond the focus of our paper. One of the major points we wish to demonstrate is that in spite of the clearly unfavourable recent economic developments, it would be too early to attribute Hungary`s present economic problems to its specific - "non-shock" - approach to the transition. Economic transition from a centrally planned economy to a market economy has no precedents and experience clearly indicates that almost all respective predictions turned out to be unfounded. The transition seems to be an extremely difficult process, involving heavy economic and social costs. Temporary successes may be followed by lengthy set-backs. This is not to say that without political and economic transformation countries of the region would be better off; it only implies that as yet there are no solid grounds for forming strong judgements on the observed performance or the strategies pursued by individual countries.

This paper discusses some of the major macroeconomic issues related to economic transition in Hungary and touches certain points related to comparison with other countries of the region. The first section treats the economic legacy of the democratically elected Hungarian government. The second deals with the initial policy-dilemma: ***shock-therapy or gradual changes***. The major macroeconomic developments and policy issues of 1991-1992 are covered in section three. The fourth section deals with the major challenges facing the country in and after 1993. As a conclusion, the outlook of the Hungarian economy is discussed, comparisons with other countries of Central-Eastern Europe (CEE) are drawn and some lessons of the Hungarian experience are spelled out.

It should be emphasized that the present survey does not cover the specific issues related to privatization in Hungary and in other CEE countries. This is explained by two reasons. First, the (English language) literature on the Hungarian transition and those of other CEE economies is saturated with publications on privatization; there is very little one can add to the already existing, vast amount of information.[1] Second, and more importantly, those issues of macroeconomic policy that this study wishes to treat are not related directly to the problems of privatization. To put it more strongly, the over-discussed and over-politicised question of privatization is not considered to be a fundamental issue from the point of view of short-term macroeconomic management by the authors. The latter questions are covered only in the context of macroeconomic policies in this paper.

[1] See eg.OECD(1991), EEC(1992), Mihályi (1992) ......

II. Economic Legacies of the Democratic Hungarian Government

Formally speaking, that is, in the legal and political sense, the beginning of Hungary`s transition towards a market economy can be dated back to 1990, the time of the election of the first democratic government after 45 years. This country`s transition, however, represents a special case among the transition stories of countries in Central-Eastern Europe. This is explained by several reasons. First, the democratically elected Hungarian government inherited a relatively stable and significantly reformed economy, at least compared with other countries of the region. Second, partly as a result of the previous domestic reforms and the relative domestic macroeconomic equilibrium of the country, the new democratic government did not, and as we shall argue, did not have to, aim at any kind of shock approach to economic transformation. Third, the new government inherited an unusually large external debt, but it also inherited creditworthiness, i.e. the country at all times fulfilled its debt service obligations. Forth, the economy was integrated into the international economy to a larger degree than other CEE countries, which is shown by e.g. the higher share of trade with the OECD region and is also indicated by the fact that Hungary was the first among CEE countries to launch a trade liberalization programme in 1989.

In the following we elaborate on the above points and give a brief description of the macroeconomic and institutional conditions of the Hungarian economy inherited by the democratic government in 1990.

A. Macroeconomic Conditions

1990 was a year following several years of continuous ***stagnation*** or minimal growth of the GDP. As a matter of fact, one of the major economic causes of the demise of the "pre-democratic" regime was that during the 1980`s it was no longer able to "deliver" what it promised: economic growth. An important characteristic of the regime - at least according to its ideology and promises - was supposed to have been that it has a higher growth-potential than market economies. The 1980`s clearly proved that this was not the case. Although in 1987 the GDP grew by 4 % (the highest in the 80`s), this was preceded by very low growth rates in the first part of the decade and was followed by two years of stagnation (-0.2 %) and by a significant decline (-4.3 %) in 1990.

At the same time ***consumer prices*** were rising rapidly - at least compared with former Hungarian standards. Until 1987, the rate of growth of consumer prices was below or close to 5%. By 1987 however, inflation was already around 8.5 %, it jumped to 17% in 1989, and reached almost 30 % in 1990. The rapid further increase in inflation was a serious danger.

But clearly, the most significant macroeconomic problems and dangers were related to the ***external balance*** of the economy. This had two components, a stock and a flow element. As far as the stock was concerned, the huge foreign indebtedness of the country, approximately 21.5 billion USD (or 75 % of the GDP), certainly entailed a serious burden, namely the financing of the debt service. But this stock-problem was coupled with a flow-type difficulty: the very significant deterioration of the current account in 1989. This was partly the consequence of a large deterioration of the balance on tourist accounts. The reason for this huge deficit was a simple policy mistake. The late communist governments, attempting to take economic policy measures that increased their popularity, liberalized the official quotas for the households to buy (and spend abroad) foreign exchange. This turned out to have been a premature decision. It was made before implementing the liberalization of imports of consumer goods and without imposing the already existing value added tax on so-called "private imports", i.e. consumer goods

brought in the country by citizens. As a result, there was a surge in household spending on consumer goods abroad, which showed up as a deterioration of net revenues in the tourist account of more than 0.7 billion dollars in two years (1988-89). This serious problem was increased by the fact that in early 1990 there was a run on the country`s international reserves - several foreign banks and other institutions withdrew their deposits from the National Bank of Hungary (NBH). In early 1990, the level of international reserves was extremely low and the country was very close to bankruptcy (insolvency). At that time it was mainly due to the activity of international organizations (the BIS, and more importantly, the World Bank and the IMF, as well as the assistance of the G-7) that Hungary managed to maintain its solvency[2].

At the beginning of political and economic transformation, neither ***unemployment***, nor ***fiscal deficits*** meant serious problems for macroeconomic policy. In 1989, the rate of unemployment was 0.2 % and by 1990 it increased to 1.6 %. The fiscal deficit was very low in both absolute and relative terms; in 1988 it was 1.4 % , in 1989 1.7 % relative to GDP and in 1990 there was practically no deficit at all. In the late 80`s and in 1990 there was certainly no indication that the state of public finances would become the major source of further macroeconomic difficulties.

To sum up, the macroeconomic legacy inherited in 1990 by the democratically elected Hungarian government was a mixed one: it inherited parly favorable microeconomic conditions and a very mixed macroeconomic situation. But what was the perspective of, and the interpretation of the situation given by, the new government itself? On the one hand, it seemed to have clearly realized that, unlike several other East European democratically elected governments, it inhered a significantly reformed economy, in which private enterprise already had a role. Inflation was creeping up steadily, though there was no danger of hyperinflation. Moreover, there was no need in Hungary, as there may have been in other countries of the region, to artificially create excessive price adjustment, since there was no significant monetary overhang (forced savings of the households). Thus, one of the tasks of the new government was to try to decrease the rate of inflation. Real activity was declining, but the reasons for the recession at that time seemed to be related either to exogenous factors (the drastic fall of exports to the CMEA region) or was considered to be the inevitable cost of the transformation. The most serious problem was considered to be the deteriorating external financial position of the country. Thus, the new government, beside stopping the acceleration of inflation, regarded balancing external payments and re-establishing the reputation of Hungary as a solvent creditor as ***the*** top priority.

B. Institutional Conditions

As mentioned above, the institutional and microeconomic conditions of the Hungarian economy were rather different from those of other CEE countries in 1990. Important steps had already been made in terms of price liberalization and removal of subsidies. The system of taxation had also been changed by 1990: the value-added tax and the personal income tax had been introduced in 1988. Progress had been made in establishing the legal framework for the private and small enterpreneurship. By the separation of the functions of the central bank and those of commercial banks, the grounds for a two-tier banking system had been laid in 1987. Beside these steps, and especially importantly, the liberalization and demonopolization of foreign trade had begun in 1989.

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[2] The specific problems of Hungary`s foreign debt accumulation and the issues related to debt management are treated in detail in Oblath (1992).

Let us take a brief look at these aspects of the transformation prior to 1990. As for price liberalization, by 1990 roughly 90 % of prices had been liberalized; the share of subsidises in government expenditures were below 10%.[3]. The character of the tax system was similar to Western countries: the VAT and the personal income tax had been introduced. Thus, in contrast with the tax system having characterised other CEE countries, in Hungary the tax base did not consist only of the profits of enterprise sector. In terms of establishing the legal framework for private enterprise and transforming state property into corporate ownership, the major part of the legislative work had already been done.

Trade liberalization and the breaking up of the monopolization of foreign trade requires special attention. In the traditional model of centrally planned economies (CPE-s) foreign trade was extremely monopolised and very closely controlled. In this respect the Hungarian system broke with the traditional model during the 1980`s in small steps. It first established the right to conduct foreign trade operations - without involving the traditional monopolistic foreign trade organizations - for many of the actual manufacturing (producing) companies, but the number of these companies was relatively small in the first part of the 80`s. The scope of direct foreign trading rights was gradually increased, and by 1990 almost all companies could directly conduct foreign trade operations. The other aspect of reforms in foreign trade was related to liberalising, or more precisely, de-licencing of previously controlled imports.

The story of import-liberalization in Hungary is an interesting one. Although we cannot get involved in the details, it may be useful to go beyond the general framework and say more on this point, rather than just present the outline of this scheme. In Hungary, just as in other former CPE-s, imports were strictly controlled. The restriction of imports was not based on a formal system of quantitative restrictions. It was informal and based on individual licensing procedures. The controls were supposed to have become effective (more or less strict), depending on the balance of payments situation of the country. As a matter of fact, the regime turned out to be rather ineffective in controlling the total volume of imports, but it did make life difficult for individual importers.

In 1989, a large scale import-liberalization programme was launched in Hungary. The programme, fully justified by economic logic, was implemented under the pressure of international organizations (the IMF and the World Bank), but without the precise understanding by these organizations, of how the actual import regime worked in Hungary before 1989. The program of import-liberalization consisted of a three-to-four year plan aimed at the progressive withdrawal of the licensing procedure for imports. In the first year mainly non-competive productive inputs were placed on the liberalized list, but this was to be, and actually was, followed by the successive liberalization of competitive imports.

Import liberalization in Hungary involved a fundamental ***paradox***. This derived from the fact that Hungary, a member of the GATT since 1973, never acknowledged that it applied controls for imports. Just on the contrary: according to the official version (presented to foreign governments and international organizations) the Hungarian import regime was totally liberal, consisting only of tariffs and a quota on imports of consumer goods. This presentation, to say the least, was rather inaccurate. Hungary`s foreign partners evidently knew this, but during the 1970`s and 80`s (when Hungary was the only reforming country in the Eastern Block), they had no interest in embarrassing the Hungarian government by openly discussing this issue. Thus, ironically, Hungary`s trade liberalization meant the removal of such controls that did not formally exist. The Hungarian government seems to have chosen the wrong tactics in this situation. It

[3] For more detail, see OECD economic survey: Hungary, 1991.

could have admitted that it had presented an inaccurate depiction of the trade regime - that is, acknowledging that the system was not liberal, but it wished to liberalize it[4]. Had the government done so, it could have justified the temporary "tariffication" of the existing informal restrictions. Instead, it started the actual liberalization, i.e discontinuation of the licensing for about 30 % of imports unilaterally and almost in secret.

However, by maintaining the fiction of an open trade regime, the country was unable to temporarily replace the non- market type protection with market conform measures, namely with the provisional increase of tariffs of the product groups that were placed on the liberalized list. Thus, in 1989 Hungary effectively began to remove the quantitative restrictions on imports, without any kind of compensating measures. The possible compensating steps that could have been taken were either temporary increases in tariff rates in order to countervail the removal of former informal protection or a real devaluation of the exchange rate. Neither of the two, or any of their combination, had been taken, and it seems to be the case that one of the major sources of the present problems are related to the misunderstandings related to, and inadequate treatment of, trade liberalisation.

In conclusion it is fair to state that the democratically elected Hungarian government inherited an economy that was already on its way toward a market economy. It also inherited both serious macroeconomic problems and the consequences of policy mistakes, but on balance, its legacy easily qualifies as the best among the CEE transition economies.

III. The Initial Policy Dilemma: Shock Therapy or Gradual Change?

In 1990, at the time of the democratic elections in Hungary, the shock-approach to economic transformation was the ruling paradigm in "Transition Economics", the emerging new economic discipline. This was mainly due to the international reputation earned by the boldness of the stabilization experiment in Poland in early 1990. An international consensus seemed to have emerged, according to which the transition to a market economy necessarily involved shock-type measures. The notion of a shock-solution had its proponents in Hungary as well, though they were in clear minority.

Since the notion of the ***"shock therapy"*** is used more often than defined, it should be useful to clarify three issues at this point. First, what is the actual meaning of shock therapy proper? Second, what are the conditions under which this therapy can be implemented? Third, what was the relevance of this idea in Hungary in 1990, and who and for what reasons supported it?

"Shock therapy" has become associated with a number of quite different policy measures. On the one hand, this term has been used to describe radical stabilization measures, aimed at

[4] Such an acknowledgement of the fact that former official information was inacurate would not have been unprecedented. In 1989, the government headed by Miklós Németh (the head of the last "pre-democratic" government) publicly admitted that the official figures on foreign debt were false; the actual amount of debt was higher by roughly 2 billion USD than what was previously recorded in official statistics.

stopping hyperinflations or an otherwise uncontrolable deterioration of the balance-of-payments. On the other hand, the notion of shock therapy has also become associated with radical changes in the institutional framework of the economy. The reason why the two interpretations came to be mixed up is that in Poland, the first experimental country in CEE for the shock approach, the two distinct elements, macroeconomic stabilization and liberalization, were implemented at the same time. But without making a clear difference between the two, serious misunderstandings may emerge.

The shock approach to stabilization of a hyperinflation has indeed several arguments on its side. Hyperinflation cannot be stopped gradually; it needs to arrested in one step. But in Central and Eastern Europe the task consisted and still consists of much more than stabilization proper; it involves systemic transformation as well. What took place in Poland in 1990 was the stabilization of extremely high inflation coupled with a very radical systemic reform. The latter aspect of the "therapy" was associated with the immediate opening up of the economy, i.e. introducing the so called internal convertibility of the Polish currency. Thus, in CEE shock therapy came to be known as the combination of measures aimed at simultaneous macroeconomic stabilization and radical liberalization of the economy.

Let us now turn to the relevance of a Polish-type shock approach to economic transformation in Hungary. There were serval influential domestic proponents of this approach, including economists of high international reputation[5] and the first Minister of Finance[6] of the democratic government.

What are the conditions under which this particular combination of policy measures are justified? In my view, there are no such conditions. To be sure, high inflation has to be stopped and the institutions of a market economy have to be implemented in CEE, but there are no clear economic reasons to do these simultaneously, and even less for doing the latter in one single step. One of the reasons for the deep economic recession that followed the economic stabilization-cum reform measures in Poland seems to be that the inevitable stabilization measures were combined with the immediate trade liberalization of an extremely closed economy[7]. The latter was the major component of radical systemic reforms.

In spite of the consensus against radical changes, not just the above-mentioned Hungarian experts, but also some of the political parties supported a kind of a shock approach to economic changes in Hungary as well. It was mainly The Alliance of Free Democrats (the largest opposition party after the elections) that primarily supported this approach. But what was the actual content of the Hungarian version of the case for "shock therapy"? There were two different arguments and lings of thought presented on this point. One was related to the possibility of eliminating inflation by one stroke; this was Kornai`s idea.[8] The other was immediate and total liberalization of imports and the introduction of currency convertibility[9]. There was a third one as well, supported mainly by Ferenc Rabár, that aimed at both the quick removal of all domestic subsidies and the implementation of total liberalization of imports for companies.

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[5] János Kornai (1990)

[6] Ferenc Rabár

[7] See e.g. Köves- Oblath (1991), Oblath (1991) and Rosati (1993)

[8] See Kornai (1990)

[9] It is not possible to present English language references to prove that there were such a recommendations. These were mainly presented in informal documents and in politiciants` statements in the Hungarian press. However, some parts of the debate are tuched upon in Köves-Oblath (1992).

These ideas met a rather strong professional opposition; they could not really be defended in Hungary. To begin with the last one, it was clear to almost all representatives of the profession that the idea was not really practical, and that it emerged from a textbook interpretation of the real economy. According to this interpretation, all you have to do is put prices right and things will take care of themselves. This idea could not be taken seriously. But there were the other two arguments for shock therapy as well: first, stopping inflation and second, instant liberalization (convertibility).

As for immediately stopping or even promptly bringing down to single digit level of the existing 30% inflation rate, this was not considered to be a realistic option by the majority of experts. What was regarded to be feasible was the decrease of the inflation rate, what actually happened in 1992 (to 23%), after a temporary increase to 35% in 1992. But the other argument, introducing immediate (internal) convertibility, certainly had an appeal. Not only because Poland managed to introduce it, but also because it seemed to have a popular attraction. "Though we cannot do much, we can give you a convertible currency" - this was the idea behind the proposal. However, the latter recommendation was also rejected by most economists in Hungary and mainly on two grounds. First, because it would have meant a departure from the already prevailing policy of "gradual" import-liberalization, which, as already mentioned, and as discussed below, was actually rather radical in international comparison. Second, given the possibility for households to place their foreign exchange holdings with Hungarian commercial banks on legal foreign exchange accounts and, moreover, given their legal right to withdraw and carry out of the country any sum of foreign exchange from these accounts, the implementation of convertibility for the household sector involved serious risks. These risks included the possibility of conducting capital transactions - implying the chance of a capital flight - through the channel of "tourist payments" in the balance of payments. The latter risks could have been avoided only by a drastic devaluation of the domestic currency. It was exactly this drastic devaluation that was implied by the proponents, and explicitly rejected by the opponents, of an immediate (shock-type) implementation of convertibility in Hungary. To be sure: the proponents never spelled out clearly the implications of their proposal. It were the opponents who pointed out that immediate convertibility may either lead to a non-sustainable fall of foreign reserves or to the suspension of convertibility. As the latter solution would have been detrimental for any further attempts aimed at introducing convertibility, the feasible solution would have turned out to be the drastic devaluation, with all of its negative effects on real production and inflation.[10]

It may be interesting to note that representatives of the IMF were also sceptical about immediate convertibility and the relevance of any kind of shock therapy in Hungary. This was revealed by the fact that when the minister of finance, referred to above, invited a mission to give advice on whether or not the immediate introduction of convertibility was rational and/or feasible, the head of the IMF mission, (as indicated by interviews given to the press) [11], rejected the question. After having discused the theoretical advantages and disadvantages of convertibility, he almost plainly stated that this was non of the IMF`s business; it was an issue to be decided by the Hungarian government. It should be remembered that this happened in 1990, at a time when the notion of "shock therapy" was in vogue, and IMF experts publicised this notion wherever they went in Central- Eastern Europe.

The last observation proves that there was a very wide consensus around the desirability and feasibility of a gradual transformation in Hungary - so wide that, implicitly, it even included the IMF, an international institution that certainly had different thoughts concerning the other

[10] See Marer-Oblath (1992)

[11] See e.g. HVG (weekly world economy, a Hungarian economic weekly) June 20, 1990.

countries of CEE. The elections in 1990 were won by the Hungarian Democratic Forum, the party that, throughout its campaign, argued that it supports gradual changes in the economy. As a result, there was no shock therapy in Hungary. However, to many observers it is still not clear, and, as time goes by, perhaps less and less clear, whether the refusal of the shock approach was for the better or the worse in this country.

In what follows, although not directly, it is this question that we wish to address. We cannot hope to give a definitive reply, but we certainly can present an overview and an interpretation of those macroeconomic developments and policy issues that may have a bearing on the answer.

IV. Economic policy and macroeconomic performance during 1990-1992

In the period 1990-1992, the Hungarian economy underwent fundamental macroeconomic changes. It would be too early to decide which of these were due to exogenous, and which of them were related to endogenous (policy-induced) factors, respectively. We shall try to present the facts on the one hand, and describe their possible explanations, on the other. In what follows we first provide some of the essential information on macroeconomic developments in Hungary in the period under survey. This is followed by an interpretation of the events, involving the attempt to separate policy-related issues from those that are unrelated to actions of economic policy.

A. Macroeconomic Developments

From the point of view of macroeconomic developments, the period 1990-92 is characterised by the following significant shifts compared to the conditions prevailing in the late 1980`s:

1) The country sank into a deep recession with unemployment increasing at an unprecedented rate and reaching levels that formerly would have been considered intolerable;

2) The foreign trade and payments position of the country improved, in spite of the almost total collapse of exports to the former CMEA area (former socialist countries);

3) The deficit of the public sector soared at an extraordinary speed, reaching about 7 % of the GDP in 1992;

4) Household savings also increased very rapidly, growing from 7.5 % of personal incomes in 1990, to above 18 % in 1992. 5) After some further increase in 1991, the rate of inflation decelerated significantly, to 23 % in 1992.

In our view, these developments are closely interrelated. The positive shifts (e.g. improvements in the external sector, disinflation) had their negative counterparts (economic recession, increase in unemployment). As a result, the sharp deterioration of the internal (fiscal) balance and the progress in establishing external balance are two sides of the same coin. Since this interpretation of recent macroeconomic developments in Hungary is far from being universally accepted, the above statement needs to be proved. We shall try to do this by examining the five listed macroeconomic shifts and analysing their interrelationships.

1) Recession.

The 4% drop of the GDP in 1990 was followed by a decline of 10% and 5%, in 1991 and 1992, respectively, resulting in an increase of the rate of unemployment from 1.6% in 1990 to 7.5 in 1991, and than to 12.5% in 1992. What were the factors contributing to these trends?

Indisputably, the almost total collapse of the country`s Eastern trade in 1991, leading to an estimated 45% fall in the volume of exports to the former socialist countries, was an unprecedented macroeconomic blow for Hungary. Some experts[12] attribute the whole drop in GDP to this particular shock, but this explanation of the recession involves a significant over-simplification. However, before turning to the other possible reasons, a brief explanation of the trade collapse among East-European countries is in order. This is useful because some other scholars almost totally deny the negative impact of the Eastern trade collapse on the macroeconomic performance of the countries concerned[13].

Generally speaking, from the point of view of individual countries participating in the CMEA (an institution that ceased to exist in 1991), there were two major reasons for the radical decline in interregional trade. First, the switch-over from a special clearing payments system (accounted in "transferable roubles") to the normal, internationally accepted standards, i.e. to payments in convertible currencies. Second, the extreme economic decline of the USSR (to have become the CIS), coupled with its practical insolvency in convertible currencies. These two factors, combined with the more or less radical liberalization of Western imports in the countries of the region (resulting in a shift of import-demand toward Western sources), lead to a drastic fall in trade among the countries that used to belong to the CMEA. There were some other causes as well, moreover, the above factors could be split into several "sub-factors", but for the purposes of the present analysis, it is suffice to consider these general reasons of the trade decline and its unfavourable impact on the macroeconomic performance of Hungary and other transition countries of CEE.

However, as emphasized, we do not consider the collapse of Eastern trade in itself a satisfactory explanation of the domestic recession. Other factors were also at work, of which we tried to single out the non-policy related components. But this, as it should immediately become clear, is practically impossible. The other general reason of the recession is "economic transformation"; but this is not the result of natural or endogenous developments. Transformation means policy measures: the state does things it formerly did not do, and at the same time it stops performing certain tasks it fulfilled until the transformation. Although there are certain aspects of economic policy under the transition that do not derive from the transformation proper (e.g. monetary, exchange rate or trade policy), but still: most of what we consider as the consequence of transition is directly related to policy measures intended to foster economic change. As a result, the division of the factors between those related to policy and those related to transformation is somewhat arbitrary.

Nevertheless, it may be safely stated that the essence of economic transformation involves that inefficient, value-subtracting or expressly unproductive activities should decline, and - if all goes well - resources are to be shifted towards productive, internationally competitive and efficient activities. But even if everything goes well and there are no coordination problems (e.g. the capital market and the banking system exist, and, moreover, they function effectively), there are inevitable lags between the decline of inefficient, and the growth of efficient activities. This in itself should lead to the decline of overall economic activity. But, as a matter of fact, in most of

[12] Rodrick (1992).

[13] See e.g. Brada (1992).

the transition economies, the basic institutions of the market economy do not even exist, and where they do, at least in some elementary form do (as in Hungary), they are not likely to work effectively. And since the implementation of new institutions and the transformation of existing ones is a lengthy process, the decline of output, at least in the early stages of transition it is more or less inevitable.

However, the decline of inefficient activities is often related, either directly or indirectly, to the activity of the state. The channel through which the latter factor worked (and still works) is the removal of, or sharp cuts in, subsidises involving substantial changes in relative prices, accompanied by the drop of real demand and/or supply. If producer subsidises are removed, the company may try to raise prices, but - due to import liberalization - this is not as simple as previously; activities becoming unprofitable may have to be cut. If consumer subsidises are removed, prices go up, real demand decreases and contributes to the fall of output. There were other reasons contributing to the output decline as well; we shall return to these when discussing the issues of economic policy.

2) External Performance and the Balance-of-Payments

The recession of the domestic economy was accompanied by a surprisingly favourable external trade and payments performance, as well as a remarkable improvement in the country`s credit-rating in international markets.

Trade performance was considered to have been surprisingly favourable for two reasons. On the one hand, in spite of the large drop in exports to the East, the significant (roughly 28 %) deterioration in the terms of trade with former Eastern partners and despite the fact that energy imports from the former USSR had to be paid for in convertible currencies, the deficit of the trade balance (USD 1.1 billion) was smaller than expected. On the other hand, a remarkably rapid reorientation of former Eastern exports towards the West could be observed. While the volume of exports to the East, as already mentioned, fell by about 45 %, the volume of exports towards developed and developing countries increased by almost 20 %.

These trends in trade flows coincided with even more favourable developments in the external payments performance. The current account, after a significant improvement in 1990 (from a deficit of 1.4 billion USD in 1989, to a surplus of 0.13 USD billion) continued to improve in 1991 (+0.27 billion), despite the deterioration of the commodity trade balance. This further improvement was due to several factors. First, the trade balance recorded in the balance-of-payments worsened much less than the one based on customs statistics, partly because the capital inflow in kind (in physical form, i.e imports) is not recorded in the payments statistics. Second, the balance on invisible trade improved. Third, net interest payments fell somewhat and the surplus of "unrequited transfers" - mostly increments on the foreign exchange account of households - also grew. But the basic balance (that includes capital transactions) improved even more than the current account, mainly because of the significant inflow of foreign capital (*FDI - foreign direct investment*). In 1990, the inflow of FDI was 0.3 billion and this increased to almost 1.6 billion USD by 1991.

Al in all, the ***international debt position*** of the country - measured by net debt, i.e. gross foreign debt minus foreign assets - displayed a remarkable improvement in the period 1990-92. Net foreign debt, having reached almost 16 billion USD in 1990, fell to 14.5 billion in 1991, and to 13.1 in 1992. The decrease in net foreign debt is mainly explained by the growth of international reserves; gross debt did not change significantly.

Thus, the foreign sector, somewhat surprisingly, turned out to be the most successful part of the economy. What are the reasons of this success? In our view the most important part of the explanation is related to the recession in the economy, though some of the economic policy measures taken in this period - i.e. strict monetary policy - also contributed to the results. (But the latter, in turn, as we shall return to this point, may also have contributed to the recession). Changes in the political environment (inducing FDI inflow) had a role as well. The way the recession could help in improving the external performance was the following. On the one hand, companies, having lost their domestic (and Eastern) markets had simply no other choice than increase their exports to the West, even if these exports were not profitable in the long run. On the other hand, the increase of imports to be paid in hard currency (dollars), resulting from both the switch-over to dollar payments in Eastern trade, and from the liberalization of imports, would have been much more significant, had the recession not deepened in 1991.

The improvement in the external accounts continued in 1992, though at a significantly decreased speed. The last months of 1992, however, turned out to be rather disappointing. The unfavourable external performance continued in early 1993. Whether this is due to a change in the trend of real domestic activity or it stems from other factors is a question to which we return.

3) Public Sector Deficit

While in 1990, the fiscal deficit was negligible, it increased to 5% of the GDP in 1991, and continued to rise (to 7% of the GDP) in 1992. This is a dangerous trend indeed, but its reasons are often misinterpreted. It is often claimed that the reason for the growing deficit is that the state still spends too much, implying that sizable improvements can be achieved by further cuts in total expenditures. In our view, this is not the case. Very significant cuts have been executed up to date, but the deficit has increased. Therefore it is of utmost importance to correctly evaluate the reasons of the increase in the public deficit.[14]

According to our interpretation, the rise in public deficit, and the accompanying rapid growth in domestic public debt, is simply the reverse side of the improvement in the external payments, and the reduction of the net international indebtedness, of the country. This is the case because the factors that had the most powerful impact on the correction of external imbalances, were more or less the same as those that contributed to the increase in domestic imbalances, most notably the rise in public deficits. The two most important among these factors were: first, the switch-over to dollar payments in, combined with the collapse of, Eastern trade, and second, the recession in the domestic economy.

The first factor needs some explanation. Energy and raw materials were relatively under-priced in CMEA transactions on the one hand, and the domestic (i.e. Hungarian) cross-exchange rate between the transferable rouble (TR) and the US dollar significantly undervalued the TR relative to the official TR/USD exchange rate in Moscow, on the other. At the same time, the domestic price of energy and raw materials was close to world price levels in Hungary (already since the early 80`s). The difference between the import price and the domestic price was collected as tax; this was a significant source of net revenue for the state. With the switch to convertible payments and the use of world market prices in trade with the former CMEA countries, this source of state revenue was totally lost.[15] But the reader is reminded that the

[14] In the present analysis we do not make a distinction between the central government and the public sector balance. In 1991, the former was larger, in 1992, it was smaller than the latter. Our points relate both to the budget of the central government and to public finace in general.

[15] In 1990, the last year of the transferable rouble payments system, this revenue amounted to about 50 billion forints or 2.5 % relative to Hungarian GDP in that year.

collapse of this trade (partly induced by the switch to dollar payments and to the use of world market prices) had a significant impact on the growth of exports to Western countries.

The other factor contributing to the increase in public deficits was domestic recession. The fall in incomes resulted in the contraction of the tax base and in the very rapid increase of public expenditures related to unemployment benefits and social outlays. The growth of public deficits in such a situation was more or less inevitable. But again, as analyzed, the recession was the other factor that forced domestic companies to increase their exports, and it was this factor that led to the smaller (than otherwise) increase of imports and, indirectly, helped the improvement of the current account and the foreign debt position of the country.

Having said this, it is should be noted that the growth of the public sector deficit in Hungary, just as in other transition economies, is not likely to be a simple cyclical phenomenon, i.e. something that would just disappear if the economy starts to grow. This forecast may be supported by several explanations, but let us point out one major reason: privatisation, the growth of the non-official (dark) sector and the accompanying fall in the share of the state in the ownership of assets.

The state-owned companies certainly did not (and still do not) function very efficiently, but they at least paid taxes. Privatisation, however, seems to imply the growth in the propensity for tax evasion. This is a phenomenon that will be attacked by the tax authorities, but all realistic forecasts should take this fact into consideration when contemplating on the prospects of the public sector deficit. Also, partly because of the high tax rates, several activities try to avoid official registration (mainly in retail trade, but there are other examples as well). They hide: although they may contribute to the GDP, their activity does not show up in the tax base.

The other aspect of this issue is related to the question, whether the growth of public deficits was (or is) detrimental for the transition economies in general, and for Hungary in particular. Our answer is the negative. Had the government not spent the increased savings of households (to which we immediately return), these savings would not have been used for private investments. The reason is that real (loan) interest rates for companies were extremely high, but not because of the public deficit. They were high because of the bad portfolios of banks and because of the high risks associated with lending. Serious companies did not (do not) take credits at the extremely high real interest rates, and those companies that wish to do so, are not likely to be considered as serious (solvent) by commercial banks. This is a kind of trap, but, in our view, this trap is not the result of public deficits. On the contrary and seemingly paradoxically, it may have been the public deficit that contributed to the spending of the use of savings and, therefore, avoiding an even deeper recession. This is not to praise public sector deficits as such, but rather to point out the fact that in the transition period ideologically driven recommendations - such as the need for the immediate cut of public deficits due to their "crowding-out" effects - may simply turn out to be irrelevant.

A further point needs to be emphsized. In 1992, the primary (non-interest) deficit of the public sector was negligible; it made up only 1.5 % of the GDP. The bulk of the deficit is related to interest payments on domestic public debt and - via interest payments to the Central Bank - on foreign debt. The expansion of interest payments is so rapid, that their growth cannot be arrested by just cutting non-interest public expenditures. The economy has to start to grow; otherwise the interest part of goverment spending may get out of control.

This is so because the public deficit also has an inherent dynamic component. If one distinguishes between the primary (non-interest) deficit on the one hand, and interest payments, on the other, it becomes clear that while non-interest government spending can be affected by

current fiscal policy, it has no effect on interest payments. The simple reason for this is that interest payments are determined by the rate of interest and by the stock of public debt. However, the public debt was accumulated by fiscal policy of the *past*. The *current* fiscal policy can affect the future interest burdens only.

Table 1 shows the composition of the deficit and its source of financing.[16] It is obvious that in contrast to the total deficit, the primary deficit remained stable in 1991 and 1992. The total deficit increased due to the rapid increase in the interest payments on the public debt held outside the central bank. Between 1989 and 1992 the new net central bank credits to the government always were less than the government's interest payments to the central bank. This implies that the public deficit was not financed by money creation.[17] However, in the meantime the public debt grew rapidly. This was caused by the deficit and by some measures of the government not related to the deficit directly (for example "bank consolidation", i.e. changing bad loans of the state owned commercial banks for governments bonds).

Table 1: The central government deficit in Hungary and sources of its financing

	1989	1990	1991	1992
Central government deficit*	-0.3	-3.2	1.7	4
Primary deficit	-0.6	-3.4	1.4	1.5
Interest payments	0.2	0.3	0.4	2.5
Source of financing				
Seigniorage**	-0.3	-3.3	-0.8	-1.7
Increase in public debt due to deficit	-0.1	0.1	2.6	5.7

* Without interest payments between the central government and the central bank

** Net of interest payments between the central government and the central bank

In general, the speed of debt accumulation relative to GDP is determined by three components:[18]

(1) the primary deficit relative to GDP,

(2) the government revenue from money creation relative to GDP,

(3) the difference between the real interest rate on the public debt and the real growth rate of the GDP.

In Hungary the third factor plays the most important role in the debt accumulation process. The primary deficit is not very high and its ratio to GDP was relative stable. The table 1 also shows that the deficit was not financed by money creation during the period 1989-1992. In contrast to these factors, the difference between the real interest rate and the real growth rate of

[16] The total deficit reported in the table is less than the official figures. This is due to our accounting method. For simplicity we have subtracted the interest payments to the central bank from the new net central bank credits granted to the government.

[17] The sources of money creation during this period will be briefly described later.

[18] See Haliassos-Tobin(1990).

the GDP was around 10% in 1991 and 1992. This difference was mainly caused by the negative real growth rate since the real interest rate on public debt was not very high.

The dynamic of the Hungarian public debt and deficit can be summarized in the following way: a relative small primary deficit financed by bonds *today* induces increased interest burdens and higher deficit *tomorrow*. Higher deficit requires new bond issue. In a growing economy the deficit can be financed by debt accumulation keeping both the public debt to GDP ratio and the public deficit to GDP ratio constant. However, this is not possible in a period of recession since the interest burden of the public debt is growing - inducing further debt accumulation. The dynamics of the interest burden makes it also impossible to continually offset the effects of the increasing interest payments by the reduction of the non interest government spending. The dynamics of the Hungarian public deficit can be characterized by exactly this process. Since the recession still continues, it seems unlikely that the Hungarian government can stop the increase of the public deficit in 1993 and 1994. The only tool available for the government, which could slow down the accumulation of the public debt in recession, is the revenues from money creation. Without real economic growth the fiscal crisis can hardly be solved.

4) Savings

Household savings increased dramatically in the period under review. Between 1990 and 1992 the ratio of net savings to personal incomes grew from about 7.5 % to almost 19 %. Interestingly, the increase of the gross savings ratio (net savings plus net new credits to the household sector) increased much less. It went up from 11.5 % in 1990 to about 16.5 % in 1992. The major explanation of the discrepancy is that in this period, the household sector paid back old loans in a larger extent than it took new credits.

Some part of the statistically recorded increase in the net savings rate may be due to inadequate accounting for inflation, but these problems can explain only a part, and, to be sure, only a small part of the increment in savings. The growth in the propensity to save was one of the most significant macroeconomic shifts in this period. This was the factor that enabled the government to both overspend (i.e. run public deficits) *and* improve the external balance of the economy. This increase in the savings ratio took place in a period characterised by high inflation and economic recession; therefore it needs some explanation. According to the most widespread interpretation, the major reason for the increase in the savings ratio is economic and political transformation proper, implying larger uncertainties concerning future incomes, employment etc.- calling for "reserves" for the future. According to an other explanation, the savings recorded as those of households are actually those of entrepreneurs, implying that these balances do not really constitute personal savings. Be it as it may, there was a significant increase of deposits and purchase of securities in this period, contributing not only to the improvement of the balance of payments and to the (indirect) financing the public deficit, but also to the fall in the rate of inflation

5) Inflation

The rate of inflation temporarily increased, and then decreased under the period under review. In 1990 the growth of consumer prices was almost 30 %; the rate went up to 35 % in 1991, to be followed by a significant fall, to 23 % in 1992.

Several reasons contributed to the favourable change in the trend of consumer price increases. An important one was the factor mentioned above, namely the rise of savings (fall of household expenditure). Relatively restrictive monetary policies also contributed to this result. Particularly important was the fact that in 1990-1991, but to some extent even in 1992, a real

revaluation of the domestic currency took place. This may have had an especially strong transitional effect on the decline of the inflation rate; we shall return to this point later.

A peculiar feature of the disinflation process was that the decceleration of price increases turned out to be much more pronounced in the case of producer prices than consumer prices. Producer prices increased by 21% and 31.5 % in 1990 and 1991, respectively, followed by a drop to 13 % in 1992. Thus, after a significant initial gap (9 % points in 1990) between the consumer price index (CPI) and the producer price index (PPI) the gap decreased to 3.5 % points in 1991, but then jumped to 10 % points in 1992. This large and fluctuating discrepancy between the CPI and PPI can only partly be explained by the increase in VAT rates and the removal of subsidises. One further explanation is related to the possibility that price margins in both retail and wholesale trade have been rising rapidly; but even the inclusion of this factor is not likely to give a full economic justification of the observed gap. In our view, there may also be some problems of measurement with the PPI, but this is just a simple conjecture. The clarification of this point requires further analysis.

There is no question that the fall in the rate of inflation was a major success in the years 1990-92. However, in order to clarify whether or not this achievement is sustainable, we should take a look at some of the main components of economic policy mix applied in this period; analyse the stance of economic policy and the present problems and prospects of the Hungarian macroeconomy.

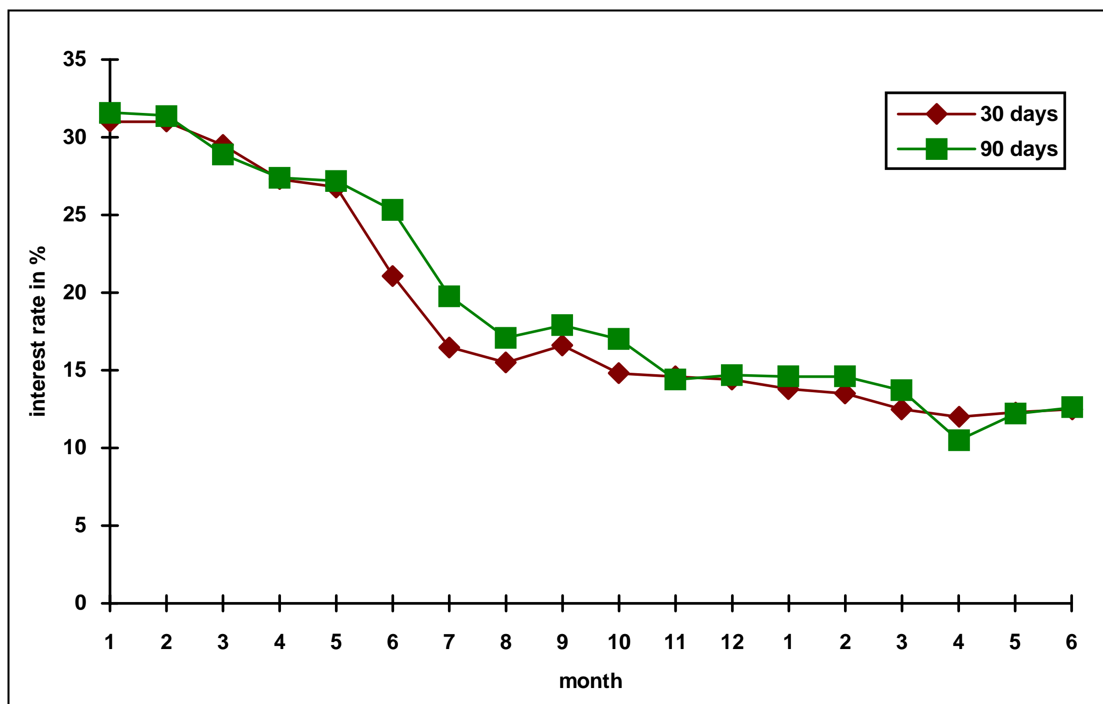
B) Economic Policies

Some of the most significant characteristics and components of macroeconomic policies in 1990-92 have already been discussed or at least hinted on already. However, a more systematic discussion of the main features of macroeconomic management is necessary to reveal the role of policy measures on actual developments, and to clarify, in which respects there may be a need for corrections in economic policies. In what follows we concentrate on monetary policy and exchange rate policy, since these are the aspects of macroeconomic management that are most often mis understood or misinterpreted.

Monetary policy was, generally speaking, rather restrictive in the early 1990`s. This statement holds in spite of the fact that there is quite a lot of discussion in Hungary on the criteria to be used for evaluating the stance of monetary policy in the particular context of a transition economy. We do not wish to go into the details of this discussion; we simply note the fact that although the growth of broad money was faster than that of nominal GDP, real interest rates surged, the rate of inflation fell and the balance of payments improved significantly. These simultaneous phenomena indicate that in the period of major structural and institutional changes it would make no sense to apply any kind of simple monetary rule. It is quite clear that the demand for money, partly due to the practical elimination of domestic shortages (i.e. economic agents do not wish to get rid of money as soon as possible), partly as a result of the rapid growth in the number of economic agents (companies), increased very significantly. Thus, according to the perception of economic agents, monetary policy was restrictive and their judgement is borne out by macroeconomic developments.

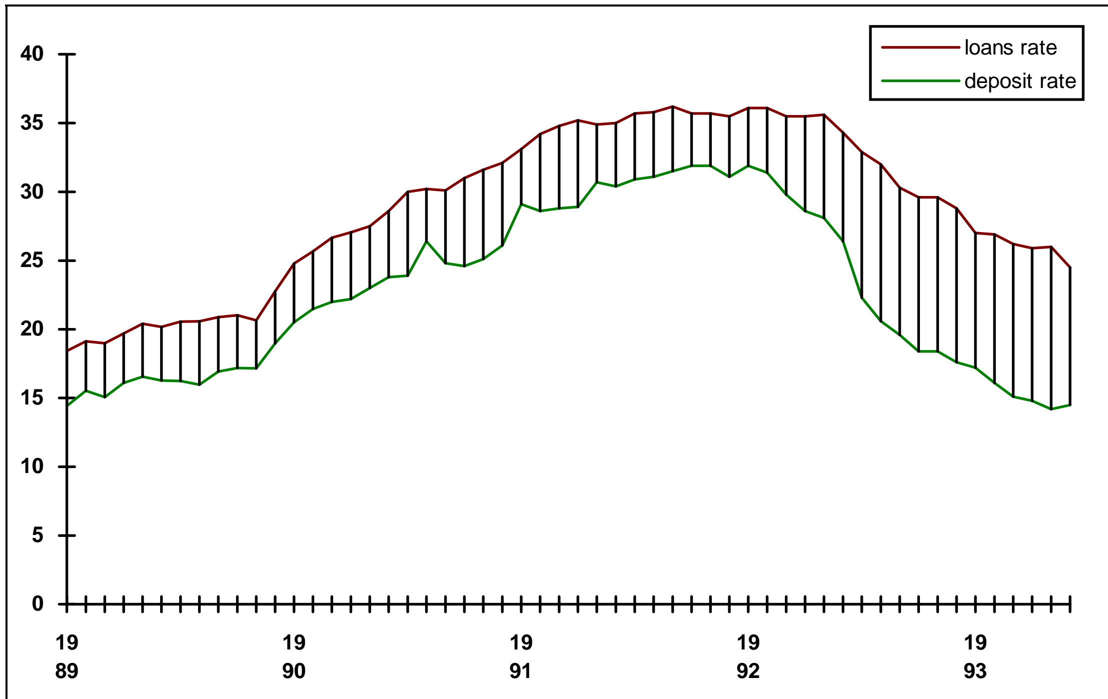
Without (relatively) restrictive monetary policy, it would have been impossible to achieve the improvement in the balance of payments and in the net debt position, as well as to contain inflationary trends. However, the same policy measures that are likely to have contributed to these favourable trends, may also have had a part in the recession of the economy. It should be emphasized that this is not a definitive statement; it simply expresses a strong probability.

True, in 1992, monetary policy changed. The central bank tried to implement a kind of growth enhancing monetary policy. To increase the loan supply of the commercial banks, the central bank reduced the interest rate on central bank credits. The effects of this efforts could be easily observed on the treasury bill market. **Figure 1** shows that the nominal yield on treasury bills fell rapidly. Since the inflation also decreased in the meantime, the real yield started to fall at the middle of 1992 only. Nevertheless, the central bank succeded in pushing down both the nominal and the real interest yield on treasury bills. This policy resulted in negative real return on treasury bills at the end of the year.



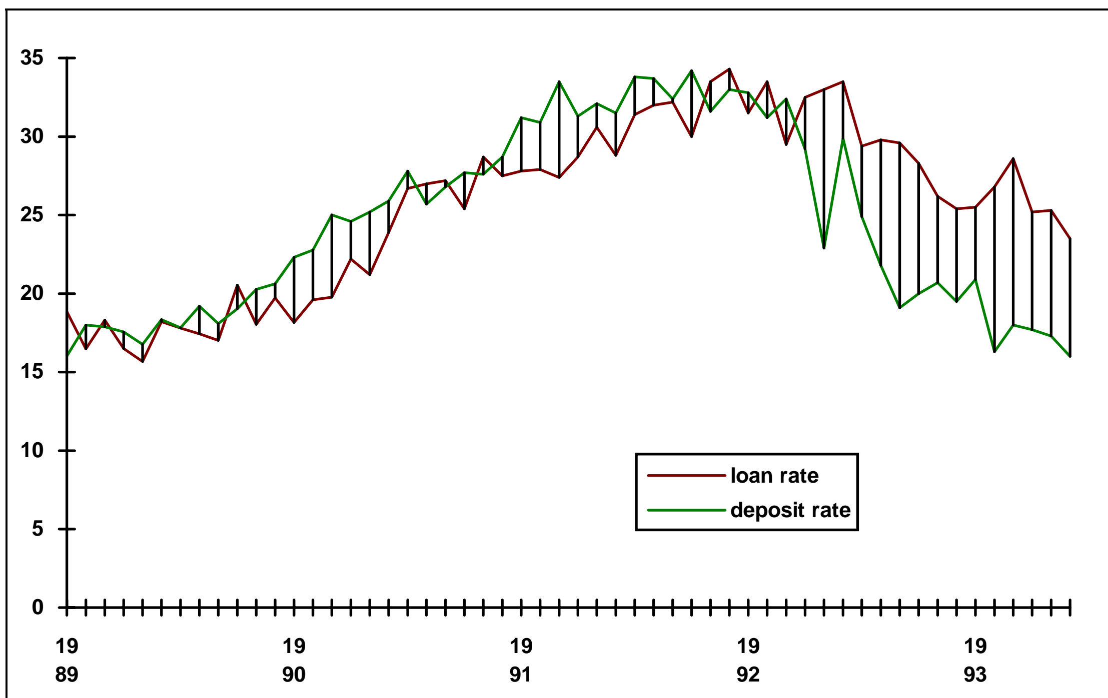
Source: National Bank of Hungary - Monthly Report nr 5-6/1993; tabl. III/6, p.64.

Figure 1: Annual yield of discounted treasure bills, 1992-93



Source: National Bank of Hungary - Annual Report 1992, p.149; Monthly Report 5-6/1993, tabl. IV/7, p.70.

Figure 2: Nominal interest rate on short loans and deposits (less than 1 year), 1989-93



Source: National Bank of Hungary - Annual Report 1992, p.149; Monthly Report 5-6/1993, tabl. IV/7, p.70.

Figure 3: Nominal interest rate on long term loans and deposits (more than 1 year), 1989-93

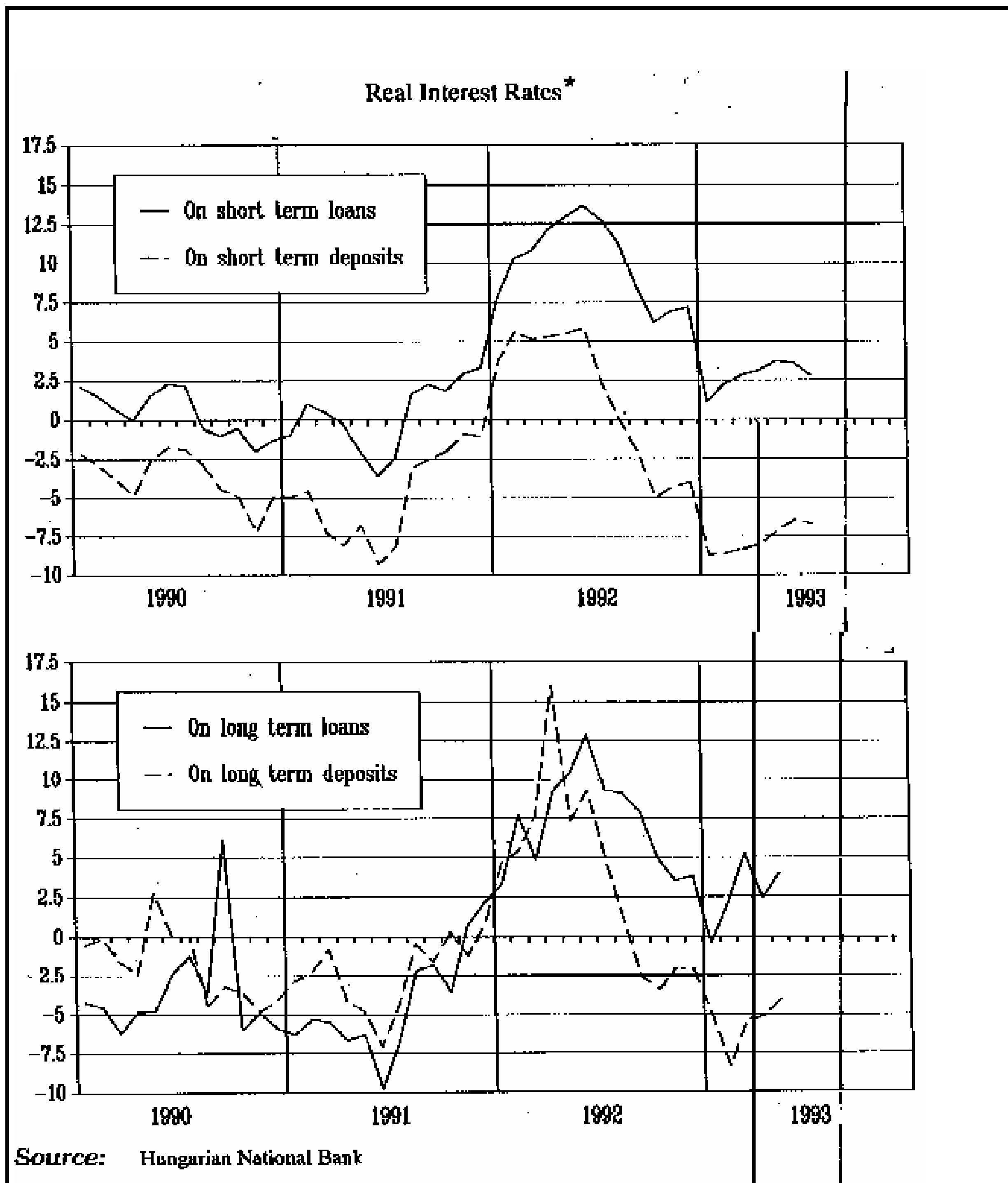


Figure 4: Real interest rate, 1990-93 (nominal rate deflated by CPI):

- above - on short term loans and deposits (less than 1 year)
- below - on long term loans and deposits (more than 1 year).

in the way expected by the central bank. As **Figure 2** and **3** show, the nominal interest rate both on deposits and loans increased. However, the deposit rate fell more quickly than the loan rate. At the last quarter of 1992 the real deposit rate became negative (see **Figure 4**). The attempt of the central bank to stimulate credit supply turned out to be unsuccessful. While the decreasing deposit rate was accompanied by a decreasing saving rate, the decrease in the loan rate did not induce an increase in the amount of loans to the business sector. At the middle of 1993, it became clear that the expansive monetary policy could not increase considerably the credit supply of the commercial banks, while the saving rate fell dramatically. Trying to stop the negative tendencies in savings, the central bank started to increase the interest rate. It means that a relative tight monetary policy returned.

Having described the events of 1992-93, the question necessarily arises why was the relative expansive monetary policy unsuccessful. Among other factors the overall uncertainty characterising the economy needs special emphasis.[19] This means that even if relative cheap founds are available, the commercial banks are not eager to lend because the high risk of default enterprises are faceing. **Figure 3 & 4** show that a considerable increase in the wedge between loan rate and deposit rate could be observed in 1992, but **Table 2** shows that the effective reserve ratio has decreased during this period. This phenomenon can be mainly explained by the increasing uncertainty banks have to cope with, but also with the increasing amount of bad loans they have in their portfolios. Another phenomenon can be observed in **Table 3**. In 1992 the central bank reduced the interest rate on its loans, but commercial banks reacted in the opposite direction to this policy as one would have expected: they decreased their liabilities to the founds available from the central bank.

Table 2: Effective reserve ratio.

	1989	1990	1991	1992
Effective reserve ratio in % (Monetary base-Cash)/(M2-Cash)	18.8	21.3	31.4	27.1

Table 3: Money creation net of interest payments in % of GDP

	1989	1990	1991	1992
Seigniorage created	2.1	2.8	5.1	2.6
Seigniorage used				
Change in net foreign assets	6.2	2.1	5.9	8.8
Change in loans to the government	1.5	-2.1	-2.7	-0.1
Change in loans to the banks	-0.6	0.3	-0.2	-6.2
Other items	-5.0	2.4	2.1	0

The implication of the Hungarian experience in 1992-93 is that during the transition period the supply of loans to the business sector, and hence economic growth, can hardly be stimulated only by monetary policy instruments, because the commercial banks experience extemely high risks.

[19] See for detailed analysis Valentinyi(1993).

A subset of monetary policy that may have particular relevance in explaining the trends in the past few years is exchange rate policy. In the foregoing discussion several allusions have been made to our perception of what should (and/or should not) have been done by means of exchange rate policy; it is time to formulate our critique more explicitly. According to several indicators of real exchange rate changes (domestic price and/or cost increases relative to partner countries corrected for - deflated by - average, so-called effective, nominal exchange rate changes vs. partner countries), the price and cost increases in Hungary have not been counterbalanced by nominal devaluations. This lead to the real appreciation of the Hungarian currency (see **Figure 5**), with rather unfavourable effects on the prospects of both exports and domestic activities competing with imports. As already mentioned, it did have a positive impact on disinflation, but the balance of the costs and benefits (in terms of declining international cost and price competitiveness vs lower inflation) seems to indicate that the costs are very heavy - a marked loss of market shares in the domestic economy and declining price and cost competitiveness in international markets.

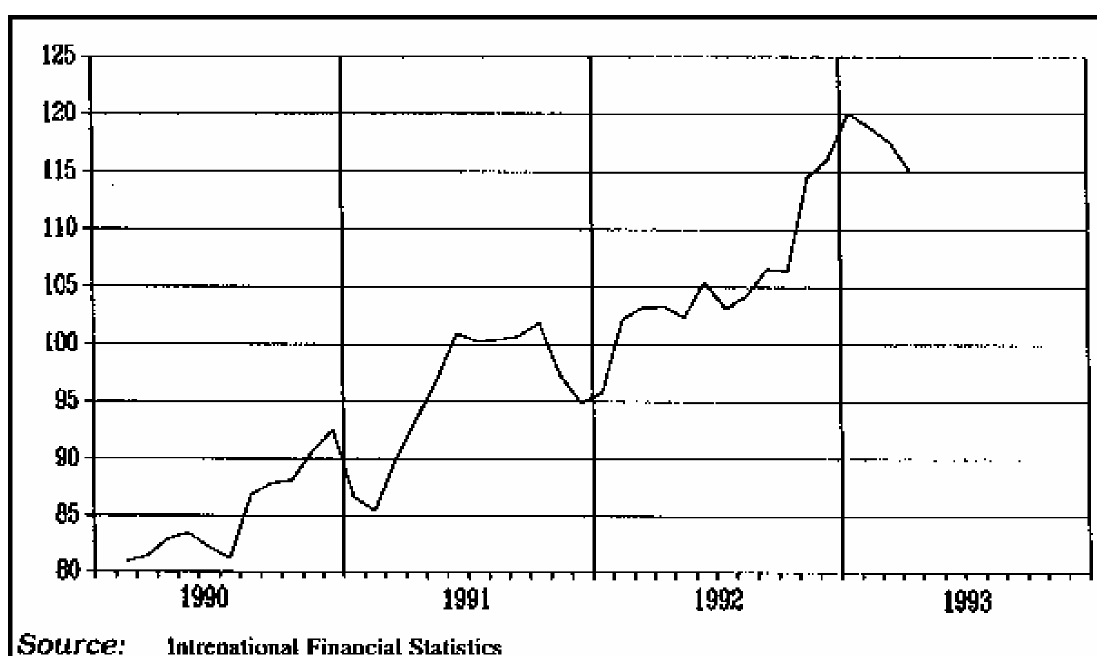


Figure 5: The real effective exchange rate of the HUF (1985=100)

We shall not discuss the features of fiscal policy, as its main constraints and characteristics have already been discussed. Instead, we turn to the macroeconomic prospects of the Hungarian economy and make some concluding remarks on the performance of this economy relative to that of other transition countries.

V. The Outlook and Some Concluding Remarks on Hungary`s Comparative Performance.

The macroeconomic outlook of the Hungarian economy is far from being encouraging. There are several signs indicating further depression or even the fall of economic activity. Among these signs the most important is the significant (25 %) drop in exports together with a 2 % growth in imports, resulting in a 2.3 billion USD deficit of the trade balance in Januar-August of 1993. Inflation increased and the public sector deficit is also likely to rise.

The macroeconomic difficulties analyzed in our study will most probably remain; we do not foresee any kind of rapid improvement, but rather expect that the large successes (e.g. in the external sector and inflation) may very easily be reversed. (The statistics for the first half of 1993 indicate a deficit of 1.8 GDP in the current account.)

This is a sad conclusion, but does it imply that the reason for the prospective economic problems of the country lie in the strategy chosen by economic policy? Is gradualism to be blamed for the present and future economic problems of the country? Or is the Hungarian privatization strategy, also involving a step-by-step approach, responsible for the macroeconomic difficulties? Our answer to these questions is definitively the negative.

Four points have to be made in conclusion in order to support this judgment. First, the Hungarian privatization fared no worse than those of other CEE countries. Second, the countries having chosen - or having been forced to chose - a shock therapy are stil not in a better macroeconomic position than Hungary, and their prospects are also uncertain. Third, the policy problems in Hungary, referred to above (e.g. exchange rate policy) derive mainly from the ***lack*** of adequate cushions, ie. compensation for those profound exogenous macroeconomic and institutional shocks that resulted from the swich-over to dollar payments in, and the total collapse of, trade with the former CMEA countries. Finally, the present and future problems of the Hungarian economy may have to do with a fact beyond the focus of our study: economic policies neglected the fundamental task of continuous building of new institutions, coordinating systems, that is, the infrastructure of the market economy.

As for privatization, an issue deliberately ignored in this paper, there are no signs that in any of the other CEE economies this problem would (or could) be handled with more efficiency or care than in Hungary. This does not, of course, imply that privatisation in Hungary goes well and there is nothing to improve on the actual procedures and techniques of privatisation. But it does imply that other CEE countries having decided to pursue a fundamentally different privatization strategy - i.e. "mass privatization" - have not as yet proved the superiority of their alternative strategy. It also supports our initial notion that the issue of privatization is secondary from the point of view of macroeconomic developments.

The comparison with other CEE countries` performance is not easy because of differences in the statistical coverage and several other reasons related to the initial economic conditions of the countries concerned. Still, it is safe to state that most CEE countries, including Poland and the former CSFR (those that are the most relevant from the point of view of comparison) have yet to apply several legislative acts (i.e. the bankruptcy law) that already work in Hungary (with all their prospective negative effects on economic performance). The improvement in industrial production in Poland, generally considered as a clear indication of an (upward) turn in economic activity, followed a much deeper recession than what was experienced in Hungary and involves some macroeconomic paradoxes. It is still not clear from the macroeconomic accounts of this country, where the statistically recorded growth went to. As for the former Czechoslovakia, the macroeconomic puzzles are even more difficult to resolve, since here the significant decline in GDP and industrial production in 1992 is combined with falling unemployment rate, improving public sector balance and a decrease in inflation. If the macroeconomic statistics are correct, the tensions are likely to be found in the balance sheets of the banks and in inter-enterprise arrears (non-payments); but these hidden problems will show up sooner or later. They are likely to influence the stance and the prospects of public finance, quite apart from the specific problems related to the separation of the two parts of the former Czechoslovakia.

As for the policy mistakes made in Hungary, there are several excuses, including that this country was the first in introducing not just fundamental reforms but in attempting to profoundly change its economic system; this may certainly explain some or most of the errors of economic policy. Whether or not this explanation is accepted by the public is a question to be answered at the next general elections due in 1994.

Let us conclude with a personal statement. Though we are far from being enthusiastic with the activity and overall performance of the present Hungarian government, in our view, the gradualist approach to economic transition was a sound decision in Hungary. Had the government opted for a "shock therapy", the macroeconomic problems would be deeper with the prospects for recovery even more slim than nowadays.

October, 1993

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