

Transformation in Hungary

Libor Žídek

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1. Development during the communist regime

- Insight to long-run political development
- Economic situation

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- Currency problems
- Privatisation

4. Economic results

- Economic growth
- Structure of the economy
- Inflation
- Unemployment
- External relationship

The first part

DEVELOPMENT DURING THE COMMUNIST REGIME

Insight to long-run political development

- **Aftermath of WWI**

- fall of the Austria-Hungarian Empire -> loss of land and population for Hungary
- recreation of „large Hungary“ -> main aim of Hungarian diplomacy
- **cooperation with fascist Germany**

- **Soviet influence after WWII**

- establishment of Soviet-style regime
- strong opposition to regime -> uprising (1956)
- **“goulash socialism”** in 1960s

- **Political relaxing**

- creation of the opposition (middle of the 1980s)
- change of the constitution + **new democratic Hungary (1989)**

Economic situation I.

- **Centrally planned system (after WWII)**
 - Similar basis but less tough regime
 - More evident differences after the reforms of 1968
- **New Economic Mechanism (1968)**
 - Certain **decentralization** of the decision-making process (from centre to companies)
 - Increasing responsibility of firms (p, w, i)
- **Measures in external sector**
 - Permission of **FDI** (1980s)
 - Unification of the **exchange rate** (1981)
 - Trade in **convertible currencies** for enterprises
 - Membership in **IMF** (1988)

Table 1: Chronology of reform measures before 1990

Reform measure	Hungary	Poland	Czechoslovakia
Cancellation of obligatory plans	1968	1982	1990
Cancellation of centralized quotas	1968	1991	1990
First steps leading to liberalization of prices	1968	1957,1975	1991
Unified exchange rate ¹	1981	1990	1991
Admission to IMF and WB	1982	1986	1990
Free private enterprises	1982	No restrictions	1991
Bankruptcy law	1986	1983	1991, 1992
Two-stage banking system	1987	1988	1990
New income tax system	1988	1992	1993
VAT system	1988	1993	1991(sic)
Corporate Law	1989	1990	1991
Trade liberalization	1989	1990	1991
Unemployment benefit system	1989	1990	1991

Source: Kornai (1996)

Economic situation II.

- **Other reforms in the 1980s**
 - continuous **devaluations** of the forint
 - change in ownership structure - > support for new **private entrepreneurs**
 - **price and trade liberalization**

Ready for the shift to the market economy ???

Economic situation III.

Well prepared at the level of **formal insitution** and **microeconomy**

BUT

Problems at the macroeconomic level

- Deficits of public finance and trade (goulash socialism)
- Large foreign debt (70% of GDP)
- Structure of the economy
- Declining trend of economic growth
- High inflation

Table 3: Structure of Employment in 1990 (shares in %)

	ČSSR	Hungary	Poland (1989)
Agriculture	11.8	17.5	26.7
Industry	45.4	36.1	36.6
Services	42.8	46.4	36.7

Source: Berend, *From the Soviet Bloc to the European Union*, 2009.

Table 2: External Debt/Exports of Goods and Services in %

	1985	1986	1987	1988	1989	1990
Czechoslovakia	32.4	33.8	36.2	40.2	45.1	56.3
Hungary	148.5	166	174.9	173.8	169.7	171.7
Poland	252.1	259.5	294.8	254.	261.7	251.5

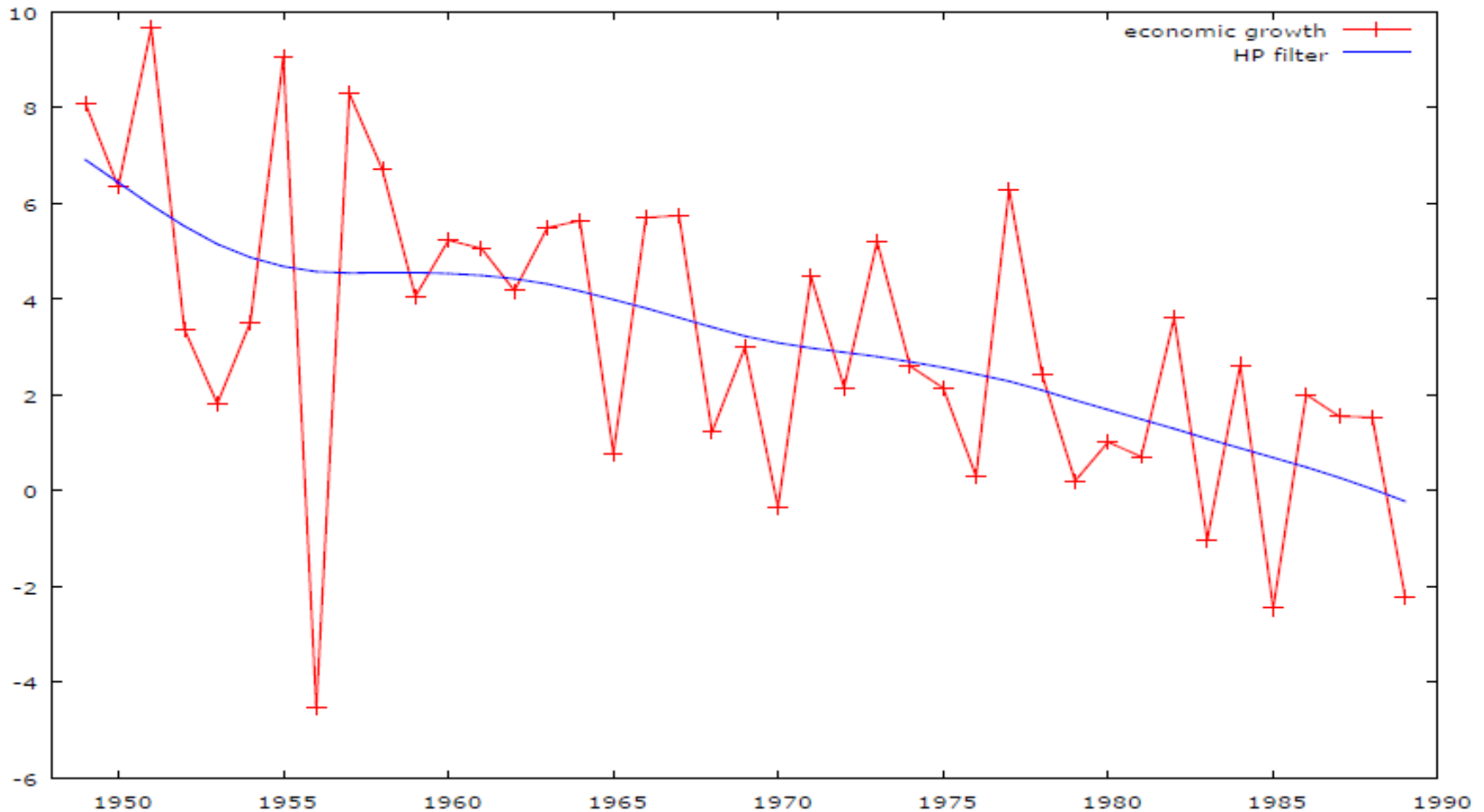
Source: Jonáš, *Ekonomická transformace v České republice*, 1997.

Table 3: Government Incomes and Expenditures in % of GDP in

Country	Incomes	Expenditure
Czechoslovakia	62.1	64.5
Hungary	61.3	63.7
Poland	46.8	48.7
Rumania	45.7	40.7
Bulgaria	57.7	60.1
Soviet Union	43.8	50.7
USA	34.3	36.5
Germany	45.7	45.9
Canada	40.3	43.9
France	46.2	47.8

Source: Jonáš, *Ekonomická transformace v České republice, 1997.*

Chart 2: Economic Growth During the Communist Regime (1948-1989) and its Trend Estimated with HP Filter



Source: Maddison, *Historical Statistics* - <http://www.ggd.net/MADDISON/oriindex.htm> ,(11.10.2010).

Chart 3: Basic Economic Indicators at the Beginning of the 1990s*

	CR	HUN	POL
Inhabitants in millions	10.36	10.36	38.11
Economic activity in %	51.6	52	42.7
Employment in industry % of total	37.9	29.7	28.4
Investment in %	37.9	29.7	28.4
GDP in billions \$ PPP	98.97	59.6	160.86
GDP/person \$ PPP	9,550	5,750	4,221
EX per person in \$	873	922	376
IM per person in \$	945	832	250
Gross external debt per person	686	2,077	1,270
In % of GDP	21.9	65.1	82.2
<i>*- 1990 or the closest year</i>			

Source: Chvojka, Zeman, *Tendence dosavadního vývoje zemí střední a východní Evropy*, 2000

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The second part

POLITICAL DEVELOPMENT

Political development

- **First post-communist government**
 - created in 1990 by Jozsef Antall
 - stable position (60% in the parliament)
 - successes – left of Soviet troops, association agreement with EC
- Discussion about the **role of previous communist elites** and nomenclature
- Elections in **1994**
 - winner: MSPZ (post-communist party) – social democracy
 - tough economic measures
- Elections in **1998**
 - shift to right-wing coalition (Fidesz)
 - membership in **NATO**
- Elections in **2002**
 - Fidesz as winner, but left-wing government



Democratic principles, membership in EU vs.

Dissatisfaction with transformation and life in general

Chart 1: Occupational Destinations in 1993 of People Who Were in the Nomenclature Positions in 1988 by Country

Occupation in 1993	Czech Republic	Hungary	Poland
All in position of authority	51.7	43.1	51.2
High political office	3.0	6.4	9.0
High manager-public	16.2	11.2	13.4
High manager-private	12.8	2.4	9.1
High cultural office	1.1	4.4	7.1
Low-level managers	12.6	13.0	8.6
Entrepreneurs	6.0	5.7	4.0
Professionals	12.2	19.9	13.9
Workers	12.6	5.5	9.5
Retired early (younger than 65)	15.4	19.1	17.2
Other retired and unemployed	8.1	12.6	8.2
All respondents	100%	100%	100%
(number)	(468)	(803)	(849)

Source: Eyal, Széleányi, Townsley: *Making Capitalism Without Capitalist: Class Formation and Elite Struggles in Post-Communist Central Europe*, London Verso, 1998

Table 7: Results of the Survey – A Comparison of Economic Situation in 2008 and 1991

„Thinking back to 1989/1991, do you approve of your country moving from having a state controlled economy to having a market economy?“

			Strongly approve	Approve	Disapprove	Strongly disapprove	DK/Refused	Total
Poland	Fall	2009	26	45	11	4	13	100
	Spring	1991	25	55	7	4	9	100
Czech Rep.	Fall	2009	28	51	12	3	5	100
	Spring	1991	42	45	4	3	6	100
Hungary	Fall	2009	9	37	27	15	13	100
	Spring	1991	22	58	9	1	10	100

Source: The PEW: Global Attitudes project, www.pewglobal.org, published 2. 11. 2009, 15. 5. 2013

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The third part

TRANSFORMATION PERIOD

Economic reforms – Gradualism I.

- **Specific feature**
 - reforms started by communist party before the fall of the regime
 - **Gradualist reforms - first half of the 1990s**
 - in contrast to radical reforms and shock therapy
 - consequence of previous steps + public opinion against radical change
 - belief that slower reforms lead to similar result with lower cost
 - with few exceptions (f.e. bankruptcy law)
 - **Macroeconomic imbalances**
 1. creditworthiness of the country
 2. inflation
 3. growing **public deficit**
- Main tasks of the government**

Table 3: Overall Government Balances and Central-bank Financing of Governments, 1992-1997 (% of GDP)

Country	Overall government balances						Central-bank financing					
	1992	1993	1994	1995	1996	1997	1992	1993	1994	1995	1996	1997
Czech R.	-1.2	-1.8	-1.2	-2.1	...	-2.1	-2.4	-1.0	-0.8	0.7
Hungary	-6.9	-8.5	-8.3	-7.1	-3.1	-4.6	16.5	13.2	11.2	7.5	7.3	1.7
Poland	-7.5	-4.0	-2.0	-2.7	-2.5	-2.3	5.2	1.5	1.5	0.1	0.1	0.5

Source: Dabrowski, *Disinflation Strategies and Monetary Tightness in Transition Economies*, 2003

Table 3: Real Wages: Annually in Percentage Change

	1988	1989	1990	1991
Czechoslovakia	2.1	0.8	-5.8	-23.5*
Hungary		-4.3	-3.8	-7.5**
Poland	15.9	-4.4	-29.7	2.0**

* - Jan – Sept 1991; ** - preliminary

Source: Winiacki; *Regional Survey*, 1993

Economic reforms - Gradualism II.

- **Reforms of the business and the financial sectors**
 - improvement of the legal system
 - privatization
 - improvement of the antitrust policy
 - bankruptcy law
- **Transformation recession**
 - relatively high U
 - continuously higher inflation
 - deficit of the current account
- **Inflow of foreign capital**



Progress on the microeconomic level vs.
Unsolved macroeconomic problems

Table 10: Selected Economic Indicators for Hungary, 1993–1998

	1993	1994	1995	1996	1997	1998
Real sector: % change						
Real GDP	-0.6	2.9	1.5	1.3	4.6	5.1
Exports of goods/services (real)	-10.1	13.7	13.4	7.4	26.4	16.3
Imports of goods/services (real)	20.2	8.8	-0.7	5.7	25.5	22.5
Fixed investment (real)	2	12.5	-4.3	6.7	9.2	11.4
Private consumption (real)	1.9	-0.2	-7.1	-2.7	1.7	3.8
Average CPI	22.5	18.8	28.2	23.6	18.3	14.3
Gross wage growth (real)	-0.5	5.1	-8.9	-2.6	3.4	4.4
Real effective exchange rate (unit labor cost)	4.3	7.3	19.4	8.6	2.7	8.5
Unemployment rate (end period)	12.6	10.9	10.9	10.7	10.4	9.1
Real sector: % of GDP						
Exports of goods and services	26.4	28.9	37.3	38.9	45.5	49.8
Imports of goods and services	34.6	35.4	38.5	39.9	46	52.3
Fixed investment	18.9	20.1	20	21.4	22.1	23.2
General government						
Overall balance (excl. privatization)	-6.6	-8.4	-6.4	-3	-4.8	-4.7
Overall balance (incl. privatization)	-6	-7.5	-3.2	0.8	-1.8	-4.4
Primary balance (excl. privatization)	-2.7	-2.2	2.2	3.7	2.7	1.6
Expenditures	60.8	60.4	54.3	49	49.2	47.1
Public debt	90.4	88.2	86.4	72.8	63.9	60.2
External accounts						
Trade balance	-8.4	-8.8	-5.5	-5.9	-3.8	-4.4
Current-account balance	-9	-9.5	-5.3	-3.7	-2.1	-4.8
Foreign direct investment	6	2.8	10	4.4	3.6	3
Gross external debt	63.7	68.4	70.9	61	51.9	56.3
Net external debt	38.7	45.4	36.6	31.4	24.4	26

Source: Stojanov, *Hungary and Bosnia and Herzegovina: A Success and a Failure of Transition*, 2004

Economic reforms – Bokros Package I.

- **Reforms of social democrats (1995), supported by IMF**
 - **Austerity** for loans from IMF and EBRD
 - Bokros – ministry of finance
- **Measures – Bokros Package**
 - Devaluation + shift to crawling peg
 - Temporary import surcharge and restrictions
 - New jobs in public sector
 - Tightening of social benefits
 - Agreements on real wage reduction
 - Privatization of state companies (FDI)
- **Consequences ???**

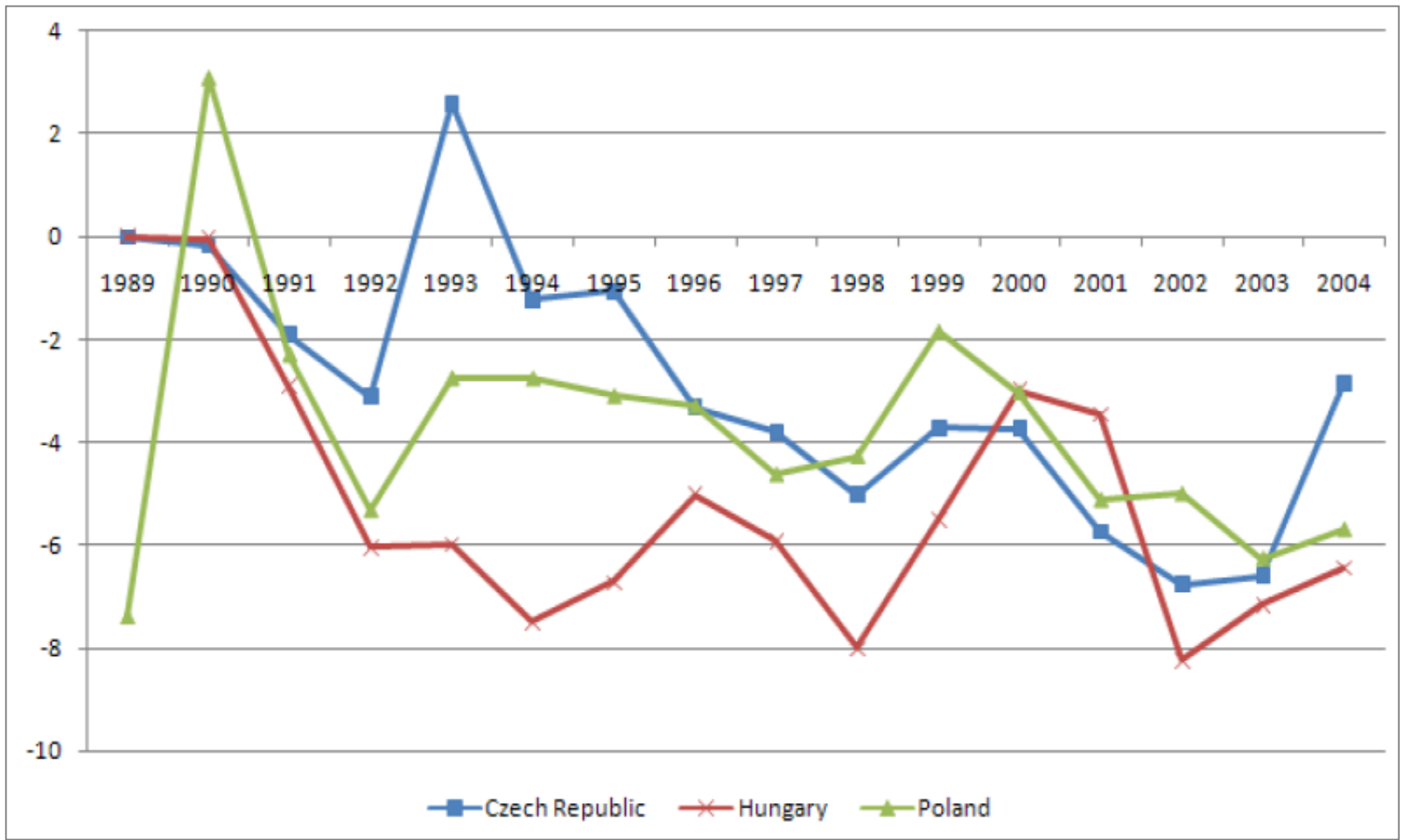
Table 11: FDI Inflows in Hungary in USD mil (1972-2000)

	In cash	Of which privatization income	as%	Investment in kind	Total
1972-1989	387	-		783	1170
1990	311	20	6.4	589	900
1991	1459	435	29.8	155	1614
1992	1471	492	33.4	170	1641
1993	2,339	1,163	49.7	142	2,481
1994	1,147	103	9.0	173	1,320
1995	4,453	3,370	75.7	185	4,638
1996	1,983	618	31.2	57	2,040
1997	2,085	1,827	87.6	22	2,107
1998	1,935	485	25.1	11	1,946
1999	1,651	295	17.9	6	1,657
2000	1,600	0	0.0	0*	1,600
1990-2000	20,434	8,808	43.1	1510	21,876

*- in the fiscal year 2000, this figure was equal to USD 280.00 – which is 0 while rounded to millions

Source: Csáki, *From Transition to Integration*, 2002, own calculations

Figure 2: Deficit in Public Finance in % GDP



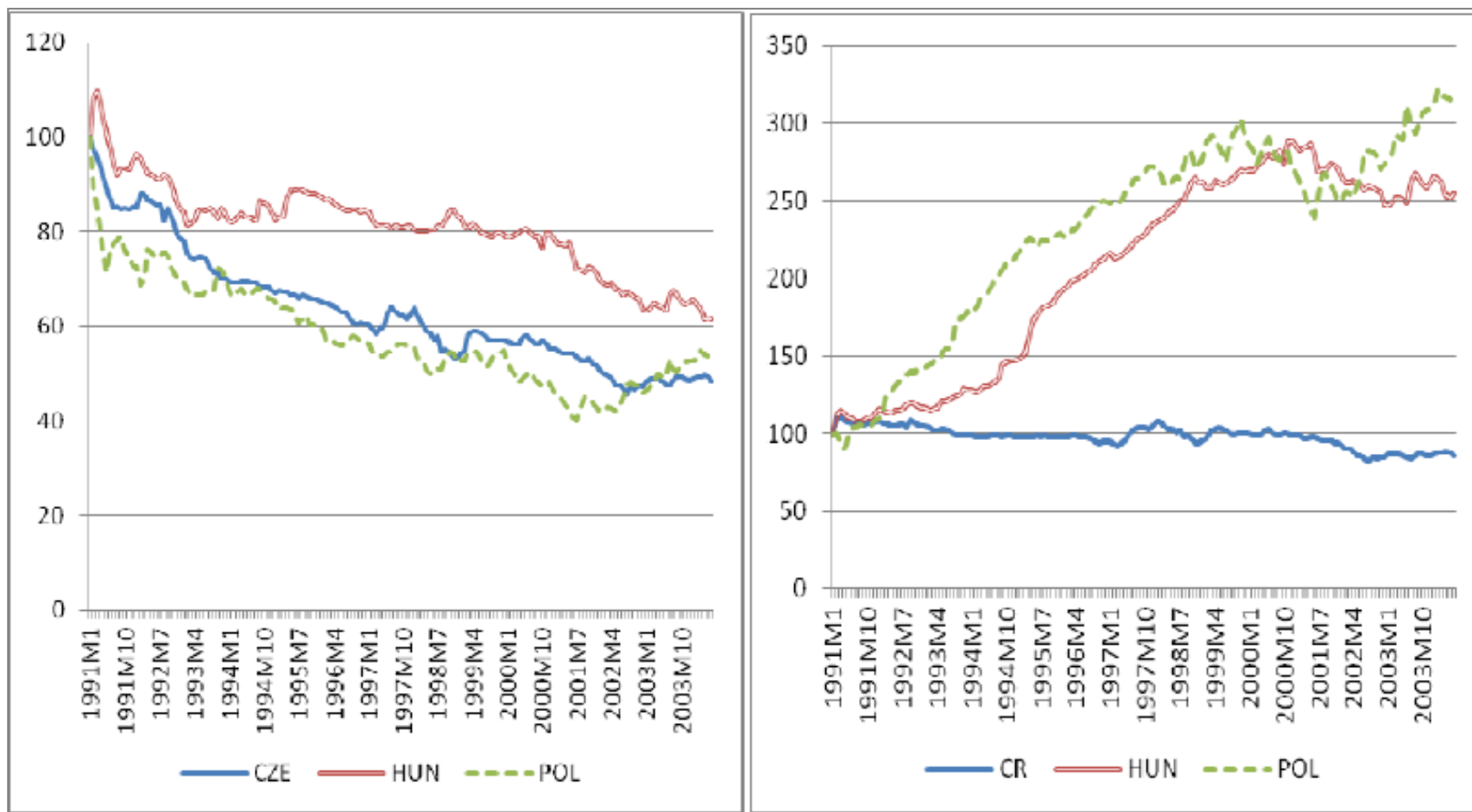
Source: EBRD: Selected economic indicators data, 26. 11. 2007.

Currency problems

- Beginning of the 21st century – **problems are back**
 - Notorious problems with fiscal discipline
 - Growing trade deficit
 - Increasing wages -> declining competitiveness
- **Monetary policy** – response to inflation pressures
 - Monetary restriction
 - Widening the fluctuation band
 - Inflation targeting (2001)
 - Full convertibility of the forint + **fixed central parity**
 - Interest rates as a single tool to hit targets
- **Loose fiscal policy**
- **Massive interventions on the foreign exchange market**

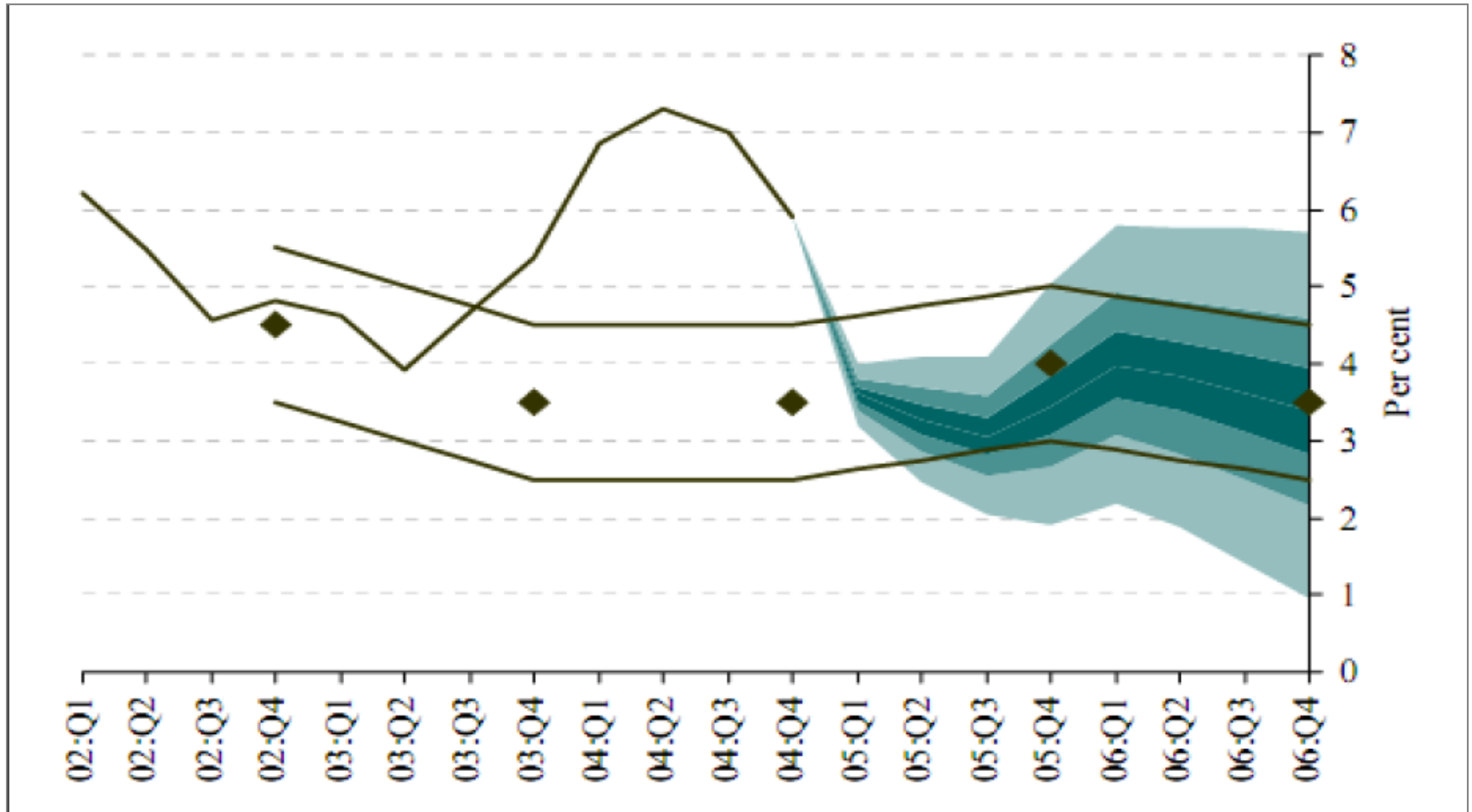
 **Loss of the CB's credibility, decline of confidence in the currency, inflation**

Figure 3: Nominal (left) and Real Exchange Rate (1991 = 100) in Hungary, Poland and the Czech Republic 1991-2004



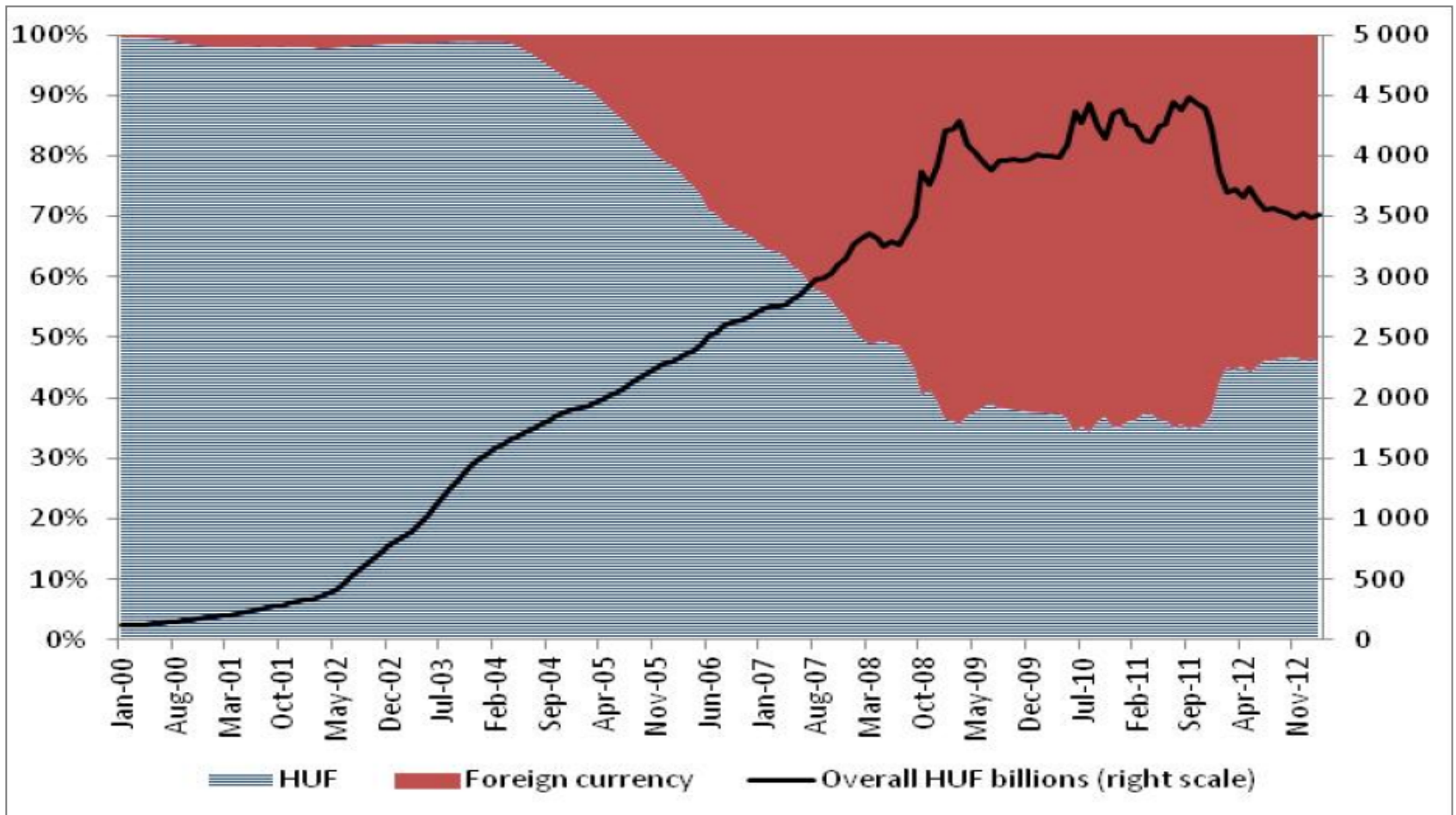
Source: IMF, International financial statistics, <http://elibrary-data.imf.org/>

Figure 4: Inflation, Its Projection and Inflation Target at the End of 2004



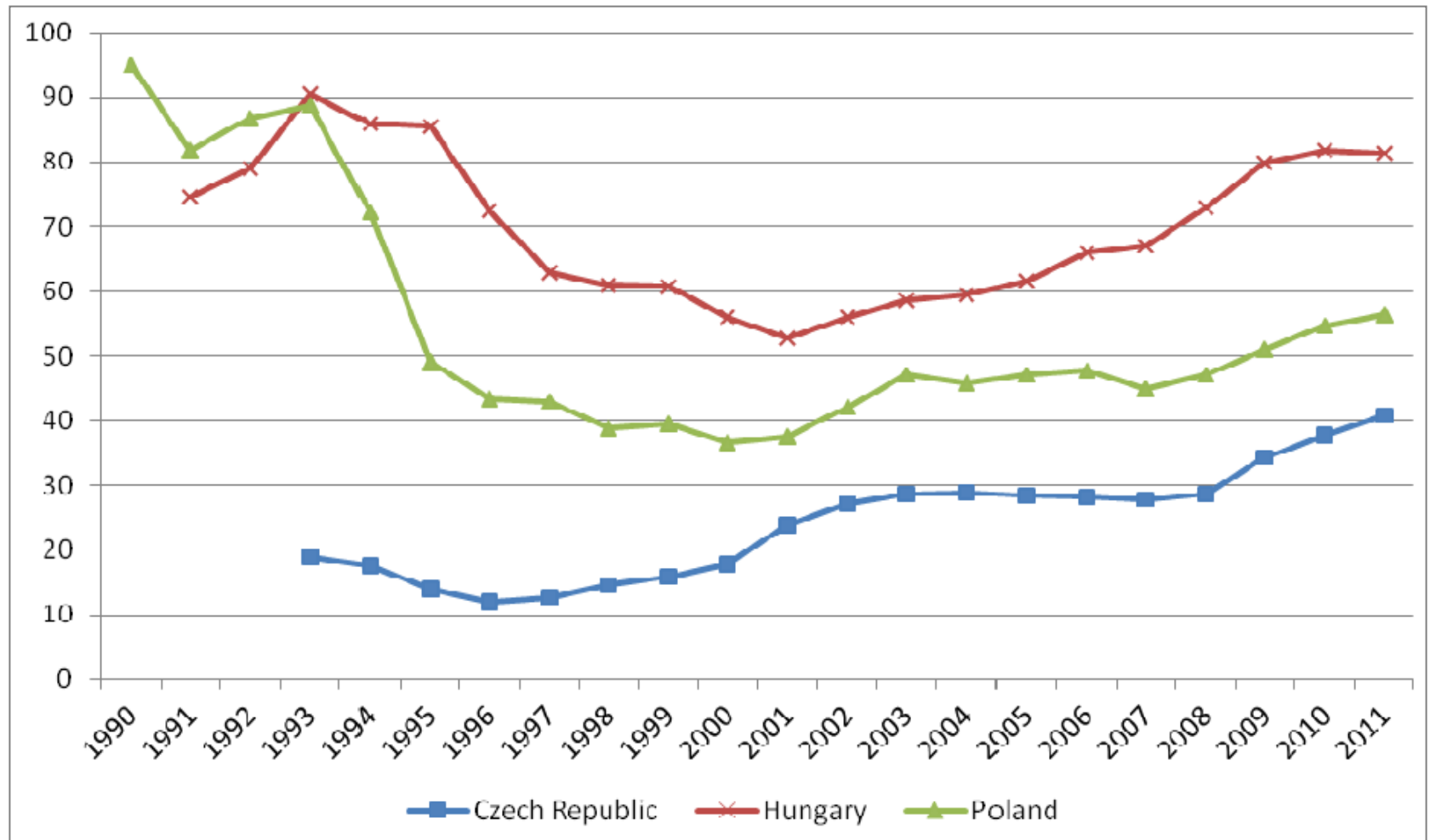
Source: Magyar Nemzeti Bank, Quarterly Report on Inflation, February 2005

Figure 5: Household Indebtedness Over One Year Maturity.
 Share of Debt in Forints (HUF) and Foreign Currency; and
 Overall Volume of Debt in Billions of HUF (right scale)



Source: Magyar Nemzeti Bank, http://english.mnb.hu/Statiztika/data-and-information/mnben_statiztikai_idosorok, 15. 4. 2013

Figure 6: Government Debt as Percent of GDP



Source: Eurostat ec.europa.eu/eurostat 15. 4. 2013, EBRD Selected economic indicators data, 26. 11. 2007

Privatisation

**Table 12: Public Survey – How Would you Solve The Problem of Ownership
November 1990/August 1991**

	Bulgaria	Czechoslovakia	Estonia	Hungary	Lithuania	Poland	Rumania	Slovenia	Ukraine
Return to the previous owner	21	34	34	12	14	17	7	20	5
Sell for the highest price offered	15	17	10	29	10	12	19	22	12
Self-management	35	27	39	28	57	47	31	40	53
Keep in state possession	30	22	18	31	19	24	44	18	31

Source: Kende, Rovnostářské a etatistické dědictví ve střední a východní Evropě in Politická a ekonomická transformace v zemích střední a východní Evropy, 1993

Table 14: Privatization Revenues of the State Privatization Companies, 1990-2000, HUF billion

	Sales and asset management	Cash revenues	Of which hard currency	Hard currency/ Cash (%)
1990	0,67	0,67	0,53	79
1991	30,43	30,35	24,61	81
1992	66,91	65,90	40,98	62
1993	164,50	133,63	110,67	83
1994	148,87	46,36	10,95	25
1995	471,93	437,80	411,48	94
1996	162,63	119,46	92,73	77
1997	340,61	317,70	208,60	66
1998	104,80	98,70	38,62	39
1999	114,95	99,23	70,00	71
2000	21,13	19,83	0,00	0
Total:	1628,2	1369,6	970,6	71

Source: Csáki, *From Transition to Integration*, 2002

Table 15: Ownership of Manufacturing Firms, % of Registered Capital

Types of ownership	1992	1993	1994	1995	1996
State	55.2	39.2	29.3	19.9	14.4
Municipal	8.8	1.6	1.6	1.0	0.9
Individual private		8.8	9.4	10.1	9.5
Domestic corporate	0.1	15.0	17.9	18.2	19.4
Employee	20.5	1.0	1.5	1.4	1.2
Foreign	3.6	30.9	37.1	46.7	51.1
Cooperative		2.6	1.9	1.4	1.2
Other		0.9	1.3	1.3	2.3

Source: Csáki, From Transition to Integration, 2002

Table 11: Change in the Affiliation of Units in the Retail and Catering Sector from 1988 to 1992

Year	1988	1990	1992
State enterprises	26,366	17,410	14,000
Incorporated companies*	671	6,240	30,000
Cooperatives	27,349	22,323	18,000
Private entrepreneurs	34,541	60,141	102,755
Total	88,927	106,114	164,755

**- including limited partnership, limited liability companies, and joint stock companies. They can be private or state-owned*

Source: Earle, Frydman, Rapaczynski, Turkewitz, *Small privatization, 1994*

Table 12: Private Sector Share in GDP (in %)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001-2004
Czech Republic	10	15	30	45	65	70	75	75	75	80	80	80
Hungary	25	30	40	50	55	60	70	75	80	80	80	80
Poland	30	40	45	50	55	60	60	65	65	65	70	75

Source: EBRD: *Selected economic indicators data, 26. 11. 2007.*

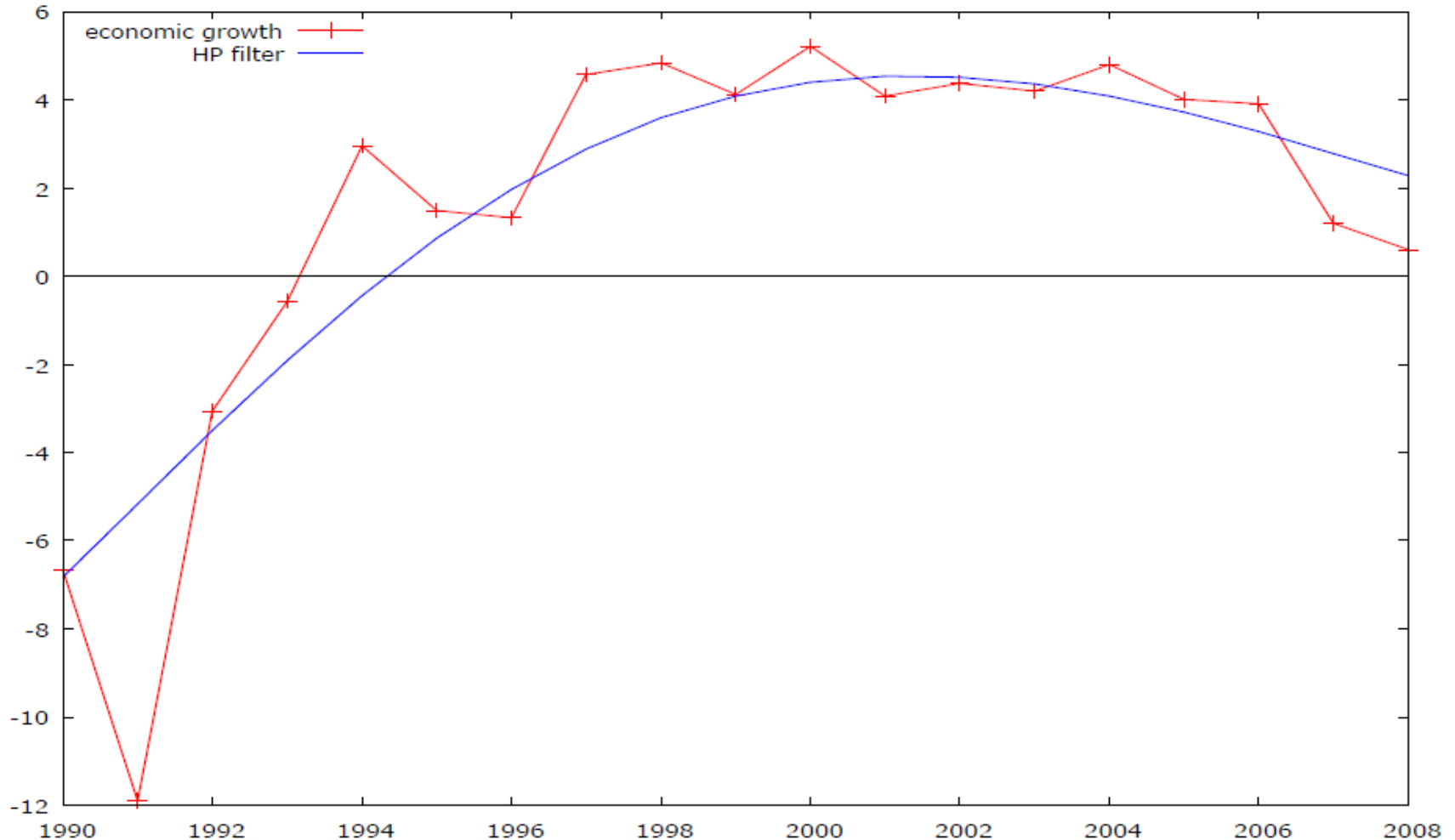
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The fourth part

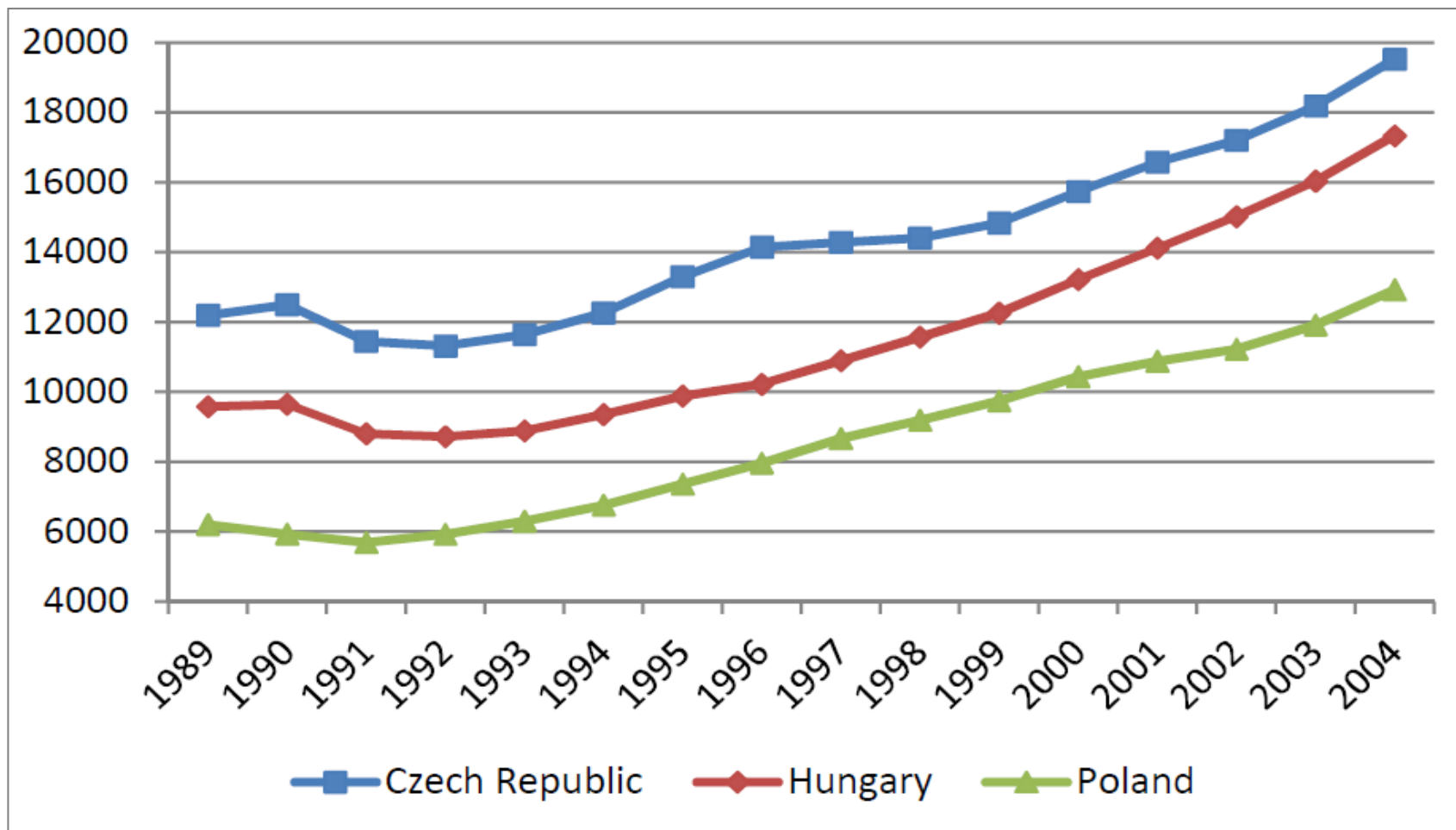
ECONOMIC RESULTS

Chart X: Economic Growth After 1990 (in %) and Its Trend Estimated by HP Filter



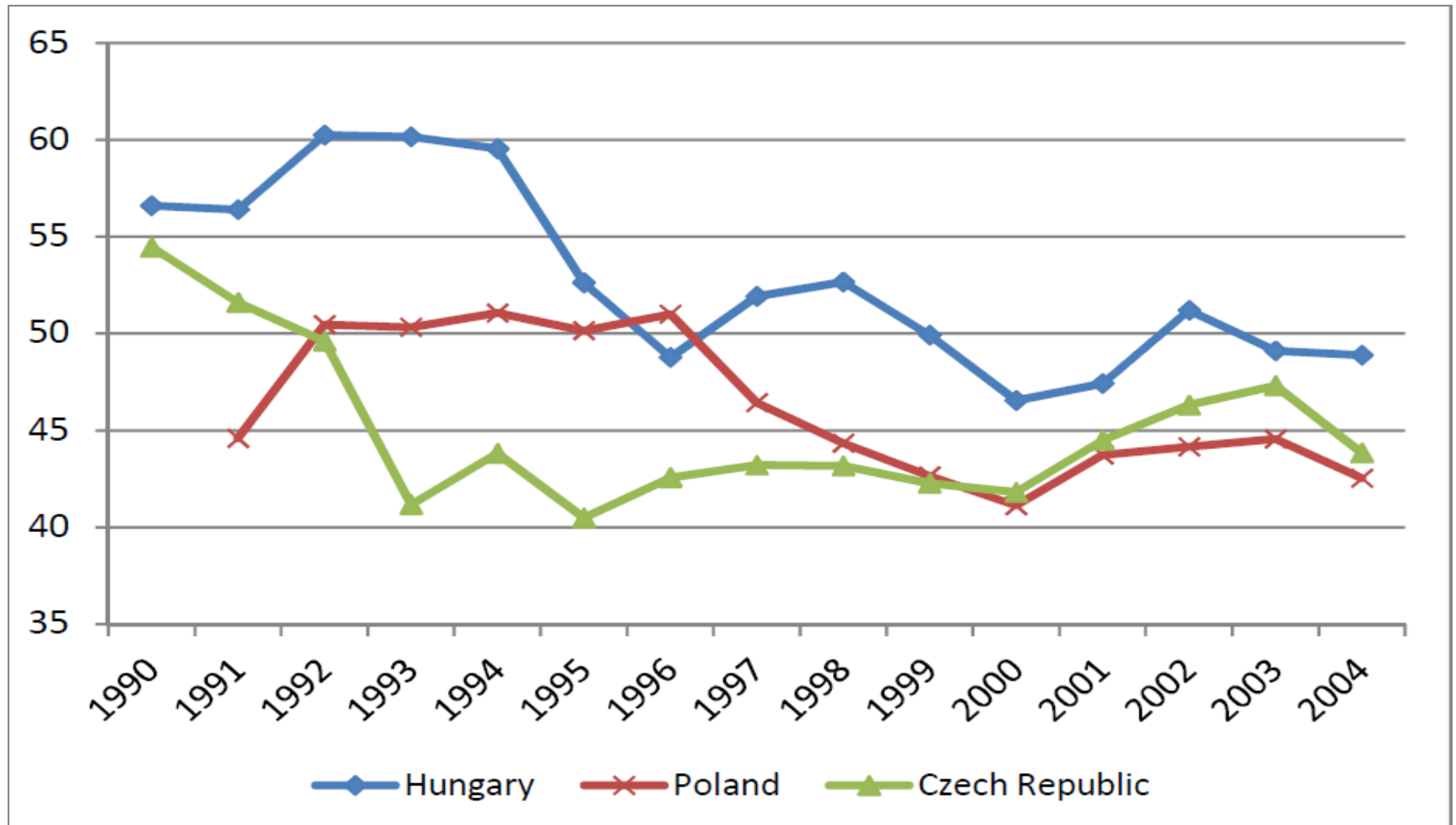
Source: Maddison, Historical Statistics - <http://www.ggd.c.net/MADDISON/oriindex.htm>, (11.10.2010)

Figure 8: GDP per Person in USD Based on Purchasing Power Parity (1989-2004)



Source: IMF: World Economic Outlook Database, <http://www.imf.org/external/pubs/ft/weo/2010/02/weodata/index.aspx> (9. 10. 2010)

Figure 9: Government Expenditure in Percent of GDP (1990-2004)



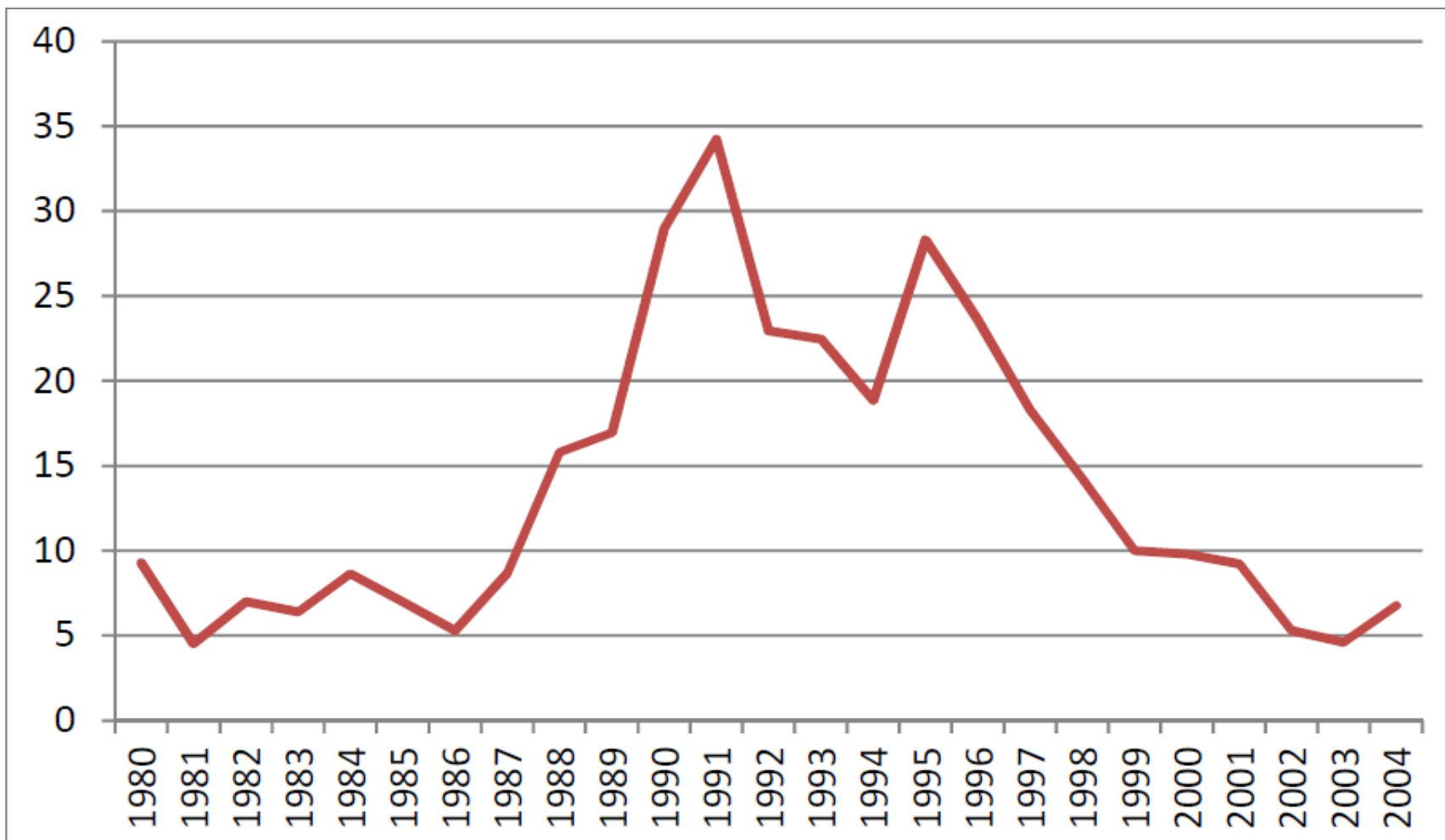
Source: EBRD: Selected economic indicators data, 26. 11. 2007.

Table 17: Structure of Economy - Share of Industry (I), Agriculture (A) and Services (S) in % of GDP

		1989	1990	1991	1992	1995	1997	1999	2001	2003	2004
Czech Republic	I		36.7	37.9	39.4	33.3	35.9	35.5	37.5	38.2	40.0
	A	6.3	8.2	5.6	4.6	4.7	5.0	3.9	3.7	3.4	3.3
	S		55.1	56.5	56.0	62.0	59.1	60.6	58.7	58.3	56.7
Hungary	I			21.0	20.4	23.1	25.0	26.7	26.6	26.7	26.5
	A			7.8	6.5	5.9	5.8	5.3	5.0	4.2	6.1
	S			71.2	73.1	71.0	69.2	68.0	68.4	69.1	67.4
Poland	I	44.1	44.9	40.2	34.0	32.1	30.7	29.7	29.5	29.6	30.8
	A	11.8	7.4	6.8	6.7	5.6	4.5	3.2	3.2	2.6	2.5
	S	44.1	47.7	53.0	59.3	62.3	64.8	67.1	67.3	67.8	66.7

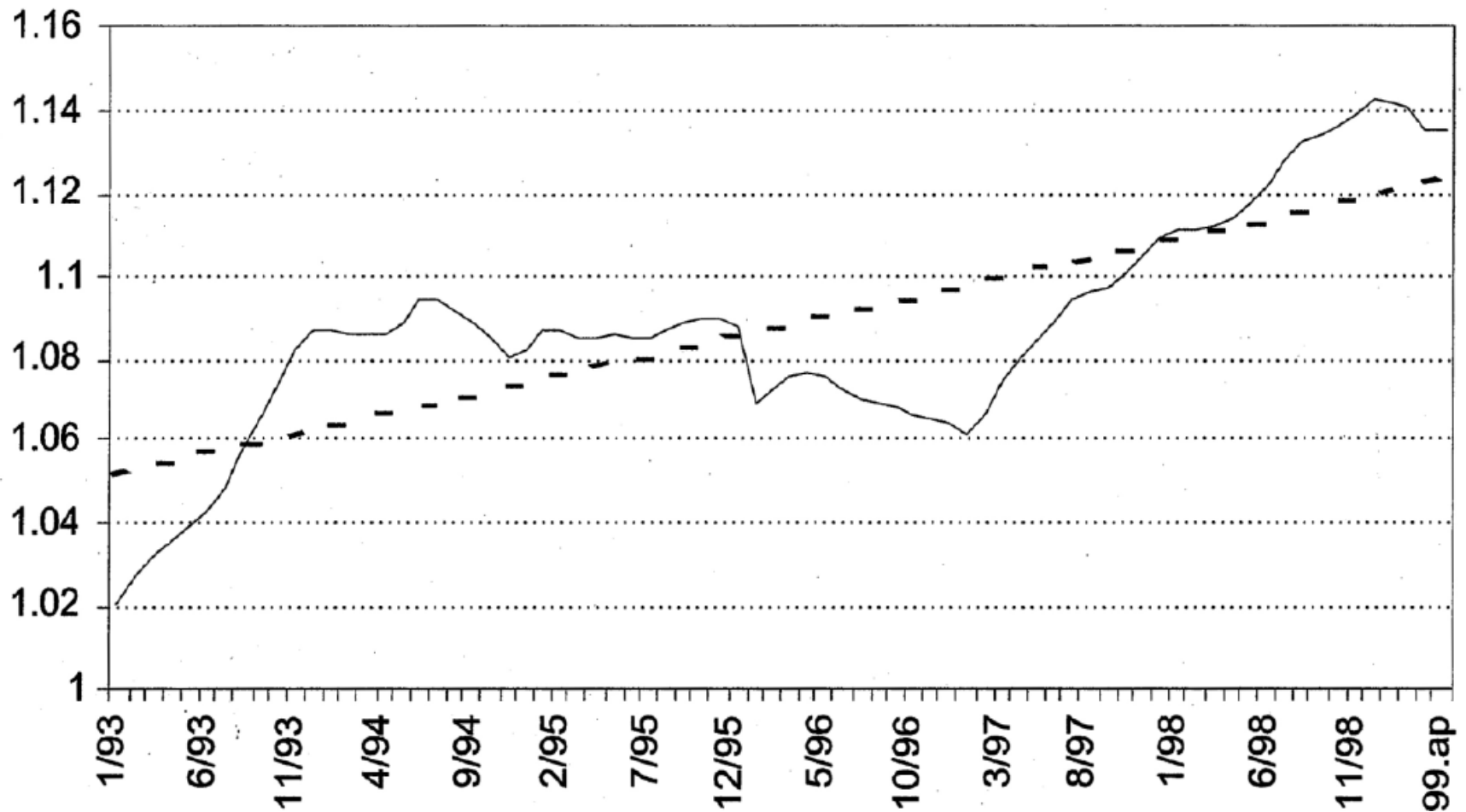
Source: IMF: World Economic Outlook Database, <http://www.imf.org/external/pubs/ft/weo/2010/02/weodata/index.aspx> (9. 10. 2010)

Figure 10: Inflation, Average Consumer Prices (Percentage Change) 1980-2004



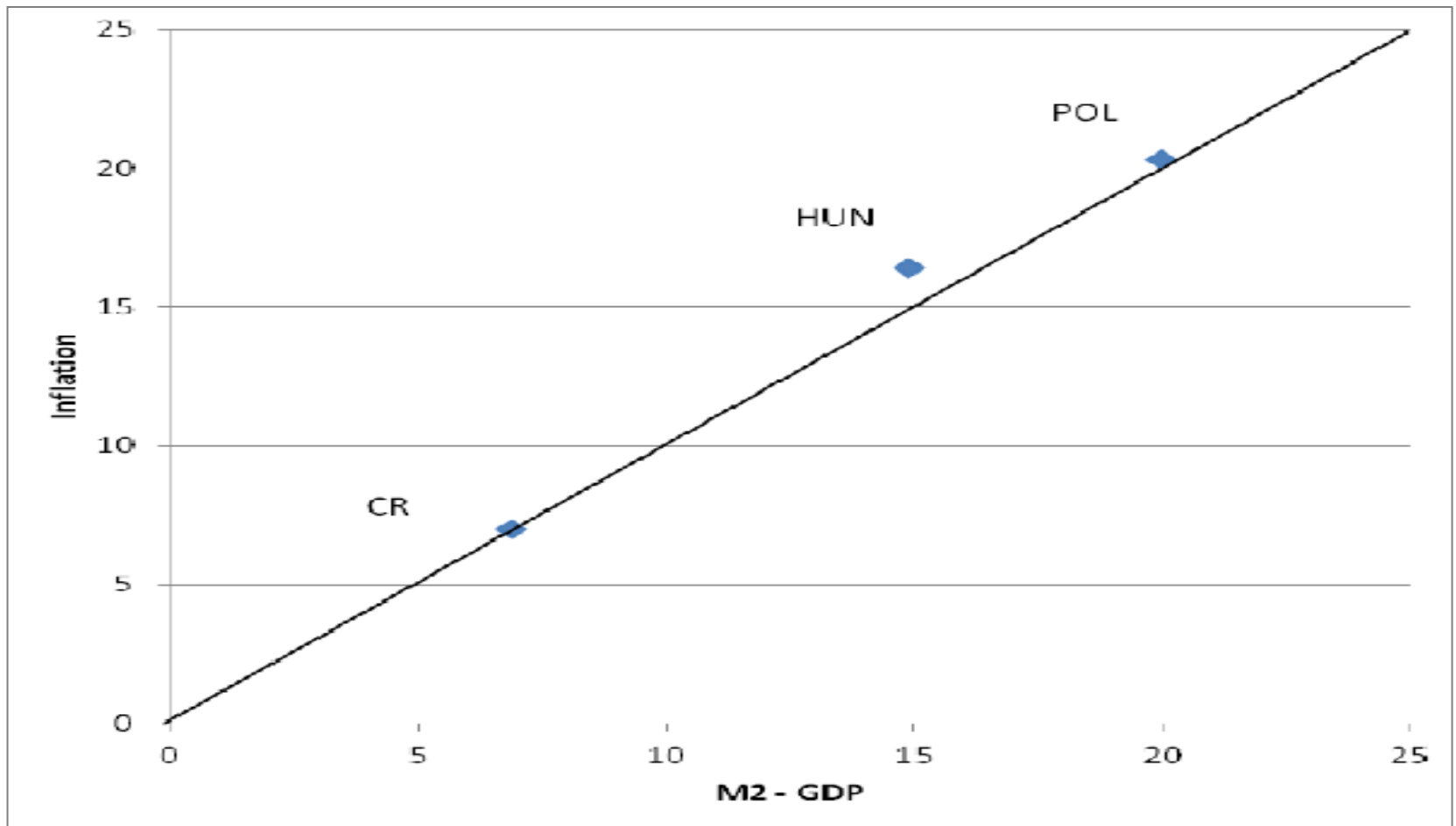
Source: IMF: World Economic Outlook Database, <http://www.imf.org/external/pubs/ft/weo/2010/02/weodata/index.aspx> (9. 10. 2010)

Figure 11: Non-tradable/Tradable Inflation in Hungary
(1991=1)



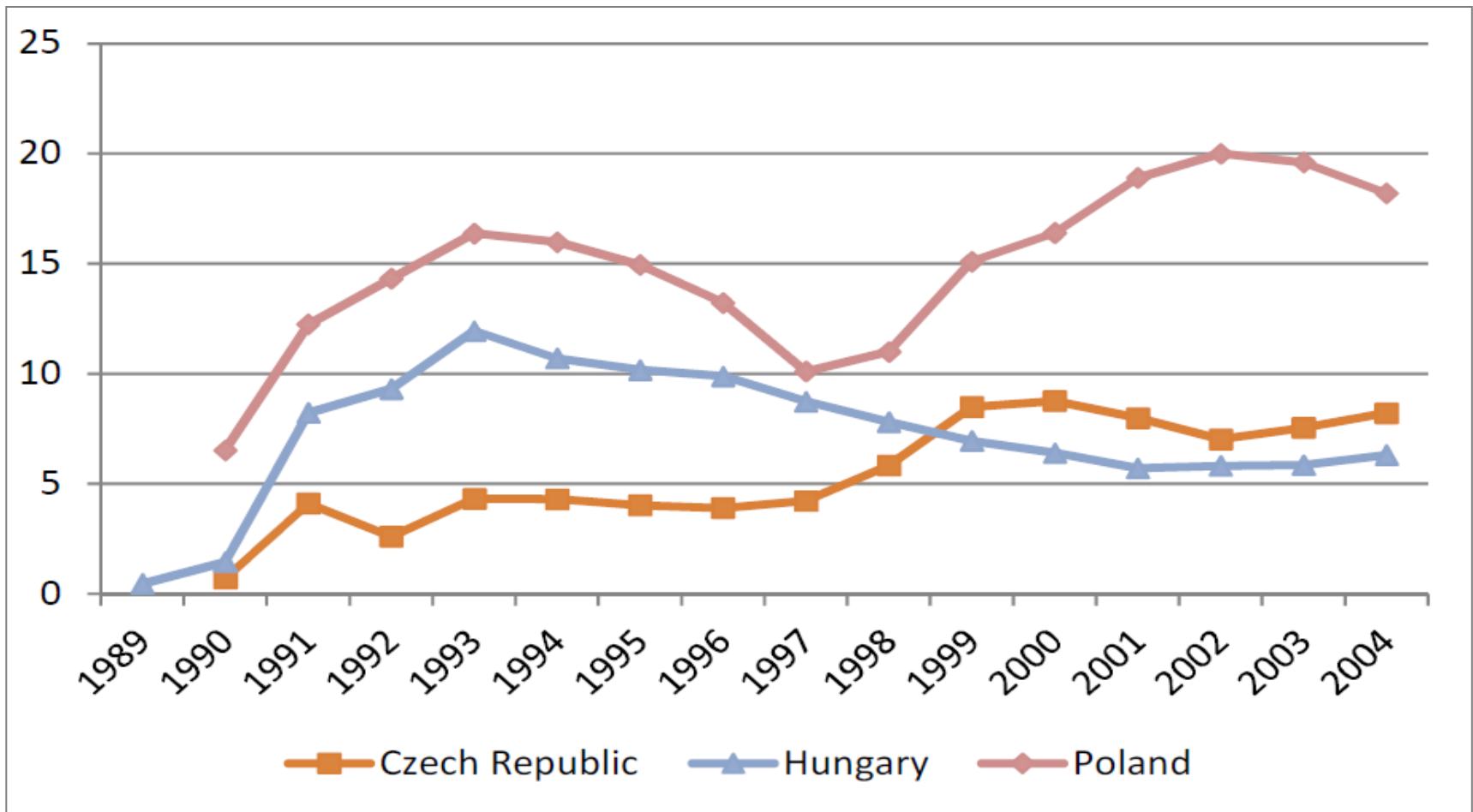
Source: Halpern, Neményi, *Fiscal Foundations of Convergence to the European Union*, 2001.

Figure 12: Inflation (Average Percentage Change of CPI) Growth of Broad Money Minus Growth of Real GDP (%) Between 1993 and 2004



Source: EBRD: Selected economic indicators data, 26.11. 2007.

Figure 13: Unemployment Rate (% of Labor Force) 1989-2004



Source: EBRD: Selected economic indicators data, 26. 11. 2007.

Table 18: Exports to CMEA Markets (mil. USD)

	1989	1990	1991	1992	1993	% decline between 1989 and 1993
Czech Republic*	5,103	3,422	2,045	1,103	1,009	80.2
Bulgaria	7,967	5,887	1,892	1,103	1,009	87.3
Hungary	4,009	2,933	2,710	2,981	3,122	22.1
Poland	4,395	4,000	1,799	1,476	1,461	66.8
Romania	3,890	2,083	1,089	702	720	81.5
Slovakia	1,827	1,169	1,376	1,200	1,130	38.1

* *without inter Czechoslovak trade*

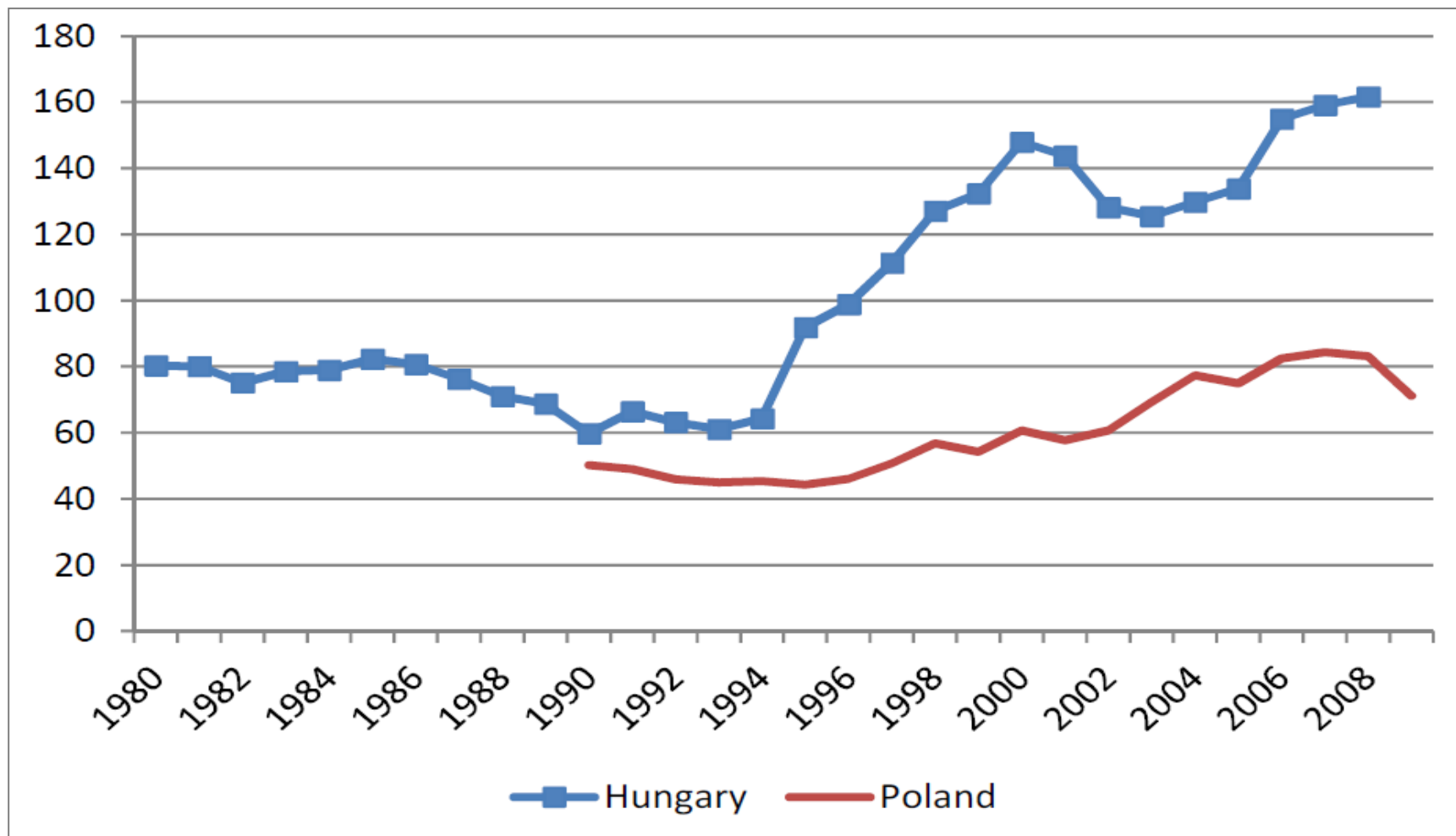
Source: Jonáš, *Ekonomická transformace v České republice, 1997*; own calculation

Table 19: The Share of the Main Trading Partners in 2003 (in %)

Imports	% share	Exports	% share
Germany	24.5	Germany	33.9
Italy	7.1	Austria	8.1
China	6.9	Italy	5.8
Austria	6.3	France	5.8
Russia	6.2	United Kingdom	4.6
France	4.8	Netherlands	4.1
Japan	4.2	USA	3.1
USA	3.2	Poland	2.3
Poland	2.8	Czech Republic	2.1
United Kingdom	2.7	Slovakia	2
Czech Republic	2.4	Russia	1.5
Netherlands	2.2	Japan	0.7
Slovakia	1.9	China	0.4

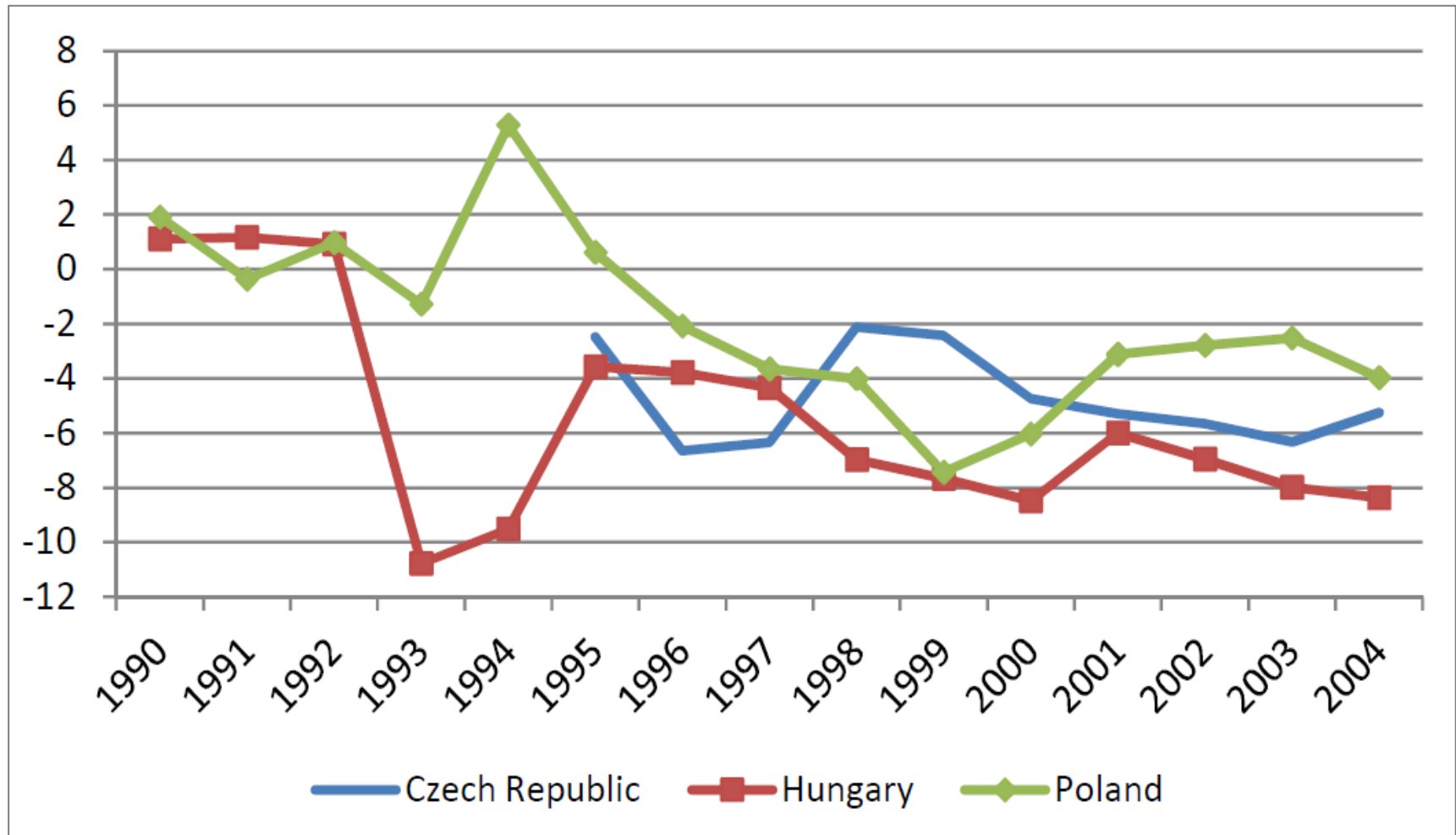
Source: Hungarian Central Statistical Office, <http://statinfo.ksh.hu/Statinfo/themeSelector.jsp?page=2&szst=QKT> (29.12.2010)

Figure 14: Exports and Imports as Percentage of GDP in Hungary and Poland (in %)



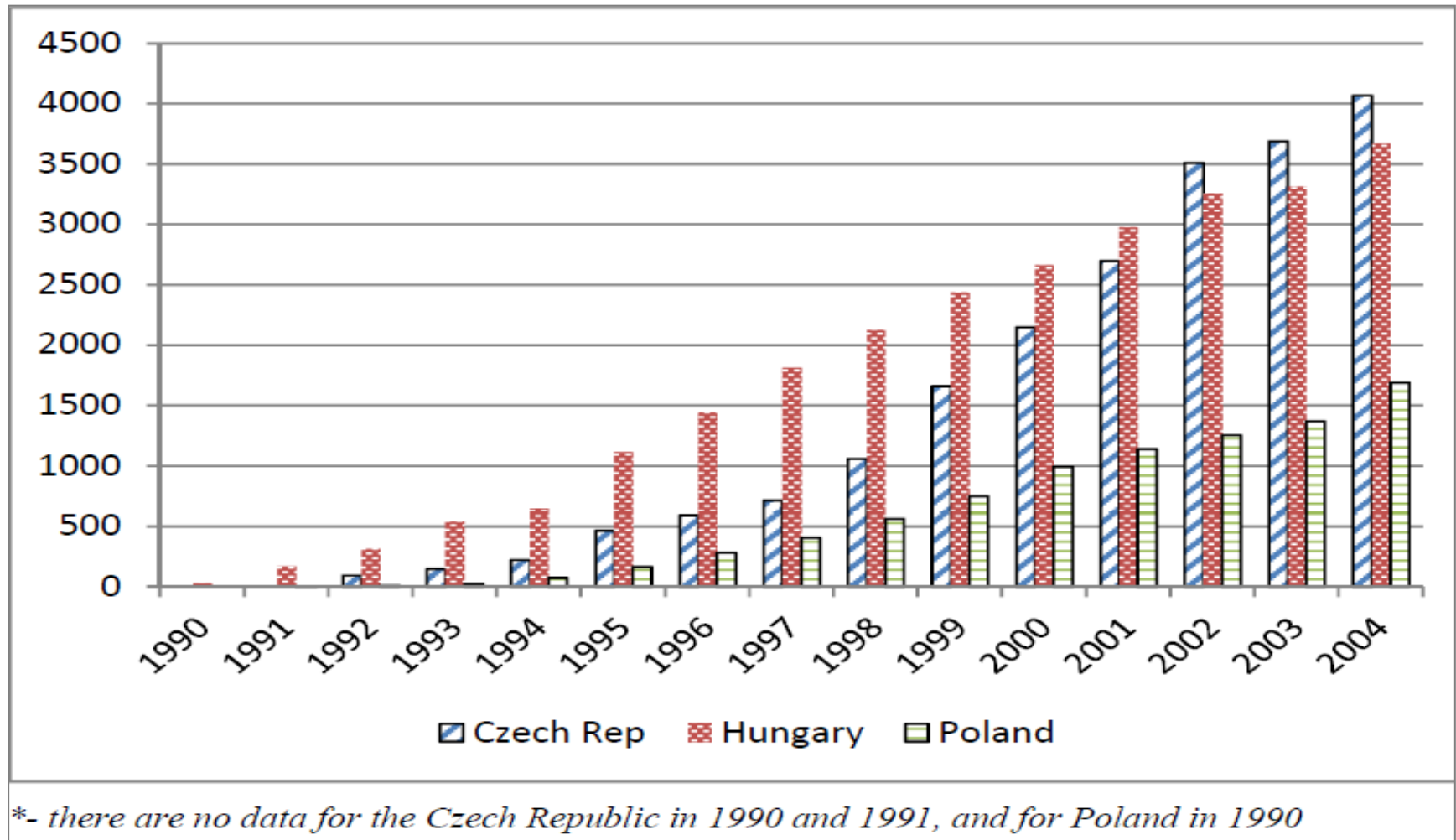
Source: The World Bank, Doing Business, www.doingbusiness.org, 1.12.2010

Figure 15: Current Account to GDP (%) 1990 – 2004



Source: IMF: World Economic Outlook Database, <http://www.imf.org/external/pubs/ft/weo/2010/02/weodata/index.aspx> (9. 10. 2010)

Figure 16: Cumulative FDI Inflows per Capita 1990-2004 in USD



Source: EBRD: Selected economic indicators data, 26. 11. 2007.

Table 20: FDI in the Czech Republic and Hungary 1990 – 2000 in \$ per Person

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
HUN	30	141	142	227	112	435	223	214	201	196	196
C.R.	13	50	97	63	84	248	138	126	361	615	447

Source: Srholec, Vybrané aspekty makroekonomického vývoje v Maďarsku po roce 1995, 2001.

Table 20: Share of Foreign Companies in Industrial Sector at the End of the 1990s

	Employment	Investment	Sales	Exports
Czech Republic	27	53	42	61
Hungary	47	82	73	89
Poland	29	63	49	59

Source: Berend, From the Soviet Bloc to the European Union, 2009

Conclusions

- **Successful results**

- **change of overall economic framework** and **membership in EU**
- almost double **increase of GDP p.c.**
- establishment of positive **growing trend**
- **catching up** with developed countries
- rising **competitiveness** of Hungarian companies

- **Troubles**

- **transformation recession**
- half-hearted economic reforms - > **economic imbalances**
- **sources of future economic problems**

**The main goals of transformation were achieved,
but some mistakes still occurred !**

Thank you for attention !