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### Hungary's Trade Policy Between the Uruguay Round and EU Accession

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by  
**László Csaba**

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## Overview

This paper is devoted to a summary view of selected trade policy issues in Hungary in the light of the Uruguay Round (UR). It is precisely the main feature and achievement of the Uruguay Round that it has managed to *extend its discipline over and above commodity trade* and encapsulate areas and national legislations previously falling outside the scope of international surveillance (Jackson, 1995). Especially the agreements and understandings on subsidies, public procurement, agriculture, sanitary standards, technical barriers to trade and environment underline the transboundary regulatory discipline (Uimonen, 1995) as a new feature of the UR. Thereby, trade policy growingly overlaps and disciplines general macroeconomic policies and regulation alike.

In case of Hungary this influence is limited as yet, although its growth is clearly discernible, especially in the laws promulgated in 1995. However, the underlying dynamics has remained under the traditional predominance of domestic considerations and developments over international considerations. This has obvious pros and cons.

When the UR was launched in 1986, Hungary had still been a modified centrally planned economy. By the time of the concluding Marrakesh ministerial conference, Hungary was facing its second free elections, with the lion's share of the institutional infrastructure of an OECD-type market economy in place and further legislation already well underway. Therefore, whereas Hungary tended to adopt a very *cautious stance* in multilateral trade negotiations, *actual liberalisation* in both the *trade* and *non-trade* areas proceeded with *big leaps*, occasional minor and temporary reversals notwithstanding. This had to do with a theoretical concept (for details cf. Csaba, 1993) which saw radical and swift trade liberalisation as a cornerstone of systemic change as a whole, in view of the lasting imperfections of markets, especially the capital market. Therefore competition from abroad has been seen as the major inducement to structural

readjustment, while financial intermediation remained inadequate and the resultant misallocation massive. This explains the historically *unprecedented unilateralism* in opening up Hungarian markets, which stands in sharp contrast to the *limited and reciprocal generosity* of the UR agreements. In the latter, though important new areas have been subjected to international discipline and surveillance, "however, much of the flesh to the skeleton remained just a hope for the future" (Cline, 1995).

Various accounts of Hungarian trade liberalisation (Nagy, 1994; Gács, 1994; Pásztori, 1993) all agree in portraying the process as a largely spontaneous breakthrough, that proved remarkably *resistant to recurring attempts* by producer lobbies *to revert it*. The 1988 governmental programme of import liberalisation has originally been part and parcel of a programme to create a socialist market economy. With the swift erosion of political power, reinforced by the Polish roundtable talks in April 1989 and the subsequent Hungarian national roundtable agreements in September 1989, paving the way for free elections, the overall contextual significance of the move has changed dramatically. It has become a part of the *avalanche* sweeping away foreign trade monopoly and administrative protectionism alike. And by the time the lobbies, having been intertwined to the old power structures recovered, the first *Europe Agreement* (EA) was signed in December 1991. This took effect on an interim base already from February 1993, i.e. prior to full ratification by all EC member-states. Following the Copenhagen summit decisions in May 1993, an official exchange of letters in 15 Oct. 1994 effectuated an additional protocol *accelerating and extending* mutual concessions, and bringing deadlines of 2001 closer, to 1998 in many areas. Parallely to this the *Central European Free Trade Agreement* (CEFTA) also took effect from 1995, granting even more lavish (mutual) market access to partners, whose market share has climbed to 7.5 per cent with the 1995 accession of Slovenia. Meanwhile the Nordic enlargement of the EU with the accession of Finland, Sweden and Austria was completed. This means that altogether over *two thirds* of Hungarian foreign trade is regulated by *regional agreements* granting palpable preferences, in terms of market access, over and beyond the multilateral MFN items.

Therefore UR agreements have had a sizable, though mostly *indirect impact* on several planes. Above all, by bringing *agriculture* under the GATT discipline it slightly improved Hungarian market access, meanwhile giving an impetus to reforming the mechanism of agricultural trade in Hungary. The latter would probably not have occurred at a time agricultural vested interest having gained a much more weighty and efficient representation in the post-1994 government. As it is known (Meisel and Mohácsi, 1993), the only area which remained virtually untouched by the 'rush' of EA liberalisation was farming, where discretionary *licensing and quotas*, i.e. the two rudest means of market protection were *jointly* applied. As the UR agreements prescribed the tariffication of these, further their stepwise reduction was envisaged, an *important improvement* in both the *methods* and the *direction of trade régime* occurred.

In fact, the liberalisation lists and sequencing agreed in the EA fully overlap with those in the original 1988 three year governmental programme, furthermore by the time the EA took force, 90 per cent of non-farming imports were already unilaterally liberalised (Borszéki, 1994, pp. 22 and 28). This not only underlines but directly proves the absolute *predominance of autonomous* deliberations in shaping the actual course of opening. However, as the GATT UR agreements in the case of farming, or the OECD/IMF insistence on further liberalising the currency code indicates, external pressures also contributed to molding the actual profile of opening.

International literature (as e.g. Subramanian, 1994) calls for *low and uniform* tariffs for a number of reasons, declaring the earlier structuralist theoretical background of discretionary protectionism largely outdated even for poor countries. This applies *a fortiori* for countries at the medium and higher levels of development.<sup>1</sup> All the more so, if they are striving for full integration. Looking from this perspective, Hungarian trade liberalisation hardly qualifies as a 'rush,' it has rather been half-hearted. Customs duties are currently spread between 0 and 170 per cent rates, remaining industrial customs stand at the

<sup>1</sup> Hungary's per capita GDP at purchasing power parity is put at 7000 \$. Cf Economist Intelligence Unit: Country Forecast of Hungary, Main Report, No. 4/1995, summary tables. Measuring the overall level of development at the market rates may convey a distorted perception.

level of 9.7 per cent. Agricultural customs have been increased from 22 to 45 per cent on average. This was supplanted by a licensing fee (1 per cent, abolished with licensing in January 1995), a customs administration fee (2 per cent) and a statistical fee (3 per cent). Though the latter two were decreased by 1-1 per cent, respectively in the EA and CEFTA, the introduction of the 8 per cent surcharge on imports in 20 March, 1995 (to be revoked in 1 July 1997) has enhanced the level of overall protection. All in all, about 30 per cent of fiscal intakes in 1995 originate from customs and similar dues, which is, of course, distortive, constantly tempting authorities to replace lost revenue with new excises. Under this angle Hungarian trade liberalisation looks semifinished and incomplete, rather than excessive. Noting this point therefore Bock (1995) rightly qualifies Hungarian liberalisation as a drifting process, lacking conceptual clarity, therefore retaining a high degree of discretionary decisionmaking, which, in turn, makes authorities vulnerable to various lobbyist pressures. Fiscal drains may only reinforce this feature, as discretion allows for easy replacement of lost revenues with new public dues, instead of enforcing spending cuts. Conceptually, the weakest point is the lack of even a proclaimed will to unify the rates of effective protection, and the resultant insistence of authorities on discretionary powers against formalised, transparent and automatic processes. This problem is particularly acute in the farming sector and privatisation, but also in areas covered by the GATS (General Agreement on Trade in Services).

Finally, mention should be made of Hungarian *exchange rate policies*. Singularly among transforming economies, Hungary has never resorted to a major real effective devaluation of its currency. It has been noted early on (Oblath, 1992) that in the international history of economic liberalisation there is not a single case to date, when abolishing administrative super-protectionism (what the command system implied) would not have been complemented either with tariffication of quotas, or a major across-the-board devaluation, leading to a flat protection of the entire domestic sector. In the cases of Poland, Slovakia and Russia, for instance, both measures were taken and complemented by other protective measures (procedural steps and surcharges). In Hungary, by contrast, the National Bank used the exchange rate as a nominal anchor in the 1989-94 period. A crawling peg régime was introduced only in March 1995. The massive

appreciation of the forint, having reached 25 per cent in real terms in 1989-92, remaining constant at this level in 1993-94, that had started from a level way above the marginal/equilibrium point in 1989.

Table 1.

**Exchange rate deviation index  
(ratio between market and PPP rates)**

Country	1994	1995	1996 (forecast)
Hungary	1.6	1.6	1.5
Poland	2.2	1.9	1.8
Czech Republic	2.3	2.0	1.9
Slovakia	2.8	2.7	2.7
Romania	2.4	2.3	2.3
Bulgaria	3.4	3.0	3.1
Russia	2.4	2.2	2.0

Source: EIU: *Economies in transition*  
(Regional overview), 3/1995, p. 27.

Figures in the table indicate, that even in 1994, when the new coalition started with a one-time 8 per cent devaluation of the Ft (followed by two smaller steps), and in 1995, when another 9 per cent devaluation was complemented by a crawling peg, the *quality* of the Hungarian exchange rate, thus *of the trade régime's openness* has remained fundamentally *different* from that in other transforming countries. On top of it, the Czech and Polish economies arrived from 1991-93 with a steeply devaluated national currency, while Hungary entered the same period with a constantly and highly overvalued currency, at least relative to other transforming countries and relative to the current account disequilibria of 1993-95. This, of course, was an invitation for protectionism to come in, whatever one thinks of the merits of the exchange rate policies in 1989-94. Interestingly the late ministry of international economic relations and the national bank proved strong enough to resist most of these pressures. Analysing the period André Sapir (1995) comes to the conclusion that the Europe Agreement has, in fact, proved to be quite a powerful weapon in the hands of the

authorities to fight protectionist pressures of various sorts. Therefore, if seen in the proper perspective, both the UR and the EA have become sources of *dynamic advantages* fostering systemic change and structural adjustment in Hungary, way above the narrow perspective of improved market access. Due to their limited nature, neither of these could, on their own, ensure compliance. However, when laid in the hands of able and willing politicians and administrators, both of them could powerfully and efficaciously be employed against repeated calls for protectionism. If one thinks of huge gains in industrial *productivity* - 15 per cent in 1994 followed by another 16.2 per cent in 1995 -, the rapid expansion of exports, the substantial improvement in the *pattern of Hungarian sales* (SITC 7 category of machines and equipment climbing up from a base 14.84 per cent in 1989 to no less than 24.86 per cent by 1994, or various industrial goods, SITC 8 category, climbing up from 12.15 per cent in 1989 to 22.43 per cent) already prove the enormous *efficiency* and *modernisation gains* originating in this very tough and consequent policy line.

## Trade in Goods in the Light of the UR

### a./ Market Access for Hungarian Goods

As seen from the sketchy overview presented above, signing the UR took place in the middle of a wider process, whose dynamics was driven by factors extraneous to multilateral talks. Autonomous decisions as well as preferential agreements conceived with a view of accelerating prospective EU membership of Hungary were clearly dominating, covering over two thirds of Hungary's trade (CEFTA included). During the UR Hungary enjoyed GSP<sup>2</sup> treatment in the EC from 1989 and in the USA from 1990, a position much more favourable than any multilateral deal could ever deliver. This was instrumental in orchestrating Hungary's successful reorientation from East to West in the middle of a collapsing Soviet empire. However, these concessions were *transitory* and *ad hoc* in nature, basically honouring Hungary's pioneering role in reforms - a position that quickly eroded with region-wide transformations. Further, the US Congress renews the status in an annual review process, which several times created an *ex lex* situation for several months. The EA has, though opened 90 per cent of the EC industrial market. However, about half of Hungarian traditional sales are in the sensitive sectors. In agriculture, market access was so minimal, that representatives of the farming lobby (Varga, 1995; Kiss, 1995) as well as some other observers (Kovács, 1995) concluded of the EA's being unilaterally advantageous to the EU, with reference of the steadily improving trade balance in favour of the EU both in general and in farm products in particular.

Judging the overall advantages from an international treaty solely on the grounds of sectoral (or even general) trade balances sounds rather unsophisticated, at best. However the claim of only *marginally improved market access* remains a valid one. Therefore Hungary has had high hopes in

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<sup>2</sup> Generalised system of preferences: duties levied on the supplies from poorest countries.

the UR's opening up rigidly protected EU and EFTA markets for farm products, restraining the escalation of export subsidies and export credits, improving access to overseas markets by limiting the notorious administration of US antidumping practices, unilateralism in quota administration and NTB<sup>3</sup>, the latter being coupled with intransparent business practices in Japan. Being a small trade dependent country with limited bargaining power, the *multilateral discipline* and *increased transparency* have been obvious gains for Hungary.

These hopes could only partially come true, due to the inherent constraints and compromises, having shaped the UR/WTO agreement. Although the new disciplines and agreements do cross a watershed in terms of international trade theory, *issues having formed the centerpiece of immediate Hungarian trade concerns have mostly remained unresolved*, at least in the medium term. As the exhaustive analysis of Baldwin (1995) convincingly demonstrates, the liberalisation in farm trade remained rudimentary and slow, administration of antidumping remained open to interpretation, restrictive business practices by firms remain largely unsanctioned, and the principle of industrial subsidy (in the form of regional support schemes) has not been abandoned in favour of retraining or relocation schemes for dislocated workers. In other words, both the roots and the means of market entry barriers remained in their place. Moreover, the issues of subsidised credits and sanctioning unfair administration of NTB remained open. Furthermore, with the great liberty given in quantifying customs equivalents, a positive inducement to open tariff increases and enhanced effective protection was created, with some parties imposing several hundred percent customs duties. What was feared to become the weapon of underdeveloped countries, has, in fact, turned to be the armoury of advanced countries, like new EU entrants, EFTA members and Japan. As long as trade distorting domestic supports sustain, it was inevitable for restrictive trade practices too, to survive. As the EU agreed to the UR only in the form that it consolidates CAP, it is unsurprising that "with most commodities, the initial tariff is so high, that even after the reduction commitment has been honoured, the reduced tariff will be high enough to keep out imports" (Ingersent, et. al. 1995,

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<sup>3</sup> Non-tariff barriers: procedural, administrative, specification and other measures blocking free market access of foreign entrants to domestic markets.

pp. 721-722). The examples of butter duty of 314 per cent, sugar duty of 267 per cent, milk powder duty of 217 per cent may suffice to illustrate this point.

From the Hungarian perspective the situation has become a bit even less favourable. The EU is known to apply 1986-88 average prices and quantities as a base to calculate bounded initial tariffs replacing border rebates. In a number of cases, relevant for Hungarian sales, like wheat or beef, the initial contingent does not encompass concessions granted in 1988-94, i.e. in the EA. As Somai (1995, pp. 95-6) shows, when minimal market access was granted by aggregated product categories, these often implied structural changes unfavourable to Hungarian exports, when e.g. allowing for beef imports "crowding out" previous pork and chicken supplies. Going through several farm product categories his analysis concludes the UR's giving *no improvement, but a deterioration* in terms of market access in this sector, insofar as concessions previously granted to associated countries were not automatically included in the minimal market access quantities, granted globally. This is a clear *erosion of previous preferences* in a series of product categories like live animals or slaughter meat. In case of wine, no minimal price was declared to retain quotas.

Accession by the Nordic countries to the EU has further deteriorated the situation in trade with them. Disputes go on, with 1995 and most probably also 1996 elapsing without stable contractual arrangements, and semiannual bilateral (autonomous) decisions governing practice. This means that previous concessions in terms of market access in such important items as wine or mountain cattle are not even maintained, but cut and/or opened for all associated countries. Contrary to general policy statements, trade administrators of the three new EU members failed to ensure that previously existed concessions be retained and integrated into the new EU régime. In other words, the administrative complexity of implementing *per se* progressive changes of the UR allowed for the resurgence of petty protectionism of the worst kind in some of the most advanced countries, by making use of time consuming talks to keep competitors outdoors.

During the UR negotiations the US negotiating party adopted a very assertive stance questioning the legitimacy of any discretionary element in the Hungarian

régime, while not giving up any of its globally known malpractices. In order to get the US acceptance of relatively high Hungarian customs equivalents in agriculture, Hungary put up with very minor US concessions (only two items: cheese and strawberry jam) in exchange for a series of American products' enjoying preferential duties when entering Hungary, like cheese, orange, popcorn, chocolate, tobacco. The EU, for its part, delayed negotiations, and finally has taken only a commitment *in principle* to retain *a part* of previously granted preferences. It was then hoped that bilateral improvements will become possible. Meanwhile, EFTA countries failed to commit themselves to retaining previously available preferences in terms of market access. In place of the previous preferential bilateral agricultural quotas new, non-country-specific limits were imposed. In a typical example, Austria used to allot a quota of 20 thousand mountain cattles for Hungary, which turned to a 5+5 thousand limit (base + preference) to be shared with Slovakia and Slovenia. It happens that preferential quotas are promulgated at the end of the year (Norway), or they are open only for two weeks (in case of Switzerland). With CEFTA countries an agreement was reached to conduct talks in a narrower circle. This proved quite efficient by late 1995, but unrelated to formal UR, while *applying many of its novelties in a much more lavish fashion*, than multilaterally. In sum, the UR has not brought important improvements in terms of Hungarian market access. On occasion entry to traditional markets proved more difficult, whereas access to nontraditional overseas markets hardly improved. Constraining the competition in subventioning farm products will be effective by the late 90s at best, and marginally improved access to "sensitive" US markets (like steel and textiles) emerged. Detailed procedural regulation of antidumping and the obligatory rejection of protests against marginal suppliers (below 2 per cent) market share may marginally improve Hungarian chances, though underpricing is not a typical strategy of Hungarian firms (they haven't lost such cases in the EU in the 90s).

Primary importance for *Hungarian market access* has been the already mentioned exchange of letters of 25 Oct, 1994 between the *EU and Hungary*. This put trade liberalisation in the political context of EU eastward accession, moving it beyond the foot-dragging, inherent in multilateral trade talks. The thus

emerging arrangement<sup>4</sup> consists of an industrial part, a textile deal, the VER<sup>5</sup> on sheep and the agreement of controlling the origins of wines. Accordingly, Hungarian industrial products may enter the EU without quotas and duties except textiles and the EASC (European Coal and Steel Association) product range. Besides, 93 sensitive product categories were listed, of which 78 fall under customs limit and 15 under customs quota. These include mineral fertilizers, chemicals, leatherwear, pneumatics, steel, iron, aluminium, radio, bulbs, buses, cars, furniture, watches and toys. For 18 textile products quotas are retained with a duty of 4.5 per cent. Starting from 1 January 1995 the average level of customs has sunk to 3/7 of that of February 1992. In the farming sector interim arrangements were made. Accordingly<sup>6</sup>, some preferences were granted. Integrating some quotas improved previously restrained sales of chicken; quotas for cheese, wheat, pigs and canned food expanded. Border rebates for such important items as duck, goose, salami, smoked sousages decreased by 50-60 per cent; entry of new wheat categories improved sales. All these add up to a potential gain of 150-160 mn \$. As the final agreement on the farming sector could not be concluded to date, the following arrangement were made<sup>7</sup>, which will probably continue into 1996. In category I 80 per cent preference from the border rebate is granted (instead of the UR 60 per cent). This includes duck, goose, poultry, smoked sausage, salami and pork. In category II the preference is between 60 and 80 per cent, like cheese, wheat, and chicken. Category III - sheep and goat - retains the VER effective since 1982, with a customs quota between 0 and 4 per cent. Category IV offers a 30 to 60 per cent preference from (the greatly increased) MFN, but no quotas are set. This includes honey, goose liver, jams, raspberry, sour cherries. Category V is characterised by a minimum entry price, which hits heavily all major exportables for industrial use in the fruit sector, and reflects primarily German producer interest. Category VI offers a 60 per cent duty reduction, but applies QR. This covers onions, paprika, tomatoes, cucumber and tobacco. Finally category VII offers a 30 per cent reduction of the MFN, except for wheat, where the concession is 60-80 per cent (but practically

<sup>4</sup> Published in: *Külkereskedelmi Tájékoztató*, 1994/60 (an official outlet of the press centre of the ministry of industry and trade).

<sup>5</sup> Voluntary export restraints: unilateral contracts where weak country suppliers agree to restrict their sales in exchange, for the strong country's not imposing a quota or not increasing customs' duties.

<sup>6</sup> Published in: *Külkereskedelmi Tájékoztató*, 1994/52.

<sup>7</sup> *Magyar Közlöny*, 1995/59 and *Külkereskedelmi Tájékoztató*, 1995/43.

next to no supplies materialised in the last few years). Fresh vegetables also encounter an entry price, whereas duties for wine decrease in 1995-99 by 20 per cent altogether (on GATT lines).

Whereas Hungary's GATT commitments implied a treatment inferior to EA for CEFTA countries, this situation has changed dramatically. Starting its history from the February 1991 Visegrád meeting, and expanded by subsequent meetings until April 1994, the agreement effective from 1 March 1993 goes, in its current shape<sup>8</sup> much beyond to what was emotionally proposed in the literature (Baldwin, 1994, pp. 207-215); the generalisation of the EAs, and *implements several progressive elements of the 1994 GATT*. The parties pledged not only to avoid new duties, but also refrain from public dues of similar effect (para 5 and 17), give up GATT-conform restrictions on payments (para 21), prosecute restrictive business practices of firms (para 22/1), apply WTO rules for public procurements (a GATT protocol, to which signatories originally did not join, para 24/2), give up mutual import restrictions due to balance of payments reasons (para 32/2)) it even contains a developmental clause (para 33) enabling extension and acceleration of its application. It limits safeguards for cases of severe shortage and massive reexportation (para 29), whereas it introduces a rather lengthy notification, consultation and dispute settlement procedure. The latter requires a 90 day period of rethinking, prescribing proportionality to damage and the declaration of a schedule of how the countervailing measure will be revoked. Given that EAs now also allow for cumulating inputs in sales to EU, qualifying other CEFTA inputs as national in the rules of origin,<sup>9</sup> these measures *do imply a sizable improvement* of market access for Hungarian products. The three lists - acceleration, deceleration, sensitive - are analogous to EA, but their material contents is by and large, the reverse, reflecting actual trade flows. In the farming sector the June 1995 Warsaw agreement calls for a 50 per cent cut of MFN duties from 1 January 1996 and 100 per cent cut from 1 January 1998. Six weeks later in Bratislava the three lists already reemerged, with 19 per cent of Hungarian exports falling in the free, 38.5 per cent in the reciprocally decreasable and 42.3 per cent into the sensitive group. All in all, in 1996 - 80, by

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<sup>8</sup> Promulgated in: *Magyar Közlöny*, 1995/24 (the official gazette of the government).

<sup>9</sup> The decision No 1/1995 of the Hungarian-EU Association Council, as promulgated in: *Magyar Közlöny*, 1995/80.

1997 - 90 per cent of industrial trade will be free, and if half of farming adds to it, the outcome may be seen as reasonable. It is interesting, that the Poles, generally favouring CEFTA with great vigour, actually insist on actual or reimposable quotas on any concession given in the farming sector. The joining of Slovenia occurred quite smoothly on similar terms. The Hungarian-Slovene free trade agreement of April, 1994, effective from 1 January 1995 allows for 66 per cent duty free access of Hungarian exports and 61 per cent of Hungarian imports, with 50 per cent customs reduction in farming (while retaining quotas). Recent press reports (cf. *Figyelő*, vol. 39 no 48) indicate of the prospective inclusion of other associated (EA) countries, i.e. the Baltics, Romania and Bulgaria on similar terms. Interestingly, a lack of such an agreement did not hinder dynamic expansion of Hungary's trade with Romania in 1993-95.

### **b./ Opening of the Hungarian Market**

As seen above, most of the unilateral opening was already in place when the first EA of December 1991 was signed, due to an autonomously undertaken three year liberalisation programme, which was also strongly encouraged by the IMF. In May 1989, when a major mismatch of performance criteria could be observed, the IMF suspended the standby agreement to ensure that a./ despite the major policy flux, current account adjustment measures be taken; b./ but, unlike in 1981-83, these do not take the form of import restrictions. As the country was heavily reliant on the IMF, especially following the pre-election hysteria, this objective was actually attained, as part of a broader package supporting the current account of the country (for more details cf. Csaba, 1995). As both 1990 and 1991 closed with a current account surplus, the overall line *of foreign economic opening could be maintained.*

However, as previous analyses (e.g. Inotai, 1995) indicated, the EA fell much short of contemporary Hungarian expectations both in terms of reciprocity and actual assistance. Market access improved primarily over the previous *legal* (MFN), rather than *actual* (GSP) standing, and some of the most dynamic sectors of traditional Hungarian sales, like agriculture, textiles and steel remained excluded, or were only marginally effected by the newly opening opportunities.

Lobbies, too, started to recover and the pressure for market protection had been on the increase.

Hungary's concessions in the UR must, therefore, be put in this perspective. As seen in the preceding section, multilateral trade talks helped only marginally overcome Hungarian grievances and produced precious little in terms of improving actual market access overseas. Meanwhile, the UR envisaged further liberalisation also in areas where even then OECD countries have yet to live up to the spirit of the new understanding. Therefore the Hungarian bargaining position aimed at a *compromise*, which allowed the country to become part of the global trading system, without, however, compelling it to futher unreciprocated concessions following the big leaps of 1988-91. With the benefit of hindsight it is already clearly discernible, that the *process of liberalisation has since been gathering momentum* in Hungary. In many areas, where late 1993 was not yet the time to move forward, important and radical steps were taken, primarily in the new *foreign exchange law* and the *law on public procurement*, which rendered Hungary's numerous GATT abstentions irrelevant by now, especially in the area of financial services (see below). Furthermore, just the limited generosity of multilateral agreements justified Hungary's intention to retain its bargaining chips to bilateral EA and CEFTA deals and not to give them up in global bargains.

There have only been two issues of principle, where Hungarian trade policy exhibited a degree of hardly comprehensible intransigence ever since the UR: discretionary licensing and adherence to quotas, more precisely to the global quota on consumer goods imports. *Discretion*, of course, is a way to comfortable life. However is burdened with arbitrariness, thus can backfire both in the media and at the courts. Though most Hungarian laws adopted in 1994-95 fail to recognise this point, it still remains valid. An official in a pluralist society can only feel secure if prefixed procedures and transparency defend him from vested interest, political leverage and malvolent publicity. The *global quota on consumer goods imports*<sup>10</sup> for the second half of 1995 covered e.g. detergents, footwear, clothing (in a very wide assortment, including second hand clothes),

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<sup>10</sup> Decree no 16/1995 of the MIT, *Külkereskedelmi Tájékoztató*, 1995/23.

various industrial products (from gobelin through ivory), jewellery, fish products and above all, cars of various sorts (listed in a separate supplement). It is very hard to relate these items to either domestic employment (like ivory or gold), or to the current account, whereas the leverage of trading and producer groups is trivial. Quantitative analyses of import patterns (Bóc, 1994; Kovács, 1995; Borszéki, 1994) show little or no correlation between import growth and the pattern of protection except for cars.<sup>11</sup> Therefore retaining the global quota has hardly been in the best interest of Hungarian officials and the economy at large. At the time of UR talks detailed analyses of the way of its functioning (Borszéki, 1993) described it as an outdated means, captive to vested interest, without, however, serving any publicly declared policy objective properly. Meanwhile, newer editions of the regulation show an interest in detail and interventionism unknown since 1968, which is a clear evidence of its being dysfunctional in a modern market economy. Once the analyst disregards the typical outcries of vested interest, one wonders what made Hungarian commercial diplomacy to be so steadfast precisely on this point, while very large concessions were made in other, macroeconomically much more significant areas.

In order to get a proper picture, it needs to be said that these items, complemented by all other elements subject to import licensing, according to governmental decree No 186/1994, like hazardous waste, drugs, arms, add up to a mere *8 per cent of total Hungarian imports*. Meanwhile, over 40 per cent of exports are liable to licensing, which has to do with the large share of agricultural goods, steel, textile and consumer goods in Hungarian sales abroad. The first three items are internationally regulated by QRs, whereas the political priority of maintaining a well balanced domestic market, not liable to hectic price volatility explains the fourth. For instance, in October 1995 the export subsidy on wheat was revoked and the exports of maize was prohibited to avoid serious disruption on the domestic market. Therefore, it might be a special feature of Hungarian trade régime that *exports are more regulated than are imports* - itself a sign of generally liberal attitude toward foreigners' market penetration.

<sup>11</sup> Here various tax exemptions and loopholes abolished only in the 1995 customs law provided strong incentives to speculation, e.g. cars could be imported as personal belonging (in tourist traffic), or apported to JVs with 0 customs duty. These are, however, textbook bases of regulatory failure rather than matters of commercial policy deliberations.

Meanwhile, it also explains why Hungarian national commitments do not cover non tariff barriers.

The UR agreement on agricultural goods compelled Hungary to *give up both of its major protective means* during tariffication. Meanwhile the US and the EU have declared their 20 per cent decrease in aggregate measure of support (AMS) completed by their 1986-1993 measures, allowing for no improvement (even a deterioration) for Hungarian market access. In turn, Hungary managed to avoid mechanic reliance on schemes for calculating customs equivalents. If these turned out to be negative or below bounded items, national offers could be made. In regulating domestic support schemes, *de minimis* regulation was allowed. Supports below 5 per cent of total output value or sectoral AMS below 5 per cent did not have to be decreased; supports could even be increased to these levels. Of the 17 product groups that were involved, 5 had a negative support; wheat, maize, barley, rice, eggs, and milk was below 5 per cent. By gaining allowance for high (double digit) inflation a sizable room in calculating subsidies were opened through interpretation.

In the area of industrial goods Hungary agreed to a 28 per cent weighted average cut in MFN customs from 9.7 to 7 per cent, with 95 per cent of tariffs bounded. The major point at this time was to secure a sequencing harmonised to EA, which was attained: a 7 year transition period was approved; spread to 2001. However, with the accelerated implementation of the EA *90 per cent of industrial imports will arrive dutyfree by the year 1999*. The US was granted a 40 per cent concession for 15 per cent of Hungarian imports, with the unilateral liberalisation of textile and steel trade rejected. The UR textile agreement lagged behind the EA. Hungary adopted a very cautious stance here, feeling the problems unilateral disarming created for this sector, and agreed to a liberalisation to 2005, with special safeguards retained for all items not integrated in the multilateral agreement. While originally Hungary did not sign the agreement on subsidies and public procurement, *by joining the WTO it agreed to the subsidy code*. Later a Law on Public Procurement conforming to WTO standards was adopted (see below). The change on subsidies was explained by the EA, which already compelled the country to adopt a much more stringent EU

version of state aids policy, complying basically all subsidies to be brought in line with EU practices. Furthermore, from 1996 the Association Council will adopt rules of implementation (though no controls) of these (Suba-Varga, 1995, pp. 74-75). These steps raise *qualitatively new standards* in terms of *transparency, promulgation, coherence, rollback schemes, publicity and even in administering* these supports in a traditionally unknown fashion. It will take time before both industries and the administration will have adopted to these new standards. Antidumping legislation does exist in Hungary, however companies have mostly found it too costly and too sophisticated a means until now. Instead they prefer quotas (which can be set as early as January, as was the case in cement<sup>12</sup>) or reliance on chambers, administering licensing. With binding international treaties narrowing the scope for these, more rather than less reliance on this is to be expected in the years to come. Incidentally, it will be a sign of growing sophistication in employing means of trade policy.

The Hungarian protocol on GATT accession in 1973 had contained a special *safeguard clause on selective measures* if imports grew disproportionately or there was a threat of it. With signing the 1994 GATT this procedure *proved illegal* and fell under universal WTO discipline. Only in the agricultural and textile branches is selective protection allowed, with selective measures falling under general prohibition.

Among the new areas of the 1994 GATT is the binding of *public dues other than customs*, but exerting similar effects, like fees, taxes and the like. Such additional costs were at 3 per cent in 1973 and were doubled to 6 per cent by 1993. The 1994 GATT bounded these and compelled contracting parties to decrease these proportionate to services. Previously quoted EA and CEFTA agreements started to decrease these: with abolishing licensing a 1 per cent fee was *abolished*, and statistical fee was also *decreased* by 1 per cent. This means a loss of fiscal revenue and increased market access for foreign suppliers. As quotas can be maintained only in case of IMF testified balance of payments difficulties, retaining the global quota on imported consumer goods, as well as customary application of this means in the steel, cement and textile sectors is

<sup>12</sup> cf. *Világgazdaság*, 10 January, 1995.

becoming increasingly inconvenient. It is hardly by chance that analysts (Török, 1995) call for more reliance on NTB on grounds of industrial policy. The problem with these is manifold. First, many agents in both business and the state administration lack the sophistication needed to employ these procedures. Second, the 1994 GATT has made a series of arrangements *positively outlawing* the previously widespread discriminatory application of these, allowing for countervailing measures, dispute settlement bodies and appeals, while requiring transparency and even-handedness, and in principle, national treatment of foreigners by the authorities administering these rules. Hungary's accession to the EU makes it unlikely that the country can, and indeed, should adopt arrangements contrary to the letter and spirit of the single market (the heart of *acquis communautaire*, unilaterally adopted in the EA). Therefore the room for applying these means in most sectors is very narrow, indeed.

As it seems today, two sectors are likely to emulate protectionist practices of advanced countries with success: *defense industry and pharmaceutical industry*. Both can employ such considerations which are hard to judge on formal criteria: security. On these grounds the former has already requested (Isaszegi, 1994) and partly gained lasting preferential treatment of 'its own' subcontractors, though surely not on a scale comparable to the US. In the drug sector producer interest, social pressure to lower prices and the fiscal interest to contain subsidies (having grown from 50 m \$ in 1993 to 250 mn \$ 1994)<sup>13</sup> together helped put together a list of basic medicines. Only these are subsidised by the social security system. These tend to exclude foreign suppliers, having made large advances in penetrating the previously closed Hungarian market. Both the list and its administration has a distinctly 'buy national' flavour. As the coincidence of three mighty interests produces a very strong case, it is unlikely that outsiders can effectively outmaneuver this arrangement.

These special cases apart, the process of import liberalisation in industry can be described in a 3x3 matrix. In terms of substance, there are three lists of commodities undergoing *accelerated*, *normal* and *decelerated* pace of liberalisation, respectively. Following the timing in the EA (to which both CEFTA

<sup>13</sup> cf. *Világgazdaság*, 7 Sept. 1994.

and WTO commitments were tailored), three periods were set. 1992-93 served for *preparation*; 1994-96 has been a phase of *quick customs concessions*, esp. on the normal list, while 1997-99 serve for *decelerated* concessions, with a concluding tariff average of 12.1 per cent. According to the summary of Borszéli (1994, pp. 26-27) the accelerated list is dominated by engineering products (45.5 per cent) chemicals (24.2 per cent), metal products (11.5 per cent), plastics and rubber (8.1 per cent). The normal list consists of engineering products (31.3 per cent) chemicals (21.0 per cent), plastics and rubber (8.4 per cent), metal products (6.7 per cent). The deceleration list also consists of engineering products (30.6 per cent), metal products (9.9 per cent), chemicals (11.0 per cent), and textiles (8.1 per cent). It is interesting to see that the share of EU skyrocketed from the 26 per cent of 1988 to 43 per cent by 1991. However, following rather drastic concessions *it has stabilised* ever since, climbing to only 45 per cent by 1994, jumping again to 61 per cent in 1995, thanks to the accession of Austria (a largest trade partner), Sweden and Finland. This data series shows the absolute *predominance of factors extraneous to narrowly conceived trade policy* in shaping the major patterns of Hungary's external trade. The collapse of Comecon and the enlargement of the EU clearly prevail over commercial policy measures, like EA or CEFTA. However, the very same figures do show that the talk of excessive opening (fashionable in some political quarters and in the theoretical literature) is basically unfounded, as these are not reflected at all in the macrodata.

Coming back to opening up the Hungarian market, the following summary assessment can be made. As listed in the present section, basically *the entire armoury of Hungarian market protection has been demobilised* by subsequent bilateral and multilateral trade negotiations. While this is truly good news in the longer run and also in theory, in the *short run it has created problems*. All the more so, as 1994 was an election year with overpoliticised economic statements floating around. Especially the farming lobby felt disenchanted by their deteriorating market access and by the very restrictive stance of EFTA and new EU countries. It is hardly by chance that calls for tactical customs increases in the range of 30-60 per cent abounded, for e.g. cattle, pig, poultry, wheat, maize, barley, sheep, oilseed, milk (Kaczay, 1994; Vámemelést...,

1994). These calls had a relatively easy way this time. First, contrary to obvious theoretical considerations calling for a separate agency to ensure freedom of trade (Winters, 1995), the ministry of international economic relations (MIER) was merged to the ministry of industry, a bastion of protectionism. Though the latter could never dominate over the much shrewder and better qualified international trade people, the latter were put on the defensive. Second, the then minister Mr. Pál (1995) made no secret of his seeing his hands unnecessarily tied by the international agreements, not allowing for either new quotas, nor across-the-board tariff increases. In this atmosphere the farming lobby has ensured that new, *higher tariffs were introduced already from 1 November 1994*, i.e. two months before the new GATT took effect.<sup>14</sup> These spread between 20 and 147 per cent, and the importation of several items, like pork and potatoes, fruit and vegetables fell under licensing. This more was seen as a patriotic move overruling protests from abroad and aiming at a 15 per cent decrease of food imports (Pál, 1994). This move was obviously counterproductive, allowing the EU to require a restoration of the *status quo ante*, thereby effectively nullifying even that protection which were legitimate under the hard fought GATT compromise. The *insecurity of suppliers*, having to live with semiannual protocols providing smallish preferences in an autonomous fashion until 1997 also fell back to agricultural exporters. Feeling the trouble the ministry of agriculture attempted to increase production subsidies from 9.5 to 17.0 bn Fts from 1995 to 1996<sup>15</sup> while retaining all previous subsidies at 'historic' levels (*Világgazdaság*, 31 October, 1995). Unsurprisingly, it provoked immediate protest - from Washington. Producers, adversely affected by the move, as well as retailers immediately protested (*Magyar Hírlap*, 26 Oct, 1994) indicating a high degree of arbitrariness in the choice of tariffs. Additional fiscal revenues proved negligible.

In an other move extraneous to commercial consideration the government introduced a *temporary flat 8 per cent surcharge on all imports* from 20 March 1995 to be phased out by 1 July 1997. This was motivated by serious

<sup>14</sup> The joint decree of the MIT and MF No. 27/1994 on changing the customs tariffs. *Külkereskedelmi Tájékoztató*, 1994/45.  
<sup>15</sup> 1995 actual export subsidies are put at 44 bn which is to decrease to 26 bn by 1996 according to the Ministry of Agriculture (*Magyar Hírlap*, 12 Dec. 1995). The GATT level would have been 20 bn in 1995.

current account disequilibria and was meant to split the effects of a very large devaluation: 9 per cent plus a crawling peg, adding up to a 29 per cent total devaluation by end-1995. These moves have certainly mildened the pressure on Hungarian producers in the short run. They are also uniform, thus not subject to arbitrary manipulation. However, the elimination of this surcharge will be all the more difficult in mid-1997 as both the Budget and firms tend to get quickly accommodated to the new comfort, provided by this step. Administration of both levying and reimbursing this item proved somewhat chaotic. Authorities had started to collect it months before actual rules of implementation were agreed among governmental departments (Tevan, 1995). Investment goods and exports were meant to be exempted, but getting things done in a perplexed, slow and poorly motivated bureaucracy proved nightmarish and incalculable (in terms of who receives what and when) (Bóc, 1995). This move though certainly instrumental in producing a turnaround in Hungary's current account, having shown a deficit of 1.5 bn \$ in the first three months and closing with 2.4 bn \$ deficit in the whole year of 1995, proved paradoxical, indeed. It reinforced the fiscal orientation of the entire customs system, which became manifest with the introduction of customs deposit and the rule of immediate customs payment (Arnold, 1994). This approach has only been reinforced by the *new Law on Customs*<sup>16</sup>, effective from 1 Dec. 1995. Not only does it institutionalise the above measures, but strengthens the use of customs authority as a means of fighting the irregular economy and crime (e.g. para 155, 157, 175, 179, 180, 185-6). This dimension is, though undrestandably, following quite a different logic than WTO, thus its administration will require a high degree of circumspection and a lot of common sense. At the theoretical level, the danger obviously arises in any case, when the economic regulatory function of customs may become hostage to considerations alien to trade policy, since clumsy implementation may well kill the best ideas. In concrete terms, entering the Hungarian market may become difficult if formalities and procedures, aiming at raising fiscal revenues and persecuting economic crime prevail. This *did not use to be the case over the last decade*, which allows us to expect a generous and flexible interpretation - if, for no other reason, in preparation for EU accession.

<sup>16</sup> Promulgated in: *Magyar Közlöny*, 1995/104.

## Impact of Other UR Commitments

Hungary has not been in the forefront of fighting the new WTO rules on trade related investment measures (TRIM), as it deemed necessary to fight their harmful side-effects only. It has already agreed to GATT paragraphs III and XI requiring national treatment and prohibiting quantitative restrictions. Hungary has had a long history of debates over FDI, involving discussions of partial incentives employed in other, then-socialist countries. This has led to a theoretical rejection of relating imports to exports, prescribing domestic shares and the like. Owing to small country size obliging large TNCs to transfer their technologies or patents did not seem realistic. On average, the narrative of FDI in Hungary (Hamar, 1993) is indicative of this form's expansion parallel to the breakthrough, when a weak state administration was in no position of requiring various plan-targets to be fulfilled. Interestingly, rules of origin in the EU provided a most influential incentive to push for domestic contents (a task which proved quite difficult e.g. at Suzuki Hungary). Besides experiences of various export promotion programmes in the post-1976 period kept alive the insistence of authorities on exporting projects. Until 1989 foreign exchange controls, too, were used to press for more exports. With the liberalisation of currency accounts that year, however, this means had lost relevance.

There are two areas where TRIMs are still in use. In agriculture certain subsidies are available on condition of improving export performance over the preceding year<sup>17</sup> - this, however seems to be a temporary measure moving on the margin, to cope with overproduction in a single year. More interestingly, the minister of industry has repeatedly publicised an idea, as reported first in (N. Vadász, 1995) of giving incentive to exporting firms if their sales grows by more than 25 per cent, or gain 50 per cent tax rebate if they invest for exports more than 1 bn Ft (100 mn DM). Given that previous customs free treatment of

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<sup>17</sup> Joint tender of the ministries of finance, farming and industry and trade on additional export subsidies in farming. *Külkereskedelmi Tájékoztató*, 1995/41.

apported items were abolished by the new Customs Law, this aims at restoring the interest of large investors - clearly against the stipulations of the 1994 GATT. It would, therefore, be expedient to retarget these incentives to forms that are in line with new international rules, like regional or structural support schemes.

As far as *trade related intellectual property rights* (TRIP) are concerned, the story consists of two parts. Signing the EA Hungary has committed itself to create full protection of TRIP by 1996, where the leasing of recordings, pharmaceuticals and agricultural chemicals figured high on the agenda. During the GATT talks, however, the US enforced also a bilateral deal, ensuring e.g. pipeline protection for medicines, i.e. a discipline more stringent than the one finally approved in the WTO. Hungarian exceptions from the latter follow EU practices for obvious reasons. Following the Council of Europe guidelines Hungary, too, joined the EU stance of defending European cultural substance from unrestrained overseas competition. Co-produced films e.g. qualify as national. Decision No 49/1995 of the Parliament<sup>18</sup> has declared Hungary's accession to UNIDROIT, while another decision, No 42/1995<sup>19</sup> declares Hungary's accession to the Geneva convention on the registration of audiovisual artworks. As copyright protection and patenting has a long history (with respective institutions functioning for decades) the real enforcement problem seems to be in fighting piracy on computer softwares and in persecuting widespread illegal trade in recordings. Severing of the Customs Law, critically evaluated above, may serve as a way of improving the state of affairs.

The *GATS* extends WTO discipline to many new areas in perspective. However, in its present form only the skeleton of a future creature came about (Cline, 1995). Importantly for Hungary, GATS makes allowance for the special circumstances of transition economies, allows for non discriminatory restrictions for balance of payments reasons, even for defending the level of reserves, and does not rule out subsidies as a matter of principle. As consolidation and privatisation in the banking sector did require precisely this, it is an important specificity. In order to join WTO, Hungary concluded bilateral agreement with 8 countries (USA, Canada, Sweden, Finland, Norway, Switzerland, Australia,

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<sup>18</sup> *Magyar Közlöny*, 1995/36.

<sup>19</sup> *Magyar Közlöny*, 1995/29.

Austria) covering 56 subsectors, besides joining the general understanding on liberalisation. The choice of sector was made in an autonomous fashion, the list of concessions was bilaterally dovetailed. Important exceptions to MFN treatment are river transport (due to traditional preferences among countries along the Danube) and road transport (also due to existing international treaties).

An important exception to overall liberalisation is in the *financial sector*. The interest in cross-border banking and the interest in building up and privatising a domestic banking sector are mutually exclusive. Therefore until the majority of banks had been privatised by late 1995, no major breakthrough could be expected. The Law on Insurance<sup>20</sup> strengthens controls, enforces licensing, and requires a permission at the sale of decisive shares in major institutions. Interviews with senior officials also support our reading of the law being a protective measure for the domestic sector, when it limits insuring, intermediary and counselling activities of foreign partners. In the banking sector the conclusion of the consolidation operation and major reorganisations in 1995 have led only 4 out of the 41 banks in the red, these accounting for a mere 3 per cent of the grand total of balance sheets. The privatization of Foreign Trade Bank in 1994, followed by the privatisation of the largest retail bank OTP through the London stock exchange in 1995, and selling off 40 per cent of the shares of Postabank, another large retail institution, further the successful sale of Budapest Bank in December 1995 are all indications of the *rapid improvements* in this area. According to current plans privatisation of the remaining two large banks (Commercial Bank and Credit Bank) will be due in 1997/98. Therefore by the time EU accession talks will take off, more active implementation of the spirit of GATS will have been possible.

Though Hungary did not agree to MFN treatment at public procurements in 1993, the *Law on Public Procurement (LPP)*<sup>21</sup> effective from 1 November 1995 actually *employs many of the concepts elaborated in the GATT/WTO talks*. It is hardly by chance that representatives of foreign firms were among the first and most enthusiastic supporters of this law. It creates transparency, competition and clear procedures for an area previously under complete discretion. The relevance

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<sup>20</sup> Promulgated in: *Magyar Közlöny*, 1995/101.

<sup>21</sup> Promulgated in: *Magyar Közlöny*, 1995/41.

of this novelty will be enhanced by the establishment of the Treasury Office (TO) from 1 Jan 1996, which will apply the LPP stipulations *in a compulsory order* for a growing number of institutions.

The LPP covers not only state agents, but municipalities, social security directorates, specially administered public funds and firms with exclusive rights. In compliance with the GATS value limits all these bodies must publicize their purchases (including services). A Council on PP was set up which includes representatives of the competition office, the attorney general, chambers of trade and industry, unions, governmental departments. This Council has the right to pass decisions on the outcomes of tenders. A special *gazette* carries all tenders, the Council decides publicly and the procedures, as well as the points of evaluation are publicised in due time. Para 24 secures *national treatment* for foreigners, para 30 ensures that the tender is not made public at home earlier than abroad. Para 40 *prohibits* the use of *technical specification* as a means of *discriminating* foreigners. The obligation to a written and public explanation and the right to appeal to courts (para 89) make biased, arbitrary decisions very hard to sustain. As far as other services are concerned, though GATS does recognise construction and professional services, as well as the right of persons offering these to move across the border, however very restrictive labour market policies of countries like Austria and Switzerland make this much of an empty shell. Regrettably, though understandably, Hungarian legislation too follows a line of narrow restrictions. Recent decrees<sup>22</sup> are conceived so as to filter out foreign labour in all cases except intrafirm transferees, top officials and 2 per cent of employees in foreign owned firms. Strengthening the role of chambers of industry in licensing both exports and imports of construction services<sup>23</sup> is of course a call for protectionism. The new law on media, submitted to Parliament in January 1996, erects an entry barrier in electronic mass media, whereas the printed media is already characterised by a dominance of foreign publishing firms. Hungary showed interest in the GATS telecommunications agreement. This was not, however reciprocated by the EU. Finally, in the areas of subsidies and privatisation Hungary did not commit itself to national treatment. The new

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<sup>22</sup> Decree No 4/1995 of the ministry of labour in: *Magyar Közlöny*, 1995/65.

<sup>23</sup> *Magyar Közlöny*, 1995/92.

privatisation law<sup>24</sup> does declare the need to maintain foreign interest in privatisation (para 2), commits itself to equal treatment of all agents and to publicity (para 3), requires, as a rule, competitive bidding (para 28) but also allows for various preferential schemes and lasting public property. In practice, esp. following the year-end sales of 1995, foreigners do not seem to face discrimination in either large deals or in strategic sectors. However, this has to do with *practicalities* at administration rather than the *rules* of the game. As seen in some other cases, actual practice could well have allowed for adopting a more transparent and *binding international legal regulation*, as the GATS would have been.

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<sup>24</sup> Promulgated in: *Magyar Közlöny*, 1995/38.

## International Dimension of Domestic Economic Policies

As documented in detail in the introductory section, the *rate of exchange* was used exclusively as a means of monetary policy in the 1989-94 period. March 12, 1995 signalled a change in régime<sup>25</sup> by the introduction of a crawling peg. This was complemented by a restrictive monetary policy, with money supply growing only half as quickly as nominal GDP in current prices. Fiscal cuts, especially related to subsidy cuts, privatisation, marketisation of public services and setting up the Treasury Office also follow suit. Therefore *commercial policy has been relieved of the burden of previous years*, when maintenance of external equilibria used to be its major responsibility, with no or insufficient support coming from related policies, especially monetary and exchange rate policies.

The real question in this respect is how much such a trade oriented exchange rate policy relates to ambitions of full EU membership. In this context it is particularly important not to mix up tasks and policies of various horizons. Full EU membership, too, may entail a longish interim period, as the Spanish case of a 10 year transition indicates. Therefore it would be wrong to mix up objectives and means. The objective is of course, price stability and market maturity in line with OECD practices. The means, in the medium run, however must be a more flexible exchange rate policy, as long as core inflation and expectations come down. This enables commercial policy to become more flexible internationally than it used to be, without endangering domestic policy objectives. A further, rather trivial point is the need for *more coherence* among fiscal, monetary and exchange rate policies, which would allow to overcome some of the more obvious imperfections in Hungarian economic policies. From *our perspective, agriculture, subsidies, labour market and remnants of discretionary decisionmaking* are the prime candidates for improvement. A serious, next to immediate task will be to accommodate the entirety of economic

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<sup>25</sup> For a convincing theoretical background of this evaluation cf. a piece of the IMF resident representative in Hungary (Kopits, 1995).

policies to the *phasing out of the import surcharge* by the second half of 1997. This seems less of a problem for trade policy, if restrictive monetary policy, fiscal cuts and a crawling peg can safely be assumed to be still in operation at that time. As the 8 per cent surcharge is flat, it does not play a role in commercial policy in the narrower sense (though it did enhance effective protection). It seems more problematic from the fiscal point of view. It is known that the surcharge has produced in three months the revenues fiscal authorities expected for the rest of the year, i.e. 9 months. By 1996 fiscal cuts and social security reforms could not proceed as radically as envisioned by finance minister Lajos Bokros. Resistance of unions and the lobbies resulted in a 4 per cent increase in marginal income tax rates for 1996. In other words, 1997 will probably see a great demand for additional fiscal intakes, there will be a great temptation to retain a very efficient means of revenue raising, rather than antagonising various quarters by expenditure cuts. Alternatively, replacement of the surcharge by indirect taxes, as hinted already by the finance minister, would be distortionary and run against the spirit of WTO agreement. This challenge may press authorities to rely more on the restrictive interpretation of the Customs Law with the resultant dysfunctions.

Meanwhile, legislation has finally passed the *Law on Foreign Exchange*<sup>26</sup> liberalising basically all *bona fide* transactions. This makes the forint convertible not only for current account transactions, as required by article 8 of the IMF, but also renders *most abstentions and reservations by the Hungarian party outdated* in GATT, CEFTA and EA in terms of *payments restrictons*. Moreover, given the very liberal conditions of foreign acquisitions and corporate establishment, further owing to lack of restrictions on profit repatriation, a *considerable degree of capital account convertibility* has also been attained. Foreigners deliberate to buy Hungarian bonds, treasury bills etc. can set up JVs. Para 31 of the law allows for Hungarians to buy equity abroad if it is 10 per cent of the shares of the company (or more). Para 12 abolished the obligation to convert export earnings to local currency (only repatriation requirement remains). This saves 4-5 per cent in cost for large exporters. Foreigners are allowed to run convertible forint accounts in Hungary (para 59), and are also

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<sup>26</sup> Promulgated in: *Magyar Közlöny*, 1995/99.

entitled to buy fixed assets (para 37). Even land can be acquired with the consent of the municipal administration (para 89/6). It is basically short term credit operations, banking and clearly speculative equity deals abroad that remain prohibited. From the trade policy perspective the Hungarian *forint is convertible from 1 January 1996*, and remaining steps of financial liberalisation will possibly coincide with the country's EU accession. Actually the Law on Foreign Exchange is more liberal than many pieces of existing legislation, thus it will take time until the latter will have been fully harmonised. The customs law, the various laws on financial institutions and the law on arable land are obvious candidates, and so are several stipulations of the tax administration (which also tends to be overburdened with fighting criminality at the cost of coherence in economic regulation). Thus the Law on Foreign Exchange may serve as an anchor for further legislative changes in the years to come.

The other obvious anchor for molding domestic policies is the EA. The *Hungarian government* already published a *White Book* of its own covering the *22 priority areas* of law harmonisation to the EU in February, 1994. The EU, for its part, also published a White Book in July 1995, which is, however, fairly general, aimed at all associated countries, making no allowance for their differences. The latter is not a legally binding document, whereas the former is a schedule of concrete actions. In the course of structured relationships several areas have proceeded in the harmonisation. *Competition policy* is one of them. It is all the more important, as competition does not fall under WTO discipline, the latter lacking traditional remedies and lasting sanctions (Llyod and Sampson, 1995, p. 703). On the other hand, the single market does require an approximation of approaches.

By signing the EA Hungary agreed to abolish all public trade monopolies in five years. It agreed to update its 1990 competition law<sup>27</sup> to prohibit vertical catels and abolish decretion on waivers. Hungary also agreed to make a *consolidated catalogue of state aids*<sup>28</sup>. If it will ever become up to date and

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<sup>27</sup> It originated in Law No 4/1984 on Unfair Market Behaviour which was already built on the EU/German concept of persecuting misuse of dominant market positions. This was updated by the 1990 law setting up the antitrust agency.

<sup>28</sup> By October 1995 the ministry of agriculture claimed ignorance of such an exercise (Dutka, 1995). Other sources report of the departments of finance and industry finishing the first preliminary assessment of state aids for the years 1992-93 (Becky, 1995), which also looks somewhat lagging behind schedule and lacking operability.

public, it will launch a useful discussion over future measures. 90 per cent of the subsidies are formally granted in a normative procedures, like closing down mines, restructuring railways or subsidising export credits.

Particularly important is the oversight of *regulated sectors* (Vissi, 1995, pp. 9-13). Natural monopolies, like the gas, electricity, water supply, postal services and the railway lines are regulated by sectoral laws, including provisions to protect consumers and limit monopoly pricing. In all of these areas private provider and competition are positively fostered by the state. It is difficult to see, however, how considerations of contestable markets could be assured in the rush privatisations, when the competition office delegates only one representative to the board of the privatisation agency, with no veto rights. The quest for fiscal intakes and quick deals is known to favour package deals, which are burdened with a notorious history also in other sectors like portable gas, vegetable oil or retail trade. In an other area, municipalities are often regulators and proprietors of local companies in the meantime. This should certainly be discontinued. In the consolidation operations of 1991-94 neither in banking nor in the enterprise sector were general rules on state aids and competition policy observed, which is but one reason to hope for a final and unconditional discontinuation of such practices in the future. The *deregulation programme*, launched in January 1995 may help overcome entry barriers caused by regulating several activities, like consulting. Public monopolies are likely to be constrained to military goods, drug traffic, issuance of banknotes and coins, trade in nuclear and psychotropic materials.

As this far from exhaustive list illustrates, trade and competition policies will increasingly become twin brothers in fostering civilised market behaviour in a maturing Hungarian economy. It would be important to ensure that such areas, which used to be exempted from this approach, like agriculture, financial institutions and the environmental regulation be fully integrated into the overall policy package aimed at market liberalisation. Only *congruous regulatory practices*, conducted *coherently by various public authorities* may become more effective in the years to come.

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