KATALIN BOTOS: BURDEN OF THE PAST AND CHALLENGES FOR THE FUTURE

What happened in 1990?

A political change of regime which declared that private property as one of the democratic rights regained its *raison d'être*. This shook the foundations of the former economic system, too, since it had been based on the state ownership of the means of production and had been centrally controlled. This is also true in the case of Hungary, although our economy was a 'modified centrally planned economy' and a bit different from the others. In Hungary a fairly broad scope of economic interests was introduced, and the elements of market, prices and supply and demand were given a greater play in the change of the processes. But, essentially, central will, too, manifested itself here, at least, in an 'indirect way' through the establishment of such a system of economic regulations which directed the economic development of the country in compliance with central objectives.

Naturally, declaration of the right to private property is much simpler than to make it the basis of the economy. This process is privatization which is not unknown in the Western world either since here, too, the privatization of state property is on the agenda. However, in East-Central Europe there was more in question than that: the proprietary attitude that had been seriously harmed over the past forty years had to be restored in the economy.

The dilemma with which the democratically-elected government was faced from where to take the owners if there were none. Wealth can be distributed - there were also theoretical roots and representatives of this in Hungary - but the easily-acquired property might be easily lost as well. Moral hazard would have been greatly encouraged by the distribution of national wealth based on the right of the citizenship but even by the acquisition of property besides a .....% loan. Therefore, Hungary chose the privatization of cash.

Simultaneously, the country made a decision on who would be the owners of Hungarian wealth in the near future: they would be foreigners, i.e. if we sell state property for money, there should be enough capital to purchase and that was a total nonsense. The proportion of net savings to GDP of Hungarian population was minimal, almost zero. (Csillik, 2002) (Table)

Choice in this field was rather narrow because the per capita debt of Hungary was the highest among the countries of the region (Table) and for the debt-servicing the inflow of operating capital was wanted. (Botos 1990). The author of this paper pointed out the inevitability of this when the programme of the party which changed the regime was under elaboration as well as in her scientific papers preceding the change of regime. (Botos, 1989)

If the question is raised why the Hungarian economy and society were the most indebted, I myself give the following reply: <u>Because it was rather the first in the introduction of market elements but the reforms were not and could not have been so far-reaching that the society might have observed the problems of a half-reform.</u> Probably, this accentuation seems to be strange but it is one of the most important statements in connection with recent Hungarian economic history. The widely-known economic thesis of the socialist-controlled economy is that soft budgetary limits - the expression has been used by János Kornai

- stimulate overspending. Parallel to the existence of state property, the decisions of the bureaucracy are not restricted by strong personal interests which are bound to the acquisition, maintenance and growth of property and, thus, wasting is always restricted from the outside, from the other side. Let me add to this that the dictated rates of foreign exchange restrictions, together with the mechanism of external trade of the CMEA, encouraged Hungarian economic units to the US$/Rouble conversion which was one of the most important sources of indebtedness. The CMEA external market was „a consumer” of Hungarian products. The Hungarian 'New Economic Mechanism' created interest in exports and Hungarian economic policy did not recognize that beside non-market exchange rates, this stimulated an exaggerated demand for convertible foreign exchange, which would result in indebtedness. Naturally, in the emergence of debts the significant deterioration in terms of trade which was the result of the oil price explosion and to which the country had not adjusted properly, played a role as well. By the revaluation of forint - that lacked all economic bases - the then ruling financial policy reduced the impacts of this change and disoriented the economy.

We could not get out of the debt trap with the help of our IMF membership (1982) either; it only made our debt manageable. Owing to the restrictive IMF policy, unaccompanied by real reforms, the average annual growth of Hungarian economy in the 1980s was hardly 1%.

Thus, the change of regime made a stagnant and indebted Hungary independent and democratic in a political sense. However, the concept of political democracy was erroneously the synonym of welfare for Hungarian society. They expected that the growth of the freedom of decision-making would result in better decisions which would increase social welfare. Instead, a drastic economic recession ensued. (Table) A decade was needed for the Hungarian economy to reach again, after the recession, the economic levels preceding the change of regime.

What was the main reason for the economic recession? It was that Hungary fell between two stools. As an economic thesis, this statement seems to be rather ridiculous: however, it well characterizes the situation in its entirety in which the country, similar to other East European countries, found itself after the change of regime. The CMEA integration had already fallen apart and EU integration has not yet received us. The reorientation of external trade - though Hungary launched it fairly rapidly - could only be partial since the goods which only met CMEA standards could not in practice be sold anywhere else. It is worth having a closer look at the change of the structure of the external trade over the decade. Here it should be pointed out that pushing a country's economic structure to and fro will be accompanied by huge losses. HUNGARY IS A FERRY BOAT COUNTRY. Its external trade orientation has drifted to and fro during the past six decades. Before World War II, Germany was our most important commercial partner with about 30% of our external trade. The trade with the Soviet Union did not reach l%. In 2002 Germany is again our leading partner with a similar proportion and, out of the disintegrated ex-states of the Soviet Union (the “NIS”), our trade with Russia, that is very important in energy supply, is slightly above 4%. Practically, the capacities suitable for the production of unsaleable goods are not needed. Superfluous capacities meant losses the burden of which was of course transferred to the Hungarian population. The question was only that how, when and to whom they would be transferred.

Challenges

Simultaneously, the change of regime had to face the following:

-- to maintain solvency and manage debt-service,

-- to re-orient external trade to solvent markets,

-- to wind up or consolidate companies which became insolvent owing to their unsaleable products,

-- to stabilize the banking system the position of which deteriorated due to insolvent partners,

-- to solve the social welfare problem of people who lost employment,

-- to launch economic growth and reduce inflation.

In addition, the switchover to the market economy and building up the internal system required by the EU had/have to be implemented. As has already been mentioned, out of these the greatest problem was <u>privatization.</u> The route to the acquisition of EU membership obliged us not only to take over Community norms (*acquis communitaire*) the work of which seems to last for many years and with which we still have something to do but <u>to acquire OECD membership</u> as well. And that was impossible without the liberalization of foreign exchange policy, including the <u>free flow of capital.</u>

Let us see what has happened in this field over the past decade! It will not be easy to discuss these questions in a logical order because things are closely interrelated: the management of foreign exchange debts with the policy of external trade; that interrelates with privatization and foreign exchange liberalization; that with the development of the Hungarian money and capital markets; that with the consolidation of the banking system and, that with the adjustment of the Budget... In spite of this close interrelationship, I shall try to study the elements of this chain one by one for a better understanding.

Debt management and external trade

The first government of the change of regime, the Antall administration, was aware of the fact that it could not afford the luxury of non-payment although it was demanded by several political forces. 'We have nothing to do with the debts raised by the dictatorship' - they said. Regrettably, there is no room for this argumentation in international capital markets. At most, some assistance and rescheduling can be forced by the threat or, perhaps, the fact of non-payment. But the price of this step would have been the shaking of the confidence of the capital markets and it is interesting that first among the socialist countries and for long alone Hungary financed itself through the capital markets even in the former system. It is interesting, indeed, because it was a positive phenomenon; it provided cheap sources to the country from abroad - had they been utilized more properly! It is absurd that those that financed themselves by bank credits and state loans fared better. These countries - I think of Poland, primarily - had better negotiating positions with their partners since banks had already written off a part of their losses and in other parts of them political motivation could be better asserted. It is true that, in addition to this, considerable immigrant masses with a strong American lobbying force were also required. But I managed to talk to absolutely authentic economic politicians and I have learnt from them what a great role good tactics of domestic policy and the confidence between the leaders of the country and financial experts played in the rescheduling of Polish debt. Regrettably, this situation was not characteristic of Hungary and I would not like to go deeply into its reasons. We did not find acceptable the offer to sell Hungarian debts to an investor of an extraordinarily high capital strength or to swap them for participation in ownership because we intended to avert overwhelming one-way economic influence. The route was left for us to perform due debt-servicing at the sacrifice of great restrictions and the IMF promised to lend a hand to this if we met its conditions. (Conditionality.)

In 1990 we balanced the Budget and continued to liberalize several economic fields. In 1992 under the stimulation of the IMF, we introduced one of the strictest bankruptcy laws which was too strict according to later evaluations. It led to the collapse of more companies and businesses and, eventually, to a greater degree of state intervention and a greater loss of the national wealth than necessary. The 'ruinous' companies could be purchased rather cheaply by domestic investors who obtained good information over privatization and by foreigners as well. But non-payment appeared in the balance of banks and generated banking consolidation - again, it can be said at a greater cost than was justified. The Hungarian economy, that restored its credibility abroad, raised more loans than necessary through the National Bank of Hungary (NBH), refilling its foreign exchange reserves. As a consequence, some growth could commence in the second half of the cycle which was, of course, concomitant with a deficit in the balance of payments but the country had reserves for some years. Undoubtedly, the size of the deficit developed by the end of the first cycle and at the beginning of the second political cycle would have devoured reserves and/or would have increased indebtedness - which had already been critical - compared to the indicators of external trade, so under normal conditions it could not be increased. It is indeed true that there was no time to wait and see as to what impacts on exports the brand new businesses, which realized investment imports, would generate because the Horn administration introduced drastic restrictive measures in 1995.

This was called the 'Bokros package' in popular Hungarian parlance which meant the introduction of extra customs duties, drastic depreciation, and budgetary restrictions. Here the dilemma of foreign exchange policy should be mentioned: in the first cycle, the forint was revalued and in the second one it became devalued by crawling peg depreciation that had also been introduced by the Bokros package. In the spring of 2001 the government and the NBH management decided to discontinue the crawling peg depreciation and to introduce broader bands. As a result, the forint has been revalued somewhat in the markets but we cannot speak about an overvaluation since it started from a devalued position. As far as external trade is concerned, of course, the slight under-valuation favours exporters but it considerably increases inflation. This is why the first administration did not implement a more drastic devaluation. When remarkable devaluation had to be done, it pushed inflation up ten percentage points. A more stable arrangement of the foreign exchange situation was achieved by the launching of massive privatization which was also part of the package of measures in 1995. The rapid large-scale privatization resulted in the inflow of several billion dollars that was spent, basically, on the accumlation of reserves and debt servicing by the government. Some economists thought that a part of the incoming amounts had to be spent on domestic developments and the stimulation of domestic economic life but this conception was realized only by the third government of the change of regime, i.e. by the Orbán administration. (Tables)

The state of foreign exchange may be hardly understood without an overview of <u>external trade relations.</u> First, it can be said that the <u>Hungarian trade balance is steadily negative.</u> It had been like that over the past 50, 60 and 70 years in convertible relations. We were in active balance when we were in clearing relations, be those German-Hungarian clearings or bilateral ones between the CMEA countries and Hungary. These outstanding debts have not been cleared at all or, if they have been, they have been done slowly and at a much lower price. (Even recently in May 2002 the sale of Soviet debts occurred which stirred up a hornets' nest in domestic policy.) Services, primarily, tourism, show an active balance, improving the balance of payments. Therefore, it was a rare phenomenon in 1990-91 when the trade balance became active. The reason for that was the already mentioned reorientation of exports to solvent markets but also the fact that imports were limited because of recession and stagnant companies used up their reserves. As far as <u>the structure of exports</u> is concerned, there were great changes in this field. (Tables) (Statistics of centuries, Central Statistical Office, 2002). The most remarkable change is that of exports of the agriculture and food industry, previously making up one-fifth of exports, had decreased to about 6% by the turn of the century.

The cause of this is complex. On the one hand, the Soviet market has been lost. The Soviet partner became insolvent and, in addition, they were given assistance in the form of food aid by Western countries. Here the EU got rid of its surplus and make a positive political gesture to maintain public peace in a poverty-stricken nuclear power. However, we were unable to sell in our traditional market as we had done before. Who would buy things for money when he is given them free of charge? Never and nobody has ever compensated the Hungarian economy for the losses caused in this way! It is sure nobody wanted to damage Hungary on purpose but, actually, this happened owing to internal and external motivations. On the other hand, it is also true that the forms of production organization of agriculture, existing before the change of regime disintegrated. Formerly, agriculture was in a special position: it was conceived as a strategic branch in the Kádár era. In Hungary it belonged to political consolidation that meat should always be available in shops. A very effective model emerged between the large-scale/co-operative estates and the so-called private household farming plots - based on the self-exploitation of peasants - which provided a significant portion of agricultural exports. With the introduction of the so-called compensation privatisation, this organizational form and system of relations ceased. Numerous and ineffective small farms have emerged, and cultivation on farming leases has become widespread. In addition, food-processing enterprises and shop chains were purchased first and foremost by foreign investors. The latter often bought only a market and brought in their own goods or, if they made a real purchase, they set the prices and dictated compulsory credit relations and deferred payment from a monopolistic stand. The profitability of agriculture declined dramatically which led to the loss of market.

Trade in several former export goods decreased. Hungary had been the greatest bus exporter before. Nowadays Ikarus sells only a fraction of its former volume. At the same time, motor car construction was launched in the first cycle by the investment of Suzuki the Japanese multinational which provides one fifth of the Hungarian market. That was followed by several other investments, thus, Hungary is now also renowned for the manufacture of Opels. Having been restructured in this way, vehicle exports continue to be a fairly great and, in practice, a decisive part of Hungarian exports. That means it is moving with international booms which actually strengthens the dependence of the Hungarian economy on external trade.

Privatization and economic growth

The first years of change can be called 'crisis' if the degree of the decline of production and the concomitant social problems are considered. True enough, this crisis differed from other ones in history to the extent that it did not result in a totally hopeless morale. Although a great many people got into difficult situations owing to the termination of their jobs, political changes freed much positive energy into Hungarian society. This, too, had some precedents. Over the economic reform attempts, the Hungarian economy also tried to do much that had been 'invented' to increase efficiency by the Western world. Such 'innovations' were the GMK and the VGMK (the Economic Working Community and the Company Economic Working Community, respectively) as well as the household farming plots which had previously been established in agriculture. From them, one million small businesses emerged as soon as a proper legal framework had been formulated; in addition, the loss of work places forced people to find solutions. Proof of Hungarian vitality is the operation of the micro-businesses which exist at the boundaries of the grey economy and implement self-employment with minimum capital. Of course, their effectiveness is low. The structure of the Hungarian economy has been divided into two extremes, namely, into advanced large companies with in practice foreign capital and micro-businesses deficient in funds. Small and medium-sized businesses, which are the basis of middle-class development in our interpretation, are 'goods in short supply.' Certainly, the bulk of employment is guaranteed by Hungarian-owned companies which produce a smaller part of GDP while a negligible part of the population are employed by export-oriented multinational and other foreign-owned companies. It has not come off either what we have expected from the inflow of capital, i.e. the latter will bind small businesses to itself and let 'the motor effect' operate. Actually, we have an export-oriented - mostly foreign-owned - economy and a stagnant one. This means that, in the items of the balance of payments, the dividend transfer appeared in the second half of the decade. Having taken into account interest service as well, it is a considerable burden in the current account. The coverage of the external trade deficit and the current transfers in connection with foreign capital, should be assured by the inflow of foreign capital investments which are not determined, fundamentally, by the possibilities of privatization any more but <u>the ability to attract capital to the economy.</u> To assure this, favourable per capita wage costs, qualified manpower, proper infrastructure as well as low-income burdens are necessary. This is given since, in Central Europe, corporate tax is the lowest in Hungary and significant investment incentives stimulate inflow.

Thus, the economic indicators for the past decade demonstrate such a growth curve which, after a 12% decline in production occurring in two years during the early 1990s, crept from the negative domain into the positive one again by the mid-90s. Thus, it indeed took a decade for economic performance to exceed the one prior to the change of regime. The first government aimed at crisis management, the second one wanted to initiate export-oriented growth and the third one's target was the stimulation of domestic businesses, strengthening the middle class and the growth of consumption. The question has frequently been raised: Why could not programmes for the stimulation of business be launched during the first government? The answer is that ruins had to be removed; losses had to be cleared away; new owners with vision had to be 'created' and production had to be restructured. The assurance of the necessary resources for this was made possible only after the solution of the debt crisis. An economy cannot be pushed either by cheap credit or state capital allocations while the financial system is not at a level where it could trace the utilization of injected capital and assess the creditworthiness of businesses. A great many of bad loans have been accumulated, the working out of which caused serious problems and became a great burden on the Budget. Just like the other transition countries, the reorganization of the banking system had indeed to be carried on the shoulders of future generations.

However, part of the losses were spread immediately. Consequently, money in circulation grew which was concomitant with the increase in prices. Inflation spread the burden of the losses of transition across society because, it should not be forgotten, the government of the change of regime showed determination in pulling down the barriers to the market economy. (It had no alternative either, since even on the verge of bankruptcy, the IMF recommendations had to be met to the greatest extent.) Businesses which had already lost their markets became stagnant for a long time, while their better parts were organized into limited companies and later, bought by smart managers. During that time, the bank loans and public debts of businesses had been accumulated. Those were settled in the losses of wealth, the winding up of companies, their privatization at a very low value, and the undertaking of the consolidation of banking debts.

The first administration represented some continuance in the reform efforts preceding the change of regime, since the concept of partial privatization had been elaborated before 1990. Privatization between 1990 and 1994 was rather slow, not without problems. Privatization, implemented without proper care, sold what could be sold from the lesser items, i.e. commercial networks. Thus, it determined the fate of the

Hungarian food industry and agriculture since purchasers who were mostly foreigners preferred suppliers who belonged to their scope of interest to Hungarians and, even if they bought domestic products, they did it at an unfavourable price. The broadening of the agrarian gap, which became so wide as nowhere else in Western Europe, is the greatest proof of this fact. (Table: Agrarian gap). Even if, during the Kádár era, agricultural production had a priority to some extent, this came to end after the change of regime. The great losers of this change are Hungarian peasants and pensioners, who are less able to enforce their interests. That became particularly obvious during the second cycle which was that of the left-liberal coalition when the real value of pensions decreased radically.

The decision of economic policy characteristic of the second administration is attached to the package accepted by Mr. Bokros, the then Minister of Finance, which proclaimed a privatization campaign with massive foreign capital for the improvement and stabilization of the external balance of payments. This era induced a 'take-off', i.e. export-oriented growth. As has already been referred to in the study of the structure of exports, the latter made the Hungarian economy highly dependent on external booms and bound it very tightly to the EU. Economic policy preferred not only export-oriented investments but, through privatization, it attracted capital to infrastructural territories which basically also produced for domestic consumption. The privatization of telecommunications and the energy sector has raised serious problems of regulation unresolved even today, and it opened up the possibility for the repatriation of income which is exclusively earned in the forint zone. This is a great burden to the balance of payments. It generates an almost infinite chain of the inflow of capital since the foreign exchange reserves to the repatriation of profits can be raised only by ever newer inflow. This chain would be broken only if there were capital exports the repatriated incomes of which would result in a better equilibrium in the balance of payments. Naturally, the 'price' of this would be the assurance of foreign exchange reserves to capital exports. As far as the most eligible sector is concerned, that has been the consolidated banking sector. There is no banking sector in Western Europe - and, probably, anywhere in the world - which would be owned by foreigners to such an extent as the Hungarian banking sector. This creates a strange situation that, over the forthcoming decades, probably indefinitely, the transfer of Hungarian tax forints in exchange for the consolidation vouchers will make up the bulk of the profits of the foreign-owned banking sphere. (Just to remember: The reorganization of banks after World War II occurred in a similar way. But there, at that time a) non-market interest was paid, b) the bonds had been repurchased in proportion to the profits of the amount of money issued by the *Bundesbank*, c) at that time, German-owned banks were in question.)

Taking all this into consideration, the third cycle projected a growth curve the basis of which would be, basically, the domestic economy and internal consumption. The larger proportion of GDP was aimed at consumption, so a more rapid growth could also be achieved only by the rise of consumption. Naturally, that would come off only if consumption were met by domestic supplies, fundamentally. That is, the third - liberal/conservative - administration - sought to combine the export-oriented growth with that generated by the domestic market. Therefore, it proclaimed an institutional state support of the domestic small and medium-sized businesses. For the realization of this approach, a more favourable international economic environment would have been needed. Since there was again an oil price explosion in the world and the struggle against terrorism, too, this had a double effect on economic growth, namely, it affected some branches negatively and caused a boom in others, the development in Europe slowed down. The subsequent waves of energy prices did not help to stir stagnant Japan either. The improving indices of the USA emerging out of recession did not assist us much at that time. However, the mobilization of internal demand was inevitably concomitant with the deterioration of external trade. The left-liberal coalition which won the elections in 2002 will try to implement a combined policy again, parallel to the privatization of the extant state property.

Protection of the value of money

The inevitability of the depreciation of money in Hungary need not be proven. The explanations above obviously demonstrate that the losses affecting the whole of society appeared in the fact that money fell in value, inflation increased and the depreciation of money, together with its economic environment, was to lead to the devaluation of forint.

Since there were foreign exchange restrictions in the former regime, devaluation was carried out by the state. Although the new Act on the NBH, passed in 1991, provided that the protection of the value of money is the greatest task of the Central Bank, it also put down the necessity of supporting government policy. In practice, that resulted in controlled devaluation, i.e. exchange rate policy was subordinated to anti-inflation efforts. The forint was rather <u>revalued</u> in the first cycle but after an initial price leap, inflation reduced almost by half. Of course, the revalued rate of exchange attracted imports and interest in exports was not satisfactory.

The drastic devaluation in the second cycle, which was an important element of the policy based on export-oriented growth, was concomitant with the practice of the crawling peg depreciation. Out of several disinflationary methods, financial experts chose the former, emphasizing that credibility and calculability are the means for the reduction of additional charges and that of inflationary expectations. (Disinflationary policy is the decrease of the rate of inflation.) It is unquestionable that the reduction of inflation had come off again by the end of the cycle. Since, over the period of the third administration, the NBH maintained its crawling peg depreciation policy for quite a long time, inflation reached the critical point of a double figure. As it became evident that, in compliance with the Maastricht requirements, a further radical reduction of inflation was to come, it was reconsidered whether the impact of the crawling peg depreciation would not reverse in the meantime, i.e. through devaluation, it would actually increase inflation. Since in the third cycle profit repatriation took place, this reconsideration did not violate to a great extent either the interests of foreign capital settled in Hungary, although exporting sectors complained about the decline of exports stimulation. In the first year of the new century the NBH, the autonomy of which had been strengthened considerably in compliance with EU requirements, ended the crawling peg depreciation and broadened the bands in the expected way but with unexpected rapidity. That meant the revaluation of the exchange rate bound to the euro. This change had a beneficial impact on inflation although the latter did not continue to decrease considerably due to several reasons. On the one hand, with conscious income policy the government increased the level of minimum wages; on the other hand, the budgetary consequences of the growth based on quickening domestic demand may also have generated inflation. Undoubtedly, it is difficult to follow a disinflationary policy parallel to the stimulation of demand. The former is also hard because the government will be deprived of a part of the seniorage incomes owing to inflation. To avoid this, the administration estimated the expectable decrease of inflation higher than it was in reality which resulted in a decline in the expenditure side of the Budget in real terms. This step in economic policy reduced general and proportionate sharing of taxation in a selective way; made the interested parties invest private incomes in the operation of public institutions (hospitals, schools) in a spontaneous way. It reverted a part of the costs of services to the user; i.e. the principle of solidarity was violated. The patient himself took the necessary medicines to the hospital, the parents of pupils painted and renovated schools. The sources liberated like this - since the income side did not alter unfavourably due to the higher than expected inflation - could be used for the stimulation of businesses and put into the service of demand-booming state policy beside partial compensation of problems.

As has been pointed out, the winners of the fourth cycle intend to continue the latter policy by other and more normative methods. The means of the stimulation of businesses will be the reduction of tax burdens. They would like to avoid the revaluation of the forint in order that exports and further inflow of capital should be stimulated. They want to fight against inflation through the reduction of public expenditure and further decentralization what will jeopardize the sources of the so-called Széchenyi Plan (the support scheme of small businesses), which the winning coalition has promised to continue.

Challenges for the future

The greatest event of the forthcoming four years will be our accession to the EU. The proclaimed point of time is the middle of the cycle as far as it can be kept. In this respect we have to face three factors of uncertainty: (l) Will domestic policy be able to meet the conditions of accession? (2) Will the other acceding countries be able to do so? and (3) Will the internal tensions in the EU not increase in the coming period?

One of the most important tasks of Hungary's economic policy will be the reduction of inflation. Without this, there is no accession. And we have seen in the past one or two years that inflation will be 'stuck' if the rate of growth is emphasized. Since over the past two decades in Hungary stagnation has been typical while Europe has made progress even if not a rapid one, catching up with the EU average requires Hungary to have a rate of growth much higher than that. The acceleration of the rate of growth has started over the past 4-5 years but has not reached the one according to which the catching up would be possible in the foreseeable future. The planned rate of growth of 5-7% could only be realized under exceptionally favourable external circumstances and the boom in the domestic economy would require a long-term and very consistent economic policy. Actually, this is hindered by the frequent changes of conceptions and the adjacent institutional frameworks as well as the unresolved tensions. The management of indebtedness has been resolved, and external debts partially turned out to be internal state debts. In the market of state bonds there is a significant amount of capital, so the management of state debt is not problematic but rather fragile. Economic policy may not deviate from the path to which investors' profit expectations have forced it. It would be good and desirable to finance the greater part of state debts out of domestic sources, however, this would necessitate a greater amount of more dynamic domestic savings. (The latter would be needed for the financing of small and medium-sized businesses as well.) This is not assisted by the growth policy which stimulates consumption.

The problems of agriculture have not yet been resolved. The profitability and interest enforcement of this sector is catastrophic; the rise of producer prices will be inevitable. Over twelve years, no competitive economic and property structure has emerged either in the form of co-operative large-scale estates, or competitive family farms. Actually, we can witness the struggle of the two conceptions but, regrettably, we can see they extinguish each other in practice. In this process the management of the question of land is playing a part, too. The representatives of the national/conservative as well as the national/liberal trends want to postpone the acquisition of land by foreigners, regarding it as the sell-out of a factor of production which is absolutely limited, to the remote future. But in the absence of this, the shortage of capital in agriculture will be more outstanding and the price of land will remain low. However, the left-liberal coalition claims that efficient operation has a priority even at the price of the participation of foreigners. In this question there is a strong confrontation in the society. Regional policy cannot be regarded as consistent; to this, in addition to the Ministry of Agriculture and that of Finance the co-operation of at least three more ministries (agrarian, water, environment) would be needed. To this end, the division of power between the coalition parties has never been favourable.

By the way, over the twelve years the question of land has been determined critically by the law of compensation. Over this step, the original property relations have not been restored but so-called compensation vouchers could be exchanged for land.

However, the significant part of the ageing population could do nothing with the newly-emerging small holdings parallel to the shortage of capital and declining physical strength, although at the beginning they wanted to cultivate land or rather, they had dreamt about doing so. They would have liked or would like to sell their property and use up the monetary value of the compensation. The solution found in the third cycle, i.e. eventually, the repurchase by the National Land Fund would lead to implementation of a delayed monetary compensation. Illegitimacy could not be remedied by a plain redistribution of national wealth; the aggrieved persons had/would have a demand on profits lost, or a proportion of them. Now state incomes have been spent on repurchase - if you like it: on renationalization -, so a kind of income redistribution has been taking place. Obviously, if using up is aimed at, it will have an inflationary impact as well.

The restoration of profitability can be achieved not only by the rationalization of production and costs savings. The rise of agricultural produce will be a general <u>cost/inflationary challenge.</u>

Another danger to bringing down inflation is the increase in <u>public expenditure.</u> Therefore, the administration will regard further privatization and the reorganization of great welfare systems as being of fundamental importance. In the past decade, we have spoken more than it has been necessary but there were only some reforms implemented. The cancellation of socio-political benefits would arouse great social resistance, however, the privatization of the health care system may be attempted by the government, although the impact of this on current expenses would result only in slight savings: the salaries in health care are so low that a genuine change would cause a pressure on expenses inevitably but capital injection may save some central expenditure.

Further on, the government cannot afford to discontinue the development of infrastructure. Here there is an exciting question whether consequent public acquisitions and tenders will not knock domestic firms out of the market. In this case, the implementation of a project may be and, probably, is cheaper but obviously, the possibilities of income acquisition of Hungarian small and medium-sized businesses will not be improved. Also, it should be pointed out that on our way to fulfilling EU obligations, external to the Budget, have to be incorporated into the balance of public finances if it is undertaken by a state-owned company and balances should be kept within definite percentages. Eventually, with respect to the per capita GNI a Hungary with more modest results seems to accede to the Union if it comes off in the projected period. This will be brought about by income transfer, owing to foreign capital injection greater than necessary and the reduction of public consumption which draw off real income. The foreseeable tendencies may be concluded partly from objective circumstances and partly from the realization of the government conceptions of economic policy. The difference between scenarios may be reduced to the question of whether, parallel to growth based on domestic market, the conditions of EU accession may be met or the per capita growth of GDP may be achieved with a greater inflow of capital. In any case, the playing field of economic policy is rather small.