The New Path of Hungarian Price Policy

Bela Csikós-Nagy
National Board of Materials and Prices, Budapest

SUMMARY: *After the oil price explosion of OPEC in the case of Hungary the adjustment to the new relative world market prices has proven to be a much graver problem than had been assumed. The correction of the economic control system will take place based on the guiding principles of the 1968 economic reform. First of all, the normative character of financial instruments is to be strengthened, secondly pricing will become competitive and in this way a new path of price policy will be inaugurated. The decision has been taken that competitive pricing is to be introduced in most branches embracing 73 per cent of industrial production, but cannot be introduced in agriculture.*

I

In the sixth year after the oil price explosion of OPEC we can state the following: in the case of Hungary adjustment to the new relative world market prices has *proved to be a much graver problem, consuming much more time* than had been assumed.

Due to the deterioration of the terms of trade Hungary lost overnight nearly 7 per cent of her national income. Nevertheless the living standard has not been lowered nor have investments been decreased. The country has rather taken upon herself indebtedness to foreign creditors, expecting that by about 1979 the disrupted equilibrium could be restored. Soviet-Hungarian relations were an exception because there was a possibility for the solution of the problem on longer terms.

In short, in 1974-75, when we were elaborating long-term plans and working on the fifth five year plan comprising the 1976-80 period, the prevailing view was that as far as a planned course of economic growth was concerned *we would not have significantly to depart from the trends that had been established.* The positive experiences gained with the new economic control system introduced by the 1968 economic reform played a role in forming this view. The reform had brought to light new energies for growth. In the paper I wrote for the tenth anniversary of the New Economic Mechanism I called the 1967-1974 period the *golden age* of Hungarian economic history and this evaluation was generally accepted. In that period the rate of economic growth accelerated by 1-2 per cent in an annual average and fluctuated between 5.5 and 7 per cent per year. Gradually productivity became the only source of economic growth. The formerly chronic deficit balance of payments with capitalist markets came to an end. Development got established on well-balanced foundations and some reserves of foreign exchange could also be acquired. This had not been achieved by a restriction of imports; and what is more, the share of imports in the supply of the population had considerably grown. While the living standard was rising at a faster rate than before, supply also became better. The shortage of goods, so typical of former periods, got limited to some products only.

It was in the wake of the 1973 oil price explosion that economic conditions became unfavourable. The negative phenomena appearing side by side with development are present even six years after the price explosion and have even become stronger in certain relations. We are struggling against problems of the production structure. In this connexion it should be pointed out that in the CMEA, the economic integration of European socialist countries, the expectation has been increasing since the sixties that socialist countries poor in energy and basic materials should more and more rely on their own resources and on such as are available on the world market. Due to this the Hungarian economy becomes more and more dependent on the world market.

Every per cent of the annual 3-4 per cent increase of the national income raises import from the world market by 1.3-1.5 per cent. And when the yearly rise of the national income is about 5-6 per cent, over 2 per cent growth of import from the world market falls to the share of every one per cent increase of the national income. That is to say, the acceleration of development disproportionately accelerates import from the world market. Exports are unable to keep abreast with this. The export potential of the Hungarian economy has grown in harmony with the requirements within the CMEA and is, in an unchanged pattern, not suitable for acquiring export markets for trade currencies. That is why a revision of our economic policy became necessary. And indeed this took place in 1977-78. The first form of its expression is the 1979 plan, whose characteristics are the following:

– it has set the rate of growth lower, at 3-4 per cent and

– has devoted the greater part of the additional income for export surplus; the investment volume stagnates and real wages can rise only by one per cent annually.

At the same time the 1979 plan indicates the *new circumstances*, which are to determine the course of Hungarian economic policy in the coming years, or, at least, in the first half of the eighties. That is to say, we are compelled to slow down both the rate of growth and the raising of the living standard for several years. At the same time we must solve the problem of the production structure, i.e. to improve the international competitiveness of the Hungarian economy. Hungarian economy must be launched on a new path of growth, by which the acceleration of growth can take place only based on foundations internally balanced.

Under such circumstances it seemed to be important to investigate what changes should be carried out in the Hungarian economic control system to achieve a qualitative turn. This critical investigation covered planning, regulation and organization alike. The work aimed at determining the whole mechanism of planned growth for the sixth five year plan, which comprises the period 1981-1985, is still in progress. But it is already in a state advanced enough for making some essential statements about it.

The correction of the economic control system will take place *based on the guiding principles of the 1968 economic reform.* Today the 1968 economic reform is criticized mostly because it has not transformed the institutional framework of the economy in spite of the fact that the system of economic regulation has been profoundly changed with the abolishing of obligatory plan targets. The trend of economic policy, according to which exemptions and preferences in a wide scope have practically weakened economic efficiency is a further target of critisicm.

As far as it can be judged today, changes in economic regulation will take place in two principal directions. First of all, the *normative character* of financial instruments is to be strengthened, i.e. the range of exemptions will be considerably narrowed down. Seen from this aspect the change can be considered as a more consistent application of the guiding principles of the 1968 economic reform. Secondly, pricing will become *competitive* and in this way a new path of price policy will be inaugurated. Regarded from this aspect the change can be considered a further step of the economic reform.

II

As a result of several years' scientific discussions the basic *perspective* principles of the price system have been elaborated and approved. Here we can only touch upon these principles:

1 The narrowing down of budget price subsidies, i.e. the harmonizing of retail prices with relative inputs.

2. The creation of an organic connexion between domestic and foreign trade prices in a way which offers the possibility of introducing competitive pricing.

3. The reduction of taxes levied on production costs; the creation of a dual price level system in which the bulk of the centralized income should be realized in the form of turnover tax, i.e. fixed in retail prices. This would pave the way to a foreign exchange reform, perhaps with the introduction of an unified foreign exchange rate, by abolishing commercial and non-commercial rates; i.e. the dual system of rates.

4. The enhancement of the flexibility of the price mechanism in a way which renders an adjustment to the changes of market values possible without considerable delay.

In connexion with the sixth five year plan a price re-arrangement is in progress. We are aiming to put basic perspective principles into practice as much as it is possible at present. In the following I should like to go into these questions.

Shifting over to rational retail prices was a requirement already of the 1968 economic reform. It was then that the idea was formulated that everybody should pay for a product the price it costs. Of course, we never meant this to be a mathematical model. Even in the long run we want to maintain the price level, low if compared with inputs, of products serving basic cultural, health and social purposes as well as of basic necessities. We also intend to maintain prices created by taxation higher than value and aimed at ensuring state incomes, as well as at restricting the increase of the population's consumption. Certain articles, such as alcoholic drinks, tobacco, cigarettes, etc. belong to this category and recently measures meant to constrain the too fast development of motoring by means of prices have been taken too.

However, for the time being the deviation of retail prices from inputs covers a much wider range. The budget is obliged to devote very significant amounts to finance deficit prices. The *price preferences meant to be abolished are classified into two groups*. The first *touches only Hungarian citizens* and comprises e.g. rents, fares, local services etc. The other group includes price preferences more organically connected with foreign trade or with such invisible exports as e.g. tourism. Here energy, fuels, chemicals and foodstuffs are of a major significance. The view emerged according to which price preferences closely affecting foreign trade should be – at least partly – abolished. On the other hand, the abolishing of deficit prices concerning only Hungarian citizens can be delayed.

In recent years Hungarian price policy has taken steps with a view to getting the consumption structure of the population better adjusted to new relative world market prices. It is mostly connected with this that while in the first half of the seventies the consumers' price level rose on an average by 2.5 per cent annually, in the second half of the seventies this increase has reached about 4.5 per cent. Anyhow, it may be assumed that in the first half of the eighties the dynamism of retail prices will be closer to that of the second half of the seventies than to the first.

The most debated question of the price re-arrangement in progress has been the scope and the extent to which the *introduction of competitive pricing* is possible in the near future. Pricing can be considered competitive if the input price of natural resources is determined by world market import prices and the output price of end products by the world market export prices. The decision has been taken that competitive pricing is to be introduced in most industrial branches embracing about 73 per cent of industrial production, but cannot be introduced in agriculture.

What is the situation in *agriculture*? The present procurement price level of agricultural products corresponds with the export price level, however, this latter can be maintained only because state-owned and co-operative farms can buy fertilizers, plant protecting materials and machinery at prices significantly subsidized by the budget. Procurement prices should be raised by 27 per cent to get the input price correspond with the import price. Moreover, taking export prices as a basis, the procurement prices of grain ought to be raised by about 30 per cent; on the other hand, procurement prices of vegetables and fruit, of livestock and animal products should be reduced. In other words: relative prices determined by production costs are radically different from world market relative prices. Under such conditions it did not seem to be possible to introduce competitive pricing in agriculture in the short run. On the other hand, efficiency requirements with a view to improving international competitiveness could be determined. We hope that by the mid-eighties it will be possible to introduce competitive pricing here too. This supposition is connected with the possibility of the introduction of an autonomous price policy of the agricultural sector in the CMEA, as wished by several member countries.

The calculation in the new price system will be based in industry on marginal import costs concerning natural resources. In the course of inflation, for Hungary the import from the world market is the more expensive import relation, because CMEA contractual prices follow the fluctuations of world market prices on the average of the preceding five years. Of course, there are raw materials, whose prices on the world market show a more rigorous fluctuation. That is why, with respect to certain raw materials, there are always periods when the CMEA contractual price exceeds the actual world market price.

This pricing of natural resources differs from the principles on which the price reform of 1968 was based. Then world market prices were used only for the light industry and for certain branches of the chemical industry. In the heavy industry the CMEA contractual price was the basis of pricing, since here the material and technical supply was mostly based upon deliveries from the CMEA. Since then two changes have taken place. First of all, CMEA contractual prices are no longer fixed for five years' periods; prices can be annually revised and, if necessary, modified. And what is more; these sectors have more and more to rely on the world market, too.

The application of world market prices in the sphere of natural resources will have two constraints. In the case of oil we shall take into consideration the saving of transport costs, due to the fact that Hungary obtains the bulk of her hydrocarbon requirements from the Soviet Union and transport is carried out by pipelines. Transport savings will be taken into account with timber too. The second constraint will be given by *self-financing import price funds* with the purpose to stabilize domestic prices of raw materials imported in great quantities. In other words: on the introduction of the new price system the accounting prices for these materials are to be determined, compared to which short-run fluctuations are to be settled with the import funds. This mechanism assumes that when the world market price of a certain raw material fluctuates, but the price level does not change, price movements will get equalized by the price funds. In case of unchanged price levels the deficit in the fund will be financed by a credit on part of the National Bank. Should the National Bank refuse the credit, this indicates that it expects a lasting price rise to take place on the world market, thus the accounting price is to be corrected. By this method we think it feasible to keep abreast with world market price trends, without being affected by short run price fluctuations.

In the price-arrangement the greatest difficulties are caused in the competitive sectors *by adjusting the industrial output price level to the export price level.* In the following I shall enumerate some technical problems: /1/ How can the price level of an industrial branch or an enterprise be controlled by the export price when export for trade currencies constitutes only an insignificant part – perhaps only 10 per cent – of the production volume? /2/ How can the general price level of the industrial branch or of the enterprise brought to a common denominator with the export price level in trade currency relations in view of the fact that the product mix of the two are different, and there are enterprises that sell such products or assortments on the world market that are not subjects to the domestic market? /3/ What role can price calculation play when the price authority does not approve of prices and does not investigate enterprise price calculations but will judge only whether the price level formed by enterprise price policy meets the requirement of adjusting itself to the export price level?

When adjusting the wholesale price level to the export price level, an *export efficiency coefficient* will be used. For understanding this, one must refer to the point that since 1968 enterprises involved in export business have been calculating the average costs of earning one unit of foreign exchange. To quantify this, a simple formula is used: costs are divided by price receipts. Based on this, the wholesale price level can be determined in an indirect way /namely through the average profit margin/, conducted as a function of time. The idea is that in competitive sectors the export price should determine the price level of enterprises and supply-demand relations should govern the relative prices of products.

To carry out such a profound change in pricing is possible only with certain exemptions. To avoid deficit in important sectors the principle of minimum profit must be applied. The difference between the export price level and a price level ensuring 2-4% of profit will be considered as price preference of a transitional nature. That is to say, enterprises in the middle range must adjust their export prices to the profit motive, or else they will meet financial difficulties.

When we came to an agreement about competitive pricing, many enterprises raised the question, *why the export price and not the import price should control the wholesale price level.* The argumentation might be the following: in numerous cases development policy has created enterprises – or perhaps whole industrial branches – for saving imports. Well may such enterprises be expected to sell their products at cheaper prices than import costs, or, at least, not to set prices of such products higher. But if import savings were aimed at by development, why should these enterprises now be qualified to be part and parcel of the export potential? And yet, the price re-arrangement had to adhere to the export price being the yardstick of competiveness, since, first and foremost, the price re-arrangement is meant to give orientation to a structural policy expanding the economy's export potential.

For an economist not so well versed in the realm of a socialist economy it is not so easy to understand why in the issue of the Hungarian price re-arrangement the debate about export and import prices was given so great an emphasis. As a matter of fact – with some exceptions – Hungary suffers significant losses in her sales on the world market. It is not the discriminations I have in mind which will inevitably appear if Hungary, e.g. wants to sell products on the Common Market. What I want to stress are certain peculiarities of marketing policy.

Within the CMEA an enterprise fulfils *export quotas* fixed in bilateral government agreements. This is something profoundly different from what is understood by marketing policy in a market economy. In the latter case the enterprise is out to acquire markets and to keep them. Marketing policy is controlled by the profit motive but profit can only be obtained if the seller adjusts himself to the buyer's requirements. Deliveries in time, and a stable quality are linked with the world market price; so are in the case of machinery, the fast supply of spare parts and a well developed servicing network. Enterprises will easily forget about all this if the main task is the fulfilment of inter-governmental trade agreements.

Finally it is understandable that when we are aiming at a considerable increase of the export potential of the Hungarian economy we have in mind not only a structural transformation and, first of all, the establishing of new capacities demanding major investment but also an improvement of the enterprise management which was launched by the 1968 economic reform, but which has not been consistently carried out.

The price re-arrangement is linked with *taxation reform*, too. Today 5 per cent charges are to be paid after capital tied up in production. In the new price system this will be abolished. At present enterprises have to pay social insurance charges and payroll taxes amounting together to 35 per cent of the wage costs. This is to be reduced to 17 per cent. In 1978 the average industrial profit margin in proportion to price receipts was 15 per cent. In the new price system this is to be reduced to 8 per cent. The decrease of the marginal profit is inevitable. The self-financing capacity of enterprises must be brought into harmony with the conditions, aggravated from the point of the Hungarian economy, of the international division of labour. Over-investment, so characteristic of past years, must be put an end to, since this is, perhaps, the main factor in the unexpected magnitude of deficit in foreign trade.

The changes in the taxation system and the decrease of marginal profit will render it possible that the producers' price level should not rise, but would get even somewhat lower. We should like to carry out a slight reduction of the producers' price level by decreasing the price level of industrial products by 8 per cent or so, while natural resources are getting dearer. Within the framework of the price re-arrangement the price level of raw materials will rise by 15 per cent and within it that of energy carriers by about 30 per cent.

Exchange rates play, as a matter of course, an important role in price regulation in a competitive price system. At present the USA $ is equivalent to 35.57 Forints. The exchange rate to be set for the price re-arrangement has not been finally decided yet, but, presumably, it will not essentially differ from the present exchange rate. In the case of export a tax re-imbursement will take place, similarly to the one which exists in countries of the Common Market, in the form of value added taxes, i.e. turnover taxes. In Hungary the budget will repay the budgetary receipts acquired by natural resources by adjusting the price to marginal import costs.

In 1978-1979 *the retail price level rose more markedly than the producers' price level* in Hungary. Presumably this will characterize the first half of the eighties as well. This should facilitate a perspective foreign exchange reform. For the time being Hungary works with a dual channel rate system, with a commercial and a non-commercial rate of exchange. Harmonized with the expected price tendency the revaluation of the Forint at the commercial rate and its devaluation at the non-commercial rate can be expected. This means that the two exchange rates will get nearer and nearer and by the mid-eighties a situation may emerge in which the introduction of a unified exchange rate may be realistic. It should also be taken into consideration at this instance that, when Hungarian citizens require foreign exchange today they have to pay different charges. That is to say, for Hungarian citizens trade currencies cost more than what is expressed by the non-commercial exchange rate. When introducing a unified exchange rate these charges could be abolished.

By a joint application of administrative and of free prices the 1968 price reform introduced a mixed price mechanism, with a view to enabling prices – within certain limits – to follow the changes taking place in demand – supply relationships, i.e. to use equilibrium prices.

In the past years we have extended the range of free prices in the sphere of retail prices. By 1979 a situation has taken shape in which 55 per cent of the volume of consumption is transacted at administrative prices and 45 per cent at free prices. With the raising of the living standard this proportion will get changed gradually to 50-50 per cent. Calculated at the level of living costs this means a government price guarantee for nearly 70 per cent. This model was foreseen as a perspective in the course of the 1968 economic reform but now we wish to decrease the share of administrative prices to 40%.

In *agriculture* ever since 1957, when compulsory deliveries abolished, price policy has played an extraordinarily active role. As early as then the situation was established in which the government would fix in advance the prices of grain, industrial plants and livestock, products that make up about 60 per cent of the procurement. In the case of vegetables and fruit, of certain animal products and other products, which altogether make up about 40 per cent of the procurement, prices are free, or else the government exerts an influence on them by means of guiding prices, minimum prices etc. This system, maintained by the 1968 economic reform, has proved sound and will therefore not be changed.

In the *building industry*, with the economic reform of 1968, prices have become subject to bargaining, when investment was financed by enterprises' own financial resources or by credits. In this way administrative pricing was reduced to 50 per cent of industrial activity. Following the 1968 economic reform, stricter measures were introduced in the early seventies. Due to the systematic increase of building costs price policy was confronted with the demand to re-establish administrative pricing except for restorations. Accordingly 90 per cent of the volume of production is transacted at administrative prices and since 1973 free prices stand only for 10 per cent. Everybody who knows the peculiarities of the building industry knows how very debatable the possibilities are that can be provided by government price regulations. Now, by slowing down the rate of growth, overdemand of investment will presumably also come to an end, and thus conditions may arise that make the liberalization of pricing possible again.

In the internal sphere of industry essential changes of the price mechanism are planned. Administrative prices will be retained for energy carriers only. All other prices will become free.

However, the parallel existence of administrative and free prices cannot give a full picture of the conditions under which pricing takes place in Hungary. The central guiding of pricing has such supplementary mechanisms too, which mostly play the role of price stabilizing factors. Following the 1968 price reform government price regulations applied various means for achieving a relative price stability in the sphere of free prices. These means are to be used in the coming years too. The following among them deserve special attention:

- Periodical modification of the exchange rate.
- Early warning system.
- Regulations against unfair profits.
- Government price supervision.
- Suspension of independent enterprise policy.

The modification of the exchange rate with a view to preserving a relative price stability means a periodical evaluation of the Forint currency, when the world market price level rises more quickly than can be brought into harmony with the principle of a relative price stability.

The early warning system, i.e. the *obligation to inform* authorities about price increases, is based on the veto right of the President of the Price Office to prevent price rises in certain cases or to delay them.

In the sphere of free prices the mixed mechanism introduced in 1968 applied one single restriction. Unfair behaviour, or *unfair profit* was circumscribed in a general form. The opinion prevailed that in every field where the market situation was in an equilibrium this would sufficiently provide conditions for rational market prices. However, the "buyer's market", so much wished for, did not emerge. Strangely enough the seller's superior position appeared even in cases when domestic orders did not fill up the enterprises' capacity. In such cases enterprises shifted over to export and costs emerging with transitional under-utilization of capacities were counterbalanced by price rises. That is why it seemed to be necessary to work out recommendations for the price policy enterprises should pursue.

III

It is characteristic of the 1976-79 period that Hungarian enterprises have profited more by export than by domestic sales and gained higher profits by export to the world market than by export to the CMEA. This is so because export price are free, whereas administrative prices are used in a large scope in domestic sales. Concerning export in the sphere of the CMEA the yearly correction of the contractual prices is often omitted. But in transactions with the world market enterprises endeavour to make use of the inflationary process. Strangely enough this ranking of the marginal profit turns to its opposite if we regard preferences from the point of sales. Enterprises – as a general rule – will prefer domestic sales to export: and CMEA export to export to the world market.

That is to say, economic processes cannot be understood simply from the aspect of the profit motive in the short run. The view has taken shape in a great many of us that the price re-arrangement and financial regulations in harmony with it alone cannot solve the problem we are facing, i.e. to restore the equilibrium of the international balance of payments. To achieve this market pressure is needed too. By market pressure I do not mean import competition in the first line, but an essential decrease of the issue of domestic purchasing power, that is to say, the creation of a situation in which there is only one way to an optimal utilization of capacities, namely export. And since within the CMEA this export is regulated within bilateral trade agreements in the form of quotas, there is only one way to acquire major orders, namely the export to the world market.

By this, in enterprise management *risk-taking* increases. That is why economists taking part in the revision of the regulation system are aware of the fact that what we are preparing for is not only a change of the economic control system to be expressed in a clear form using the formulae of economic laws. What we have to face is more than that, namely a learning process. The way of thinking of managers is profoundly different when their activity is controlled by obligatory plan targets or when economic instruments are used, i.e. when a freedom of enterprises exists and with it initiative, risk-taking and responsibility are expected. The 1968 economic reform has solved many problems in this learning process. But it has not been able to terminate the deceptive feeling of security created by the enterprises' shifting over all risks of decisions to the budget. We wish to connect the introduction of the new price system with a strengthening of the normative character of financial regulation by the abolishing of exemptions or by their considerable decrease. We expect this to strengthen the price function and, along with it, enterprises' rational behaviour.