REFORM OF THE ECONOMIC MECHANISM IN HUNGARY DEVELOPMENT 1968–1971

Akadémiai Kiadó . Budapest

Edited by Ottó Gadó

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A reform, deeply affecting the whole system of economic control and management in Hungary, was dealt with in the volume *Reform of the Economic Mechanism in Hungary* (Ed. *I. Friss*, Akadémiai Kiadó, 1969). As a direct continuation of the mentioned book the present volume evaluates the experiences of the first years of the reform and the Fourth Five Year Plan (1971–1975) which made it both possible and necessary that the economic tools used in the control system (prices, credit, wages, taxation, foreign trade regulations, etc.) should be improved.

This volume of twelve studies provides a survey of the economic regulators applied so far in order to meet plan requirements and seeks to find out ways of improving these regulators. In addition, it also contains analyses dealing with foreign trade, consumption by the population, the food economy (agriculture and food processing), as well as a review of the economic activities of local councils.

The Editor's introduction explains the reasons why the correction of the reform programme was necessary and also describes the main objectives of the Fourth Five Year Plan.

AKADÉMIAI KIADÓ
Publishing House of the Hungarian Academy of Sciences
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Development 1968 – 71

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Edited by

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EDITOR'S PREFACE

Chapters I–X of the present volume were originally published in Hungarian under the title "Közgazdasági szabályozó rendszerünk továbbfejlesztése" (Further development of our economic regulatory system), Közgazdasági és Jogi Kiadó, Nov. 1970. – Chapters XI and XII appeared in Hungarian in a separate book and from these an extract was prepared for the purpose of English translation.

Each chapter, including the Introduction, differs from the original Hungarian edition only insofar as was made necessary by the closing dates for the manuscripts (September and December 1970). The Fourth Five-Year Plan of the Hungarian economy for 1971–1975 was enacted after the Hungarian manuscripts had been approved and this also necessitated some supplementing. Finally, such explanations and data were added which are of particular interest to foreign readers.

In a sense, the present volume is a continuation of the volume of studies "Reform of the Economic Mechanism in Hungary" ed. by István Friss, (Publishing House of the Hungarian Academy of Sciences, Budapest, 1969, reprinted 1971), but it is also suited independently to give a comprehensive survey of the Hungarian system of economic control and management.

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FOREWORD

Economic control and management in Hungary has for over three years been relying on economic regulators, mostly indirect ones, instead of using detailed plan instructions. Three years are certainly not long a period in the life of a country, still long enough to enable us to give an outline of the operation, efficiency, actual questions and future problems of the new system of economic control and management.

Today we can state with a fair degree of certainty that the system of economic regulators has stood the test. The efficiency of national-economic planning and the rate of economic growth have in no way deteriorated, rather they improved in many respects. This is a highly important point for the assessment of the present state and the lines of further development of the system of economic regulators.

Experience has convinced us that, beside strengthening the planned character of development, the system of regulators offers a large scope to, and what is more, definitely calls for, autonomous initiatives of enterprises. It helps us discern the world trends in technical development, join the ever-widening international division of labour, establish a balance between demand and supply, achieve a more effective allocation of production factors, generally speaking, it ensures a more flexible economy complying with the interest of the national economy.

These three years have also called our attention to various tasks connected with the system of regulators.It has been found necessary to introduce certain modifications in some fields where temporary solutions have been applied deliberately – in order to ensure smooth transition in the first years and to overcome obstacles – and also in fields where certain regulators have proved less effective.

During the five-year period ending in 1970, national income in Hungary rose by 40 per cent, which is a considerable achievement even by international standards. Our industry developed at a satisfactory rate. In 1970 also the growth in productivity, hampered by serious difficulties earlier, showed a remarkable improvement. Reserves and potentialities are still considerable in this field, and we hope that the modified system of regulators will give them a gradually widening scope for asserting themselves.

An important means of increasing productivity and efficiency, not adequately exploited so far, is the improvement of management and organizational work in enterprises. Theory and practice of business organization in Hungary are still far from what can be termed an advanced level, although a more reasonable organization of labour could release considerable new resources. Development in this field can be expected from the program relating to the application of computer techniques.

Agriculture in Hungary has achieved outstanding results by securing a stable level of food supply for the population and also by enabling significant exports. In spite of the floods and inland waters causing damage and unforeseen costs of about 8,000 million forints in 1970, neither our plans nor our budget had to be changed in any substantial way. The fact that the country was able to cope with such surplus costs almost without a hitch is a promising token of the stability of the economy.

As for the investment targets so very important for the whole of the national economy, the five-year plan starting in 1971 concentrates on some eight or ten large-scale economic and technical projects unanimously accepted as fundamental. The presence of certain economic determinants surviving from an earlier or from a more recent past still prevents us from applying a selective development policy of a more decisive nature. However, in the course of the national economic plan of 1971—1975 we shall have to, and we shall be able to, open the paths for a greater freedom of decision.

The living standard of the population has considerably risen; nevertheless we are well aware of the problems still awaiting solution in respect of a more effective proportioning of incomes and earnings, and a smooth and continual rise of the level of living. One of the main tasks of our wages policy is to ensure a more sensitive differentiation by performances and a better implementation of the principle of "equal pay for equal work". Another task is to reduce the all too great differences in the per capita incomes within families by a more appropriate administration of pensions and family allowances which are instrumental means for achieving this end.

Our foreign-trade turnover in 1970, calculated in dollars, was about 4,000 million, which is a considerable amount. A foreign trade of that volume is indispensable for Hungary because a small country cannot reasonably join the international division of labour without wide-scale foreign trade.

The increase of foreign-trade turnover exceeds all other growth indicators of the national economy and, on the strength of the above considerations, this should be looked upon as a healthy process. Direct contacts of the producing enterprises with the world market during the years of the reform have proved useful and fruitful, have rendered our economy more flexible, more ready to react to changes in the world economy, and the direct perception of trends on the world market has promoted a thinking in terms of perspectives.

The stability of Hungarian foreign trade is determined by long-term trade agreements, and contracts on actual development projects, concluded with socialist countries on the basis of a mutual co-ordination of the national-economic plans. In addition, it seems to be a healthy thing to permit world market to have direct impacts upon the national economy, although its impacts must not be allowed to assert themselves with full spontaneity. Market effects and the regulating function of the state must be brought into harmony also in this respect. Interference of state through the system of regulators is both welcome and necessary to an extent where the two factors exert an optimal influence.

The system of regulators has made it possible to meet interstate obligations towards the socialist partners and also to initiate a dynamic phase in the trade with capitalist countries. Also in foreign trade the most important task is to increase efficiency. Today we cannot yet rest satisfied with the commodity pattern of foreing trade and with its economic efficiency. At the same time, we are aware of the fact that uneconomical production cannot be changed overnight; with due regard to economic, political, employment and other aspects, it obviously takes time to develop an optimal economic structure. The modernization of an economy is governed by two factors; one is to make rapid headway in further developing what is best, what is most advanced, the other being to withhold what is the least advanced, or offering the narrowest perspective development. In our policy regarding investments, development and subsidies, we wish to proceed gradually towards this goal.

Considering the situation of the national economy, Hungarian national-economic plan as a whole entitles us to optimism as far as development is concerned, yet we know very well that Hungary does not yet belong to the countries where the growth of national income and the rate of economic development are the most dynamic. The reform, the new system of economic control and management has not yet run its full course; the coming years will witness the unfolding of results which are already in the offing, and this will enable us to achieve our goal — the building of socialism on a higher level.

The studies to follow describe the main conclusions that can be drawn from the operation of the economic regulators over three years and—by making a critical assessment of them and relying on the principles that have proved correct—point towards the future, giving an exhaustive picture of the most important problems of improving the system of regulators.

I welcome the decision of the Publishing House of the Hungarian Academy of Sciences to make available to the foreign readers these studies originally written for the information of the Hungarian public. The methods of Hungary's planned economy have already solicited a wide interest. A foreign-language publication of the experiences and the tendencies of further development will certainly contribute to enhance this interest, answer several problems and show how the implementation of planned economy and central management is interpreted in the Hungarian People's Republic not only in general outlines but also in many details of the problem.

Dr Mátyás Tímár

Deputy Prime Minister

INTRODUCTION

by

OTTÓ GADÓ

1. The main characteristic features of *economic development over the years since the introduction of the reform*—features showing the internal growth conditions, external effects and the impacts of the system of regulators[1]—could be summed up as follows:

The national economy as a whole has essentially been developing in compliance with the objectives of our economic policy. The growth rate of industry, after a slight decrease in 1969, again accelerated in 1970. During the past years the share of accumulation (gross investment) has somewhat diminished but not to an extent enabling us to fully restore equilibrium between demand and supply in the building industry. Consumption has grown in keeping with the annual plans, yet quicker than production. This, in addition to increased imports, resulted in a growth rate of final use exceeding that of production, which can be registered as an achievement. When the reform was launched the market was quiet—mainly owing to central measures taken during the years of preparation—but early in 1969 these favourable conditions deteriorated; yet in 1970—under the impact of new measures and in spite of a rapid growth in consumption—the market can be said to have been balanced.

The stability of the price level has been essentially maintained. Consumer prices and those of the building industry started to rise in mid-1968, but—considering the total price level—have not increased by more than 1—2 per cent annually.

Certain changes can be observed in the major proportions of the national economy—mainly under the impact of developments based on direct government decisions,—but have not resulted—nor could they have resulted during such a short

[1] The concept of the "system of regulators" is understood in this introduction and all studies to mean only the *indirect* economic regulators. The direct instruments of state regulation are not analysed here, although their importance for the implementation of the plan is undeniable.

time—in substantial structural changes. There are signs of favourable changes, pointing towards a better adjustment to market demands, starting in the enterprise sphere.

A wide-scale reduction of working hours[2] has affected many branches of production, and the industrial development of the countryside has been carried on. Owing partly to these circumstances, employment, i.e. demand for manpower, has greatly increased. The growth of productivity in 1968—1969 was not satisfactory, which was largely due to our system of regulators promoting temporarily the conservation of a high employment level, that is, enabling a steady increase in manpower rather than intensifying efficiency. Development in 1970 in this respect was more favourable, thanks to the partial modification of regulators in addition to the influence of factors of social policy and to an increasing labour shortage.

Our foreign-trade turnover has increased at a rapid pace, resulting in a pattern and balance more favourable than expected. In socialist relations we have met our international export obligations. The rate of imports in 1969 was slow, but this was corrected efficiently by a partial modification of the regulators.

The foreign-trade balance with capitalist countries has shown favourable trends. Although in 1968 this was achieved rather by reducing imports, the year of 1969 witnessed a rapid expansion of exports. The growth rate of export in 1970 accelerated—mainly by making use of possibilities offered by boom—yet, owing partly to unforeseen factors, imports showed an even more marked growth. The influence of the system of regulators as a whole is partly responsible for a balance more favourable than expected. Inventories grew intensively in 1968, less so in 1969. Nevertheless, in the non-seasonal industrial branches the growth of inventories was still quicker than that of production. A decrease of inventories in the trade of consumer goods in 1969 had a somewhat untoward effect upon public supply but in 1970 inventories were replenished, mainly owing to a modification of regulators.

The technological development of enterprises has not attained (nor could it have reached) the desirable efficiency during this short period.

Experience gained during the introduction of the new system of economic control and management has shown the principles underlying the reform to be correct. Planned management

[2] A 44-hour working week instead of 48 hours

with the help of economic regulators, activization of market factors, wider scope granted to enterprise autonomy have proved useful. It follows that *the fundamental principles* of our control and management system need not be modified in the course of the Fourth Five-Year Plan. All we need is to improve certain elements of the regulating system so as to allow the fundamental principles to assert themselves more consistently.

2. We assume that the fundamental principles underlying the reform of economic control and management (new mechanism) introduced on January 1, 1968 in the Hungarian People's Republic are known and we can therefore dispense with their discussion.[3]

It seems, however, indispensable to explain some of the basic features of the reform on account of misunderstandings stemming from certain publications abroad:

– the system of economic control and management – also its reform – constitute an instrument for implementing (plan) objectives of economic policy;

– Hungarian economy continues to be centrally planned; the principles, methods and chief measures of economic regulation are determined in compliance with the national-economic plan and in mutual correlation therewith;

– the aim of the reform is to link the central plan with the operation of the plan-regulated socialist market, to let the market have direct influence on the producers, but the main trends and proportions of development are directly determined by the plan;

– the basic questions of the reproduction process are decided upon by the central organs of management; thus the right of decision in major problems associated with the major proportions of the national economy, with the rate of growth and with structure rests with the state;

– within the scope and to the extent determined by the economic regulators established by the state, the enterprises have the right of decision in such matters as the volume, trend and composition of production and realization and the utilization of the enterprises' own resources (serving development targets and the raising of personal incomes).

Thus the backbone and core of the mechanism of socialist planned economy is the national-economic plan which comprises

[3] See: *Reform of the Economic Mechanism in Hungary*, ed. by I. Friss, 1969, Akadémiai Kiadó, Budapest.

objectives of economic policy, the direct decisions of the state and the principal directions of regulation, but unseparable from this core is the system of regulators which orientate enterprise decisions in keeping with the national-economic objectives.

The national-economic (five-year) plan —approved by Parliament—is binding upon the Government as a public body directing and controlling the implementation of the plan, the realization of the economic policy. A specific feature of the Hungarian system of economic management is that the national-economic plan is no longer broken down to ministries and further, to enterprises. The ministries are not given nor do they issue what are referred to as plan instructions. The enterprises (in some cases, the trusts) have been granted a wide scope of authority for taking their own decisions; the limits of enterprise competence are determined by government authorities—usually by the "functional bodies"[4] responsible for the entire economy from different aspects—with the help of regulators ensuring that the totality or the resultant of enterprise decisions shall coincide with the plan objectives of the national economy.

The chief aim of the economic regulators is to influence enterprise decisions, to keep them in line with the objectives and interests of the national economy. The regulation covers the totality of production and embraces to a certain extent also the problems of expanding capacities, which can hardly be treated separately from the former.

The question arises whether the efficiency of central management has decreased by this expansion of the authority of enterprise managers. In our opinion, this decentralization of spheres of authority has enhanced the effectiveness of the central economic management, permitting the central authorities to devote more energy to the main problems of national-economic development. Questions determining the main directions and proportions of development are invariably decided centrally, within the framework of the plans. By evolving economic regulators setting limits to the spheres of enterprise authority we wish to ensure that the enterprise managers, while enjoying wider autonomy, shall act in accordance with the economic policy laid down in the national-economic plan. This is what we mean by saying that central management has become more efficient in this system.

[4] Such functional bodies are the National Planning Office, the Ministry of Finance, the Ministry of Labour, the National Board for Prices and Materials, the National Bank of Hungary, and so on.

It may be asked whether the rights granted to enterprise managers are satisfactory or not. As far as the legal framework is concerned, they are satisfactory. Yet the content of authority depends, in the first place, on the means available to the enterprise and—where the sphere of authority is divided between the enterprise and the supervisory bodies (e. g. price, product turnover)—on how this division affects the content.

This content can be deduced from the economic situation. The level of advancement, the structure of capacities evolved under the old conditions, and the internal and external factors of our participation in the international division of labour have a lasting impact on the system of regulators, and thereby also on the actual possibilities of the enterprises, while the plan, the system of economic control and management and the regulation contribute to a gradual modification of these factors.

Political, social considerations and those of economic policy made it imperative to ensure a comparatively smooth transition to the new system of management under conditions when tensions affecting the whole course of economic development (investment market, balance of payments, etc.) had already assumed a sharpening tendency. In order to prevent the situation from becoming more strained, wide-scale intensive limiting and restricting factors were brought into play initially to ensure stable and safe conditions for production in every economic unit, to put a check on sudden differentiation of enterprises, although they did not have a sufficiently stimulating effect upon technological progress, upon ventures serving the interests of perspective development though involving financial risks.

The kind of regulation aimed at increased safety obviously failed to initiate a more dynamic development. After a while, however, these limitations had to be gradually abolished or reasonably mitigated in order to accelerate development, for otherwise they would have engendered new contradictions and tensions. Nevertheless, the improvement of the regulating system—for instance under the 1971—1975 plan—is invariably governed by the principle of endeavouring to maintain smooth progressivity and to avoid jerks and shocks.

But what is, in fact, to be understood by the often recurring term of *economic regulation?*

Direct state decisions refer to the implementation of some basic development objectives of the national economy and are assisted by instructions concerning the modes of implementation.

The essence of indirect economic regulation is to create specific enterprise interests which connect national-economic and personal interests, and to ensure a tendency of co-ordination among these three types of interests. If the system of regulators operates properly, it takes into account the contrasting interests of the interacting enterprises, channelling their resultant parallel with the interests of national economy.

This regulation relies on making the enterprises interested in

— optimally utilizing the available capacities for producing and marketing commodities meeting demands;

— attaining their output (trade) with the possible smallest inputs, making simultaneous efforts at ever higher quality;

— endeavouring to achieve a comparatively high rate of technological development and in earning the financial means necessary for expanding production;

— ensuring an increase in the personal income of their workers and employees (to the global extent foreseen in the plan) and in earning the financial means for this purpose.

3. The regulators so far applied have not had a satisfactory effect required by the development of the national economy or, in some cases, have not influenced economic conditions in a favourable direction in the following fields:

(a) The mechanism destined to realize the organic unity of socialist planned economy and of commodity relations presupposes that the enterprises come under the impact of a market regulated in compliance with the national-economic plan. Yet, domestic market cannot operate properly without *competition* between enterprises, that is, without market conditions under which the position of the seller and the buyer is at least equal, or that of the buyer more advantageous.

Although measures have been taken to evolve competition, the conditions of economic competition have not yet developed to the necessary extent. Thus domestic competitions have deliberately been given a limited scope, restricted to areas where conditions are favourable and where competition may be expected to yield progressive results viewed from the angle of the national economy as a whole. Owing to the inadequate development of the market, the advantages deriving from the conception of associating plans and market have not yet asserted themselves sufficiently. This should not be ascribed merely to regulators but also to insufficiency of supply and to organizational problems, that is, to interaction of the two.

A further phase of the reform, i.e. transformation of the production pattern requires a gradual development of the conditions of domestic market and competition and, in the first place, a more intensive utilization of the possibilities inherent in import competition. It should also be remembered that many of our producing enterprises compete on foreign markets with foreign companies, and this, too, has a stimulating effect on production, on technological development. Nevertheless, we are trying to stimulate market competition within a reasonable scope, to keep the market-shaping role of monopoly organizations within appropriate bounds and to turn economic activities towards social interests with the help of the planning and regulating activity of the state.

Economic competition is related to the regulators, modifying their influence and also being dependent on them. When establishing regulators, it is therefore necessary to consider the conditions —whether deliberately created by economic policy or existing independently of our decisions—under which the internal market and competition operate, and, at the same time, the regulators should be chosen so as to promote the evolution of competition.

(b) The system of profit-taxation applied makes the enterprises interested in increasing profits by raising its proportion to the production factors (assets plus wages).

The high level of profits attained when the reform was launched permitted a smooth transition to the reform, steady production and marketing and the development of enterprise autonomy. At the same time, however, the concentration on the side of material interest did not favour the improvement of efficiency. The comfortable position of the enterprises was enchanced by subsidies, by exemptions from remittances to the budget, by concessions, etc., even though these were somewhat moderated in 1969 and 1970. Owing to these factors—as well as to insufficient competition—the improvement of economic efficiency has not been acting as an indispensable necessity on enterprises.

The linking of enterprise interests with personal interests usually created a system of intensive "short-term" interests and did not stimulate to undertaking risks for technological development which is of slow return. Methods for creating long-term interests have not yet been evolved. The ministries have not sufficiently availed themselves of the opportunity of combining the remuneration of the appointed executives with factors other than the current year's profit, when assessing enterprise activities.

The system of income regulation used so far has not made it possible to apply uniform principles in the assessment of production factors—assets and wages—additionally drawn into production. Nevertheless the greatest problem is that the costs of raising employment and of raising the wage level—as parts of expenses on live labour—have been evaluated very differently and to a varying extent. This has led to an uneconomical management of live labour, to an unnecessary boosting of the staff. Although the system of wage level regulations has met the basic requirement of preventing the wage level from rising too high, and thus precluded an exaggerated differentiation between enterprises, its effect on labour management and discipline, and its failure in prompting to choose intensive development alternatives, require corrections. (The 1970 modification of wages regulation partly served this purpose.)

In order to ensure the proportion between accumulation and consumption scheduled in the national-economic plan, a central decision has divided enterprise profits into two funds, one for increasing personal incomes and one assigned for development purposes, not allowing any transfer between them. This method — to be regarded as justified and correct under the present conditions of the national economy —has, however, a certain restricting effect on the increase of enterprise efficiency.

(c) One of the main objective of the reform has been to accelerate technological progress and to increase efficiency also by developing a more adequate production pattern. It is becoming increasingly clear that the system of regulators has not completely attained the objectives *as far as the formation of funds for enterprise development is concerned.*

Funds develop—at a relatively high rate—also in such enterprises where development is not justified whereas in enterprises where the national economic objectives prescribe a rapid growth such funds are formed at a rate lower than required. Although this can be promoted with credits, the magnitude of the development fund sets limits to creditworthiness.

The principle of self-financing (that is, the financing of accumulation costs from enterprise resources) is in many respects correct and is to be observed in the allocation of investments also in the future. Practice, however, is not without excesses because self-financing—at whatever cost—of developments scheduled in the plan results in an unjustified rise of the price level (in a striving for so-called self-financing prices) and also prevents the implementation—within reasonable terms of crediting—of certain developments requiring exacting inputs from the given enterprise yet indispensable for the national economy.

In order to achieve a smooth transition and to avoid a differentation more acute than what is tolerable, the formation of development funds was made possible at the start for all enterprises by establishing the extent of subsidies and by a compulsory division of profits. This essentially enables even the less prosperous enterprises to make investments without meeting any particular efficiency requirements. Thus the formation of development funds acts in the direction of preserving the existing structure.

To sum up the main conclusions of our analysis, we may establish that the improvement of the system of regulators is a justified and timely task consisting in a more consequent application of the fundamental principles — made possible by the evolution of the reform — but not in their modification.

The necessity and timeliness of development are indicated by the following:

— the initial system of regulation necessarily bears marks of transitions; a system entirely satisfying the fundamental principles adopted at the start can only be evolved gradually, after a period of transition;

— since the experiences gained so far are predominantly positive, we can safely say that a more consistent application of the principles of the new mechanism and an acceleration of their evolution have become possible;

— in addition to overwhelmingly positive experiences, negative tendncies can also be observed in some respects. These negative tendencies are obstacles, and growing obstacles at that, to the full realization of our objectives of economic policy.

4. *The objectives of the Fourth Five-Year Plan (1971—1975)* also require a modification of the indirect economic regulators. The essential change should not be understood to mean new objectives of economic-policy but a tendency according to which the plan relies more on the observance of efficiency requirements duly taken into account already when shaping the mechanism. And this does not necessitate any modification of the fundamental principles of the regulating system. Yet the objectives of the plan cannot be regarded as realistic unless the system of regulators is moulded in a way permitting a more consistent imposition of both efficiency and equilibrium requirements.

The results achieved so far in building socialist society have created most conditions for insisting on these requirements.

They are included in the Fourth Five-Year Plan in the form of the following stipulations:

— 85 to 90 per cent of the increment of the national income derives from increase of productivity and from a rate of development exceeding average in branches with high productivity. The increase of the national income per earner is to attain 28—29 per cent;

— in the major productive branches (calculated by enterprise methods) the increase of productivity will also be considerable. Increase of production per worker (productivity) will be responsible for 75—80 per cent of industrial production and for 75 per cent of the production in the building industry. Since the number of workers employed in agriculture is decreasing,[5] the full increase of production will be met by enhanced productivity;

— since productive consumption of material grows slower than gross national product increases, the growth of national income will be quicker than the growth rate of the gross national product.

These are strained provisions, but the challange can be met by intensifying the efficiency of economic regulation and by up-to-date production organization.

With due regard to the above considerations, the Fourth Five-Year Plan provides for an economic development permitting the growth of national wealth, a steady and comparatively rapid raising of the living standards, a gradual reduction of the gap separating us from more advanced countries in respect of per capita production and consumption.

Shifts in the basic proportions of utilizing national income and the changes planned in the production pattern promise a more favourable and balanced development.

An annual increment of 5·5 to 6·0 per cent of the national income[6] is scheduled for the period of 1971 to 1975. The efficiency of the plan is corroborated by the existing fixed and circulating assets and by the possibility of increasing them, by the available manpower and the growth of productivity, by the purchasing and marketing possibilities co-ordinated with the CMEA coun-

[5] At present some 25 per cent of the earners are engaged in agriculture.

[6] Computed on a comparable basis, the per capita national income of the population in 1970 was \$ 750—800.

tries, as well as by the existing and presumably expanding relations of Hungary with capitalist countries.

The development planned does not cover all possibilities of quantitative growth. It may therefore be expected that in the course of implementation the producing enterprises will make efforts to exceed the planned growth rate. Lucrative and marketable surplus outputs, endeavours at more rapid growth than planned, are encouraged by incentives.

Conditions thus evolving (some slight excess supply, for instance) may help production to adjust itself closer to needs and promote equilibrium between demand and supply.

A growth more rapid than planned is desirable when

— this is based on a rapid improvement of efficiency;

— it does not jeopardize a proportional rising of the standard of living;

— it does not tell on the international payment positions of the contury;

— it does not even temporarily weaken the internal financial equilibrium.

A more or less steady rate of growth is also an important requirement of a proportional and balanced economic development.

National income and its domestic utilization is scheduled to grow at a steady rate by about 32 per cent during the Fourth Five-Year Plan. The parts of the national income earmarked for accumulation (gross investment) and consumption are scheduled to grow at a similar pace, unlike in the previous period. Consequently, the ratio of accumulation to consumption (about 25–75) will remain about the same as in 1970.

The structure of accumulation will undergo a substantial change. A part of accumulation smaller than in 1966–1970 will be assigned to increase stocks and a major one will be used for increasing fixed assets. Investments for this purpose will be distributed among the various branches of the national economy in a way very different from their distribution in the previous plan period:

— investments into productive branches will go up by about 24 per cent and their share in total investments will drop from 84 to 81 per cent;

— industrial investments will surpass the 1966–1970 level by 21 per cent, those in the building industry by 48 per cent, agricultural and forestry investments will exceed it by 17 per cent, water regime investment by 70 per cent, trade investments by 31 per cent, transport and telecommunication investments by 19 per cent;

— investments in non-productive branches will increase by 60 per cent, a rate above average, including housing investments which will almost double.

Thus the combined growth of fixed and circulating assets in productive branches will engage a smaller part of the national income than before, and there will be an increase in the part earmarked for consumption and for improving the living conditions of the population through investments.

In the coming period of national-economic growth, scientific research and the application of its results in practice acquire enchanced importance for increasing efficiency and for laying the foundations of technological progress. Accordingly, the share of scientific research in the national income will be raised from 2·4 per cent in 1966—1970 to 2·8 per cent during 1971—1975. The adoption and observance of the principles of science and administration guarantee the efficient utilization of these allocations.

During the Fourth Five-Year Plan, production will increase by

32—34 per cent in manufacturing and mining industries,

41—43 per cent in building industry,

17—19 per cent in agriculture.

By improving efficiency of production the contribution of industry and the building industry to national income will be 39—40 per cent higher, of agriculture, forestry and water economy, 15—16 per cent higher. A quantitative increase of production must be accompanied by an *improving production pattern.*

A substantial improvement of the *living conditions* of the population is an important task of the economic policy during the Fourth Five-Year Plan. The main targets of our living-standard policy are as follows:

— higher growth rate of real wages to encourage the improvement of efficiency in production in addition to further raising social (fringe) benefits;

— increased housing development, especially the construction of flats to be built by the state;

— strengthening the balance between demand and supply on the market of consumer goods and a considerable improvement of supply;[7]

[7] For a more detailed discussion, see Chapter V.

— the introduction of the 44-hour week in other branches.

The per capita real income of the population will grow 25—27 per cent and the per capita real wages by 16—18 per cent during the plan period. The real income of industrial workers, white collar employees and of the agricultural wage earners is scheduled to rise at an identical rate.

The income policy relies on the principle of distributing incomes according to work, that is,

— wages should be differentiated depending on the amount and quality of work performed, on the necessary skill, on growing responsibility in management, on local conditions of work, etc.;

— parallel to the differentiation of wages, the dispersion of per capita incomes due to the demographic conditions of families (the ratio of earners to dependants) should be reduced, and for this purpose society should take upon itself a growing share in the maintenance of the old and the young, in keeping with the rising standard of living;

— retail prices should continue to come closer to proportions stimulating a rational consumption pattern and more consistently reflecting inputs.

With the extremely high employment level achieved by 1970, employment policy (owing to labour shortages in certain fields and jobs) has the following tasks to fulfil:

— efficiency requirements should govern labour management in manufacturing, mining and building industries, and employment should be restricted to the staff really necessary for the given tasks with due regard to intensifying the productivity of labour;

— labour mobility required by structural changes in production should increase and the socially unnecessary migration of manpower should be stopped;

— The extent of employment should increase in service-type branches in keeping with financial possibilities and quicker than before;

— the flow of manpower from agriculture into other branches should be maintained in keeping with the labour requirements of the different sectors of the national economy.

International economic relations should be dynamically developed in order to improve efficiency of social production, to achieve a balanced development in national economy and to consolidate equilibrium.[8]

[8] For a more detailed discussion, see Chapter IV.

The targets for *regional development* derive from the general objectives of the national economic policy. The regional development policy is based on two fundamental requirements:

— The geographical location and development of the forces of production and the modification of their regional distribution should promote the efficiency of social production;

— differences in the living standards of the various regions should be reduced by bringing closer employment and regional supply levels to each other.

The process of urbanization has a decisive significance for the improvement of living conditions. The plan ensures that the rate of urbanization meet the needs aroused by development. For this purpose more than 90 per cent of central allocations for developing the infrastructure is concentrated in towns; about 75 per cent is meant to improve urban living conditions and about 25 per cent to meet the needs of new urban settlers directly or indirectly. An important factor of raising the living standard of the rural population is development of services and institutions of the basic branches of supply.

5. The requirements of the plan for regulation can be summed up as follows:

Regulation should maintain an adequate ratio between consumption and accumulation (essentially the level achieved in 1970), that is, comply with the structure of accumulation as outlined in the plan (implying a reduction of the share of stock increment).

The system of regulators as a whole should make the enterprises intensively interested in economic growth and thereby in the growth of national income. A more intensive stimulation will, obviously, involve a wider differentiation among enterprises. To keep this diversification in line with the interests of society, efforts should be made that profit differences reflect real differences in performance .

A comparatively permanent money value is conditioned by insistence on a dynamic equilibrium. By consolidating the equilibrium, endeavours should be made to stabilize the level of producer and consumer prices, including a gradual improvement of price relations.

The steady increase of productivity—taken in the broadest sense of the term—is a basic source of improving efficiency. An accelerated rise in the efficient utilization of live labour is an indispensable factor of stepped-up development where labour supply shows an objective tendency of becoming exhausted. Even short-term results should be encouraged by stimulating rearrangement of redundant labour, by establishing adequate regulators for rational regional development. A lasting growth of productivity can be achieved in the long run by turning out more up-to-date products, by using modern technologies and by better organizational work. The entire system of regulators should encourage endeavours to this effect.

The scope of enterprise decisions should be further enlarged, gradually permitting the positive effects of the new system of economic management to assert themselves.

The general objectives of the plan postulate a pronounced enfolding of economic competition. The prescribed rate of production generally does not engage all capacities available in the manufacturing industry, leaving scope for competition. But competition should be promoted also by a reasonable abolishing of the monopoly position of producing and marketing enterprises, by an enhanced exploitation of the possibilities of import from both socialist and capitalist countries, that is by creating conditions on domestic market for import competition, by price policy, by using various financial methods.

In addition to assuring wider assortment for consumption, trade should be made interested in increasing turnover, improving supply, keeping stock necessary for safely meeting demand and thereby enabling them to have a stimulating effect upon producers.

It is necessary to create a general economic and market environment in order to encourage enterprise activities in favour of technological development.

The main regulators directly affecting foreign-trade activities should be further evolved into more intensive stimulants towards enhanced economic efficiency, increasing "convertible" export capacities (i.e. such as turn out goods equally saleable on all markets) and improving the export structure. This endeavour should be well co-ordinated with the safeguarding of equilibrium on domestic market. The interest of users in expanding imports from socialist countries and in adapting new technologies for enhancing labour productivity should be intensified in all groups of commodities.

More attention should be paid to develop regulators stimulating to co-operation with socialist countries and warding off possible unfavourable effects deriving from differences in economic mechanisms.

The system of preferences should be focused on the economico-political objectives included in the plan and on a reasonable number of state undertakings. The justification of preferences of a protective nature should be subject to revision.

In order to ensure an adequate allocation of development funds among the branches of the economy, it is necessary to leave scope for the distribution (flow) of enterprise capital to be released, even if the "self-financing" proportions will be reduced to a less dynamic state than what they display today.

A system of instruments promoting regional development of the forces of production should evolve within the system of general regulators.

The plan, naturally, envisages also the use of direct regulators (central statutory provisions) within certain spheres (e.g., individual or lump-sum investments, central development projects). Their most important form is associated with development policy. The relevant problems are dealt with briefly in the corresponding chapters of this volume.

6. There is a close correlation and interaction between national-economic plan and the system of regulators. This system is meant to ensure the implementation of the major objectives of the plan embodying the national-economic policy, but, at the same time, it raises efficiency requirements with regard to the economic targets, contributing thereby to a selective approach to them.

In the Hungarian management system the national economic plan is the most important instrument for guiding and developing the national economy. It expresses in concrete terms the economic policy to be pursued in a definite period, setting a co-ordinated and compulsory direction for the activities of the government and of the bodies responsible for economic management. It comprises for the given period

— the targets of economic development, first of all its rate of growth, the major proportions, the fundamental social and technico-economic tasks of development;

— the material, intellectual and financial means to be used for achieving the targets and the modes of their utilization;

— the regulators ensuring planned development, the basic principles of their application, the principal numerical measures, the government decisions and provisions made for implementing the objectives.

The coherent system of the national-economic plans consists of plans drafted for periods of different duration:

The long-term plan outlines the long-range objectives of developing the national economy, of expanding international economic relations, of improving the living conditions of the population, as well as the fundamental conceptions of regional development in the country.

Under the new system of economic management, the central control and management of the economy relies mainly on the five-year plan. A period of five years is short enough to permit a reasonable assessment of the expected development in the economy and the setting of realistic tasks. At the same time, it is long enough to ensure the necessary perspectives both for economic control and management and for enterprise economy. The stability of the system of regulators requires the major prescriptions of regulation to be valid for a certain length of time, ensuring thereby a smooth operation of enterprises and the implementation of long-range conceptions. This is why the system of regulators is attached to five-year plans into which it is organically incorporated. The economic circumstances, the activities of enterprises are essentially determined by the five-year plan and its system of regulators, shaping and moulding the tendencies in the development of the national economy.

The task of the annual plan is to schedule and interpret the targets of the five-year plan, on the basis of an analysis of the actual economic situation, and thereby to translate the five-year plan for implementation. In this quality of mediator, the annual plan relies mainly on such elements of regulation as would not be expedient to determine for a period as long as five years. The plan thus makes sure that the conditions of the operation of enterprises are in keeping with the main objectives of development, with the requirements of national-economic equilibrium and with changing circumstances. It may therefore happen that—in the wake of an analysis of the actual situation—some provisions of the five-year plan or certain elements of regulation are modified in compliance with the main objectives.

The quantitative formulation of the objectives of economic policy in the national-economic plan is based on definite conditions. The planned character of development is assessed by confronting the plan indicators with the actual growth data. Evaluation of development requires a qualitative comparison of the objectives with the implementation, the subsequent assessment of the plan itself. It may occur—as it often does in practice—that the deviations from plan indicators are caused by changes made to promote the achievement of the original objectives, by changing conditions or by the shortcomings of the plan. Quantitative deviations are therefore not necessarily symptoms of an unplanned character. The planned character of economic development should be understood to mean co-ordinated, proportionate implementation, that the major objectives should be achieved in a harmonious combination, not at each other's expense.

The *guiding, controlling function* of the national-economic plan means that

— planning—especially long-term planning—proceeds from the objectives of economic policy and the new proportions required by them; that is, planning does not simply follow and extrapolate the market tendencies;

— the plan computations encompass all economic processes, to varying depths though exhaustively, include all the main factors of demand and supply, trying to achieve adequate proportions between these factors and to secure a balance between demand and supply;

— planning develops a market regulation in which the interests of enterprises—although conflicting in themselves—show a tendency to concur with the interests of national economy, and thus the market processes generally contribute to, instead of frustrating, the reinforcement of the planned character of development.

But the system of economic management takes into account also *the growing impact of market forces, too.* This should be understood to mean that

— economic and market processes are taken into account and prognosticized in planning, and no plan is accepted unless it reckons with market conditions in its implementation;

— the position of buyers (money owners) is sufficiently strong, they may choose within a range, and the sellers take the buyers' demands into account and even compete in meeting them;

— the economic units, the enterprises enjoy an adequate autonomy in the legal sense of the term and as far as material resources necessary for development are concerned; in other words, the enterprises are entitled to make decisions on certain investments and on utilizing various resources (capacities, labour, wages, money resources);

— one of the main criteria of enterprise economy is the result achieved (the regular and long-term formation of profits); and the diversifying effect of profits upon enterprise incomes, development possibilities and upon the income of the workers manifests itself perceptibly, though within certain limits.

The Fourth Five-Year Plan is our first medium-range plan drafted and started under conditions of the new economic mechanism. Thus, besides planning and co-ordinating the utilizable means the planners kept an eye on the possibilities and methods of regulation. It was both possible and necessary to consider the effects deriving from the further development, independently of the plan, of the system of regulators, necessary for eliminating its shortcomings, and for releasing the originally applied brakes, etc.

The closeness of the links is also shown by the fact that Act II of 1970 on the Fourth Five-Year Plan contains—for the first time in our legislation—the main principles of the regulating system together with the objectives of the plan. This collection of studies wishes to describe the changes in the regulation system applied so far rather than the main principles of it, yet it seems useful to quote the principal provisions of the plan relating to regulation:

40. § (1) The purpose of economic regulation as a tool of economic control is to realize the economic objectives determined by the Act.

(2) A harmony must be created among the different components of the regulating system in order that the aims set should be attained under their joint effect.

(3) The Government shall formulate the economic regulating factors in such a way that they promote realization of the main proportions, the planned growth and major objectives defined by the plan.

41. § (1) With the joint application of the constant and the changeable elements of regulation it shall be attained that economic growth should be realized—while putting the efficiency requirements into the foreground—by securing a stable equilibrium of the economy. The regulating factors shall be in force—in general—for a longer period but they should also adjust themselves to the changing situation of the national economy in a flexible way.

(2) Development of the national economy and the efficiency of the regulating system shall be constantly followed with attention, and individual components of the regulating system shall be modified in the course of the plan period whenever unfavourable changes occur, or there is a need to increase the efficiency of the said system. In case of an incidental modification the different organs of the national economy shall be granted the

opportunity to take the necessary steps in order to adjust their activities to the new conditions.

(3) The provisions which are included in the present chapter and deal with enterprises also apply to cooperatives, allowing for certain differences due to the specific character of group-ownership.

What we want to achieve by further developing the system of regulators is not an enforcement of the numerical targets of the plan but to promote implementation of the objectives of economic-policy contained in the Fourth Five-Year Plan.

The co-ordination of planning and of improving the system of regulators requires a specific development of the planning methods. These problems are not dealt with in this volume, although the necessity of such an analysis cannot be left unstressed.

7. The various fields of production and turnover in the national economy have different specific features which must not be left out of consideration in regulation. This, however, does not mean that different regulators are to be applied in sub-branches of industries because such a practice would deprive us of the possibility of comprehensive judgements and would also result in a redundant diversification of the efficiency requirements.

When establishing the present regulators, that is, at the beginning of the reform, we insisted all too strictly and somewhat rigidly on the requirement of uniformity; this may be ascribed to the fact that during transition the different characteristics of individual circumstances could not be adequately assessed for lack of experience. This has resulted in unequal conditions for some branches and had a disadvantageous effect upon proportional development. But now, in possession of realistic data, we can rely on principles derived therefrom for further development and in the various spheres of reproduction (production of raw materials, processing industry, transport, agriculture, services, foreign and home trade) we can *create a regulating system better adapted to the actual specific characteristics in addition to observing the general and fundamental principles*, a system from which only very few justified cases shall have to be excepted.

Stability of the regulating system is indispensable for ensuring the conditions of purposeful enterprise activities and a balanced development of the national economy.

It is, however, not expedient to assign regulators of a *general character* to periods of time (e.g. five years) because in the middle of the five year plan and, particularly, in its second half this would fail to offer the necessary perspectives. The requirement of stability must not preclude changes in certain regulators if these are motivated by national-economic interests. But even in the case of modifications, it is necessary to give the enterprises opportunity to make adequate preparations. The extent to which regulators are applied should be capable of being altered readily in case of need, but the system itself must be treated in a comparatively stable manner.

In cases of regulation of an exceptional i.e. *individual nature* it may be justified

— to set time limits or

— to introduce adequate periods of notice in certain fields.

When deciding on the stability of the modification of regulation it should be remembered that in case well known methods are changed to which the economic units have accommodated, one has to reckon with a considerable length of time until the expected economic effects of the modified regulation make themselves felt, on account of the time element inherent in the process of reproduction relatively determined by practice and by earlier decisions made, and in the familiarization with the new. This time factor, which, of course, varies from regulator to regulator and also with respect to the nature of the change, largely enhances the responsibility of the authorities introducnig the regulators on the one hand, and acts objectively against relatively frequent changes in methods on the other, less so, as regards the extent of application.

8. Another task of the modification of the regulating system was to adapt the revenues of state budget to expenditures incurred in compliance with the plan. Since budget expenditures have not diminished and do not diminish in keeping with the plan objectives and with the allocation of investment resources at a rate assumed in 1968, the centralization of the social net income will be slightly enhanced under the new regulations, the share of profit in the social net income will somewhat diminish by a slight extension of the sphere of taxes levied before the formation of profits, and so will budget subsidies, granted under various titles.

These problems are analysed in detail by the authors who have contributed to this volume. For general information see a summary tabulation on the next page.

As a result of the modification of the regulating system, the increment of the net income from 1970 to 1971 essentially goes into the central fund, yet considering the dynamic character

	Distribution of net income	
	1970	1971
Profit	69·9	68·7
Taxes incorporated in production costs*	41·2	42·3
Incomes associated with turnover**	25·9	24·1
Total	137·0	135·1
Subsidies	37·0	35·1
Net income	100·0	100·0
Including: centralized	66·7	69·4
decentralized	33·3	30·6

* Charge on assets, wage tax, contribution to social insurance, production tax, etc.
** Turnover tax, customs duties, import turnover tax.

of profits, the share of decentralized incomes is, naturally, expected to increase somewhat in the coming years.

9. Having acquainted themselves with the economic regulators the national-economic objectives and detailed targets of the Fourth Five-Year Plan, the enterprises draw up their own five-year plans and annual plans. These plans should be adapted to the character of the new system of regulation and are thus to represent novel features themselves.

It is the actual task of the plan to mobilize the enterprise collectives to reveal the existing reserves during both preparation and implementation, to accelerate technological development and to increase economic efficiency. These requirements are met by plans worked out in more than one variant and by planners who try to avoid the old-style "plan haggling".

The economic regulators create the environment in which the national-economic plan can be fulfilled. Yet it must be made clear that implementation of a plan does not depend merely — and not in the first place — on regulators. Even the best system of regulators cannot dispense with the purposeful, foresighted, guiding activity of the state, a management that does not interfere in local questions of detail. This management, however, cannot renounce direct instructions when these are needed. This thought has from the very beginning been reflected in the resolution of the management system, and is incorporated also in the 1967 decree regulating the position of state-owned enterprises (Law-Decree 11/1967).

Part of the government control apparatus remained a passive observer of processes induced by regulation in the first period of the reform. But now we can witness a gradual evolution of methods, thanks to which the sectoral and supervisory controlling activity can effectively be practised without undue interference in questions of detail and without overly frequent instructions. A conscious development of these results, appropriate organizational and managerial work at various levels of the national economy as well as in enterprises is, however, indipensable for a successful implementation of the tasks set in the plan. This is expressed in one of the clauses of the law on the Fourth Five-Year Plan:

"56. § (2) When certain objectives of the national economic plan cannot be realized with a suitable alteration of the regulating system, and if such action is motivated by the interests of the national economy the ministers concerned shall use their legal power and issue orders to the state enterprises."

The present collection of studies describes and analyses in detail the considerations outlined above. Our original intention was to assist the work of the enterprise planner and the good organization of plan implementation by clarifying concepts, by sincerely revealing the problems, encouraging the fulfilment of the lofty and inspiring aims of the Fourth Five-Year Plan. In addition to this, the present addition wishes to give adequate information to foreigners interested in Hungarian economic life.

We are convinced that the new system of regulators – even though not solving all problems known today – ensures a firm ground and proper economic environment for achieving significant results in the further building of socialism.

Chapter I

PRICE SYSTEM AND ITS DEVELOPMENT

by

PÁL VALLUS and LÁSZLÓ RÁCZ

1. THE TASKS OF THE PRICE POLICY

The foundations of the present price system were laid down by the 1968 reform which ruled that the basic function of prices was to orientate and stimulate producers and consumers in their economic decisions. The price system was meant to promote rational utilization of economic resources, adaptation of production to effective demand, the spreading of up-to-date products, formation of an economical consumption pattern, as well as equilibrium between demand and supply. According to the criteria, established for the price reform, the prices fulfil their basic function if they reflect the combined effect of (1) production costs, of (2) the value judgements of the markets and of (3) the state preferences' priorities of economic policy.

The tasks of the price policy of the Fourth Five-Year Plan derive mainly from the fact that the criteria underlying the price reform of 1968 have not yet fully asserted themselves. The following circumstances are of particular interest in this connection:

1. Owing to inadequate evolution of economic competition and to the high number of exceptions to the regulating system, the market does not yet exert a sufficiently intensive effect upon prices.

Our present price system is characterized by the requirements of transition and is, accordingly, too autarkic. One of the guarantees of a smooth transition was, namely, that the right of incorporating domestic inputs in the prices was recognized in a wide field. The drawbacks of this kind of price formation, which was necessary at the beginning, have later become more and more apparent. This was predictable. Indeed, one of the provisions of the reform has been to bring prices gradually closer to world market prices. But the transformation of price relations in a given system and their development towards world market price relations is by no means a simple task. In fact, what has preserved and still maintains the autarkic price system is not the survival of official prices based on production costs in the first place but the "*financial bridges*" *conforming to the prices and costs*. In this manner price competition is unable to exert a benefical influence on actual inputs which are often unjustifiably higher than the present international technical level, and the prices do not reflect the efficiency of economic work in the enterprises. But in accordance with the original purpose of the reform endeavours are made to bring the elements of a competitive price system to the fore.[1]

a. Consumer prices are still rather detached from producer prices. The 1968 reform has hardly affected consumer prices. Their substantial approximation to rational proportions—considering the requirements of market equilibrium and of the living-standard policy—can only be achieved gradually. Thus discounting the high consumer prices or articles of clothing and of monopoly commodities, the scope of heavily subsidized consumer prices has remained large. During the past years we have made a certain progress in improving price relations (of many miscellaneous industrial goods and even of clothing), yet tensions between producer and consumer prices still survive and, in some fields, have even increased. The situation is particularly strained in the field of staple food stuffs where state subsidies to consumer prices continued to grown—owing to the rise of producer prices and to the simultaneous maintenance of unchanged consumer prices—(the increase against 1968 is from 26 to 56 per cent for beef, from 30 to 46 per cent for pork, from 43 to 59 per cent for bottled milk, etc.).

The wide-scale preservation of consumer prices deflected by subsidies and turnover taxes makes it difficult to change the consumption patterns in many fields and acts as a general brake on evolving a sound balance of the national economy.

The present level of retail prices and the substantial state subsidies to them are obstacles also to developing international economic relations in a reasonable direction. Many problems of financial character and of commodity turnover derive from the fact that our currency is valued at about 30 Forints to a dollar on the basis of consumer prices, and at a much lower price on the basis of our export structure.[2]

[1] Competitive prices are prices evolving in an advanced monetary system where foreign trade – export and import alike – are seldom subject to statutory instructions and export calculations are adapted to international conventions. (The exporter is given certain preferences, but the extent of support is limited by macro-economic considerations.)

[2] The problem of the system of consumer prices and the direction of

b. The Hungarian price mechanism is known to comprise officially fixed, officially maximized prices and prices moving within officially set limits, as well as entirely free prices. *The officially fixed and maximized prices prevent market appraisals from evolving in more fields than is desirable.* Owing to the more or less necessary lack of competition meant to evolve for other reasons, the development towards competitive prices is not satisfactory even in fields assigned to freer price froms. Consequently, a further "liberalization" of prices—that is a widening of the scope for applying freer price forms—proceeds at a slower rate than was originally thought it would.

c. Our present producer prices may be objected to on the ground that the price relations *are not based on an adequate proportional assessment of the resources.* The problem arising most frequently is that capital investment is expensive (the prices of investment goods, the rate of interest, the development taxes are high, the amortization time of credits is short, etc.) and this often prompts enterprises to raise prices. Another aspect of the same problem is that labour-intensive products seem to be less expensive and the capital-intensive products more expensive than justified. (This has, in fact, inverted the pre-reform situation when most of our problems derived from the under-estimation of capital-intensity.)

The adequate proportionality of the price system is jeopardized also from the aspect of the capital factors inasmuch as the asset-proportional costs and incomes are established according to the gross value of the fixed assets and not according to their net value. The assertion of efficiency differences, the criteria of competitive prices require the asset-proportional price factors to accomodate to the real asset value in the calculations.

In connection with the unsatisfactory growth of industrial productivity in 1968—1969 the question may be raised from another angle: whether it was not expedient to create a new situation for price calculation by increasing the tax on live labour.

d. An analysis of the first three years' experiences revealed that *the industrial price level is higher and the agricultural price*

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its development will be analysed in another chapter from the angle of trade policy and of living-standard policy. This is why in this chapter we shall only deal with the industrial price system or with questions closely related to the development of the price system as a whole.

level is lower than justified. The industrial price level is contested, in the first place, on account of the asset-proportional price level being too high, and on account of the high profits. And in agriculture the problem is whether the preferences established in keeping with the lower price level create adequate lucrativity and interest conditions for encouraging agricultural production.[3]

Owing to the existing structural conditions of our economy, to production-technological and market conditions, the above circumstances may be partly looked upon as objective factors braking development which cannot be basically changed over a short period by the new instruments of economic management (what is more, they have been acting as obstacles to the consistent application of the instruments of management). It follows that our present producer prices do not sufficiently reflect the internationally recognized utility of social productive labour; the dimensions and proportions of incomes realized in prices do not sufficiently orientate in the direction of rational development. The socially expected perspectivic economic development requires a gradual improvement in this field by altering the price relations; in other words, the lasting world market price relations expressing the efficiency of productive labour should exert—under specific conditions of our country—a more consistent influence upon price development and, viewed from the other angle, development of our production and a better organization of marketing should enable us to enter the world market with ever more competitive prices. This last requirement mainly applies to industries where significant production growth or rationalization is envisaged by economic policy. This, of course, does not mean that we shall be able fully to eliminate, within a short time, the disproportions deriving from the existing economic structure. Even countries possessing stronger economic potentials are unable to achieve such results. Nevertheless, endeavours should be made for price relations enabling calculation to indicate a more advantageous international situation in competition than earlier in branches implementing significant investments.

Development towards price relations reflecting international efficiency (competitive prices)—imperative as it may be—can only be evaluated and insisted upon in compliance with complex

[3] The chapter examining the regulators of food economy is devoted to a more detailed treatment of this question viewed from the angle of agricultural prices.

economic development. Under circumstances when evolving competition is one the conditions of reducing official interference in pricing, the improvement of the price system should be achieved within the comprehensive system of economic planning and management. But the material-technical development production bases and the improvement of the system of regulators require a considerable length of time during which not to carry out mature price-political measures would be a mistake just as bad as making hasty decisions.

Although one of the central tasks of our price policy is to induce our enterprises to intensify efficiency, to approach the competitible prices, it must be made clear that a simple copying of foreign-market price relations and their introduction into the domestic price system would not promote our development. One of the positive outcomes of our preparation for the plan period of 1971—1975 is that we can now formulate in more concrete terms our conception outlined earlier in more general terms. We have worked out several important preconditions of further progress, chiefly in the field of foreign-trade regulation (customs duties, subsidies, trade policy), but also in such domains as the improvement of enterprise interests, of financing etc.

2. FINANCIAL REGULATORS AND PRICE POLICY

Under conditions when the scope of official pricing is reduced, the changes in prices are determined—beside the market situation—by regulators under which prices are formed. In this respect the financial regulators play a distinguished role. In the sphere of official prices these regulators act as the supporters of the price system established on 1 January 1968, a predominantly autarkic system, whereas in the sphere of free prices they, so to say, replace the official pricing based decisively on the domestic costs. All this is expressed in the following manner:

a. The tendency is that the calculated so-called *ideal prices expressing national value* (in fact autarkic prices) should operate as real prices. Opinions are frequently voiced and given emphasis that the energetical and metallurgic price level should be raised, and some add even the price level of certain chemicals, just because the prices do not secure the average industrial profitability. In the interest of economic discernment the revision of the regulating system has resulted again in suggestions to found domestic prices "on the national-economically adopted average assessment of the actually used resources". If then a price thus formed (one which incorporates the total net income, proportional to inputs, thus also profits !) is judged unrealistic on the market of final consumption, then—according to these opinions—consumption and exports should be subsidized. Yet in a price system shaped in this manner, foreign trade (the world market) and the buyers' market are unable to exert criticism in the sphere of production, and with such prices it is impossible to maintain either the equilibrium of the balance of international payments or that of the domestic market.

This is why it is important for the development of prices to take measures making our system of export subsidies more selective, enabling us gradually to reduce customs duties unreasonably protecting our domestic producers, to reduce the diversity of rates of turnover taxes and to organize the support given to production (the granting of state subsidies) in a manner avoiding the stiffening of prices, for otherwise we would find ourselves encouraging the reproduction of backwardness. The specific feature of price development in the Fourth Five-Year Plan—as against the years of 1968—1970—will consist in the regulators "taking notice"—on a widening scale—of prices shaped by market judgements (prices considered "low" compared to autarkic inputs), and the enterprises will be subsidized not by raising prices but by making available for enterprises such financial funds as are not incorporated in the prices yet are indispensable for the activities considered necessary in a given enterprise.

b. The revision has established that the present regulators of financing and interests have had an unduly wide-scale influence on *encouraging an unreasonable practice of self-financing prices.*[4] The enterprises have started calculating prices to recover—within a comparatively short time—all burdens on their profits stemming from the investments made for increasing production.

The issue is complicated by two elements assosiated with interest in profits. (1) One is a very progressive tax on the so-called sharing part of the profit, connected with the rise of wages, a tax which, when viewed from the angle of the central control, is a necessary restriction of the increment of personal incomes and, when viewed from the angle of the enterprise, is a criterion of the profit rate necessary for the desirable extent

[4] Self-financing prices must not be confused with financing from enterprise funds. See below.

of average increment of wages. (2) The other element is a rigid dissociation of the development fund, as parts of the profit, a separation which, when viewed from the angle of economic policy, is meant to promote desirable proportions between consumption and accumulation, and when viewed from the angle of the enterprise, is an irrational regulator of the domestic selling price owing to the diversity of market conditions.

These elements of material interest are based on the assumption that the situation on the market does not permit a rise in prices. In practice, however, supply is still a decisive factor for price conditions on a wide scale.

The principles adopted during revision could not solve the entire problem. Nevertheless the changes concerning enterprise funds and in financing must be considered very important for they have a bearing on principles. The changes have greatly contributed to making the pricing conditions more rational. The legal and financial system of various possibilities of association, the transfer of development funds without association, against compensation, the realistic possibilities of regrouping between the sharing and the development funds, the reduction of the progressive taxation of the sharing funds, etc., concur in solving these problems.

3. EXPORT–IMPORT PRICING

A requirement of growing stringency in the development outlined above is to make it possible for the foreign-exchange prices prevailing in foreign-trade relations and their changes to be directly communicated to the domestic price system. Although the decisive step in this respect was made in 1968, the system must be further developed in compliance with the new requirements.

The improvement of our management system—including that of the price system, an important element thereof—will have to be achieved under circumstances when the socialist countries are making growing efforts to apply more advanced forms of international economic relations. All this predicts changes in the contractual rouble prices, too. Within socialist integration the contractual prices are expected if, gradually, to approach the prices of the capitalist world market. But it should be remembered that certain characteristic differences will remain between the levels and the relations of the socialist and the capitalist world market prices. This will be reflected in the comparatively more favourable level (and especially in the favourable proportions) of the socialist prices in spite of the fact that we are making efforts also to improve our relations with the capitalist countries, and the financial burdens which are still reducing the level of foreign-exchange price returns of our export on account of certain discriminative measures, will in all probability be moderated.

The more advantageous socialist foreign-exchange relations should be preserved in our domestic price system also in the future. This means that the price relations at home may continue to differ in a particular way from those of the capitalist world market. Our conditions of trade on the socialist regional market are more favourable than those on capitalist markets (and this applies particularly to the price structure; export prices are not reduced by customs duties and discriminations, etc.). One of the objectives of the prices and financial policy of the Fourth Five-Year Plan is to preserve this preference and even to enlarge it in certain fields (e. g., in socialist machine imports). Parallel to this, interest should be increased in foreign trade with capitalist countries.

It has been difficult to define the actual tasks of the price policy, because the modification of socialist contractual prices has not yet been placed on the agenda in our countries at the time of revising the system of regulators. Therefore only the general trend of the price policy was determinable.

One of our perspective aims is to approximate our domestic price relations to the capitalist ones prevailing on the world market. Yet, a *price proportionality similar to that of world market prices* is only an instrument to make our price relations reflect the efficiency recognized on an international scale. Therefore, the price system expressing efficiency proportions must definitely be distinguished from the mechanical adoption of world market price relations: the price relations of the export market must not be adopted mechanically when the products of certain branches can only be marketed at low dollar prices on account of capitalist discrimination but the cost of domestic production are adequate in international comparison and are suitable for satisfying domestic needs or socialist exports economically. When examining efficiency, it is always necessary to ascertain whether or not the foreign-trade price relations are distorted in foreign countries by financial means introduced for specific reasons to an extent that their automatic adoption would inadequately serve the promotion of Hungarian national-economic development. Since such kinds of financial methods are known to be used in capitalist countries, it would not be expedient to make efforts mechanically to standardize the foreign-trade pricing in certain trades, branches or relations. *Instead, we must resort to a financial policy in keeping with our interests (tax, tariffs, subsidies) for linking the capitalist foreign-trade prices to the domestic price system.*

But the requirement of alignment to the capitalistic world market prices is much more severe within certain trades and homogeneous or mutually fungible groups of products: world market prices are to exert a stronger influence on the prices of different products manufactured on identical capacities, on replaceable products, ect. This usually has a beneficial effect on technological development, stimulating enterprises to improve their products and use advanced technologies.

The significance of this problem goes beyond capitalist foreign trade. And the problem is not only that socialist contractual pricing must necessarily consider capitalist prices which, in turn, affect domestic prices. What is more, the proportion of world market prices and domestic prices have to be examined also in fields where we have no actual foreign trade now.

When revising the system of regulators, this issue was subjected to a many-sided analysis. Therefore, when dealing with the various regulating elements (tariff policy, subsidies, lifting the restrictions on commodity turnover and foreign trade), we shall often come back to them. A separate chapter has been devoted to the business cycle aspects of the issue. We are making a wide and deep analysis of the proportions between authoritative world market prices and domestic forint prices, of the causes responsible for the differences in relative prices, etc. Considering the subject of the other chapters, we shall now but briefly outline the results of these analyses. An assessment in broad outlines is justified also by the fact that the results are by no means so firmly founded as to serve as a solid basis for future price development.

4. DEVIATION OF MAJOR PRICE PROPORTIONS FROM WORLD MARKET PRICES AND FROM CALCULATED MODEL PRICES

Analysis has established that our main price relations are by and large adequate even when viewed against relevant world market prices. Deviations of the main price proportions from world market prices are of a magnitude that can be looked upon as natural in every normally functioning domestic price system. Yet there are some exceptions to this: first of all, the price levels of sources of energy and clothing are higher and that of the non-ferrous metals is lower than what would seem justified on the basis of world market prices.

In the case of sources of energy this is due to the fact that the input average taken from a basis in the price revision of 1968 included a decisive amount of coal, and the costs of coal production are very high in Hungary. Countries on a similar level of industrial advancement can usually calculate the sources of energy on a much more favourable domestic price level. The price level of the energetic industry has, however, a decisive influence on the entire industrial price level, raising prices especially high in the chemical industry, in non-ferrous metallurgy and in the industry of construction materials.

The prices of the non-ferrous metals are lower than world market prices. The main problem is that the world market prices of these products are permanently above the average price of the 4 to 5 years prior to 1967 that had been used as a basis for the price revision.

The high price level of clothing articles is mainly due to the fact that the price revision relied on inputs based on backward technologies. True enough, the principles underlying the reform would have required a calculation of lower profits for comparatively unfavourable inputs, but it was impossible to insist on this principle. Owing to the overwhelming weight of "input proportionate pricing"—encouraged also by enterprise interests and market problems—high profits had to be conceded already in the initial price calculations. And the prices have gone up since 1, January 1968, contributing to the maintenance of high profit level in the entire light industry in spite of strict measures.

The price levels of metallurgy, of the building-material industry, the chemical industry, the metal working industries and even of the food industry show only slight plus—minus deviations from the world market price level. Yet, our analysis has revealed that within and behind these comparatively sound branch price relations the prices of essential groups of products or of individual products often show very substantial deviations from world market prices. In the chemical industry, especially the prices of plastic materials and of such semifinished goods have turned out to be very low. These prices had been formed, namely, by using a dollar multiplier lower than average, and the formation of world market prices during the past years has not produced the dollar price reduction expected in 1966—1967. While prices of plastics are low, the input-proportionate prices of other products of the chemical industry (e.g. fertilizers) are very high. This shows that the average hides a wide dispersion.

But there are internal disproportions also in other important branches (e.g. in the building-material industry, the food industry).

These relative deviations of branch price relations have been subject to a very thorough and complex analysis. We have considered particularly the development conceptions we wish to abide by in the plan period of 1971—1975 and during the subsequent fifteen years. It has been found that all that is necessary are comparatively slight corrections in the main price relations. What has been definitely decided is the price reduction of hydrocarbons, but the modification of prices of non-ferrous metals and plastics is still being examined by analysing in greater detail the price tendencies on the world market. A definite stand has been taken on not using official price-adjusting measures for transmitting the necessary changes towards the price for users. All official price adjustments involve the risk of slackening. When the main tasks of the Fourth Five-Year Plan are to consolidate equilibrium, to increase production and to increase interest in satisfying needs, any measure involving a general price adjustment may cross the main purposes of the government. Consequently, conditions for large-scale measures in this line have not yet matured.

In addition, the maintenance of the comparatively high branch price level in some cases is also justified by financial reasons: the use of enterprise funds in financing large investments, that is, a correct coupling of the macro-economically determined direction of development with enterprise interests can only be achieved, it seems, by using enterprise funds of an adequate volume in many cases (e.g. in the textile industry). And the corresponding profit can only be secured from the existing prices.

With due regard for these considerations a wide-scale general modification of price relations within industrial braches does not seem to be advisable during the Fourth Five-Year Plan. Nevertheless, in addition to corrections in the branch price relations, great importance should be attributed to *a better adaptation of prices* differentiated according to assortment, quality, modernization, replaceability etc. within the various product groups *to the requirements of the international market.* Besides, with the help of financial bridges determined for a given industry, trade and group of products, we are going to intensify the pressure of foreign markets on our producers. By using all possible means of management we try to create a maximum interest of enterprises in shaping their production costs and prices according to price relations justified by international competition.

5. THE IMPROVEMENT OF PRICE MECHANISM

A gradual production of the share of officially prescribed prices is a permanent aim of our price policy. Another one is to replace stricter price forms—where their complete release is not possible—by looser forms.

During the first two and a half year of the reform many steps were taken to reduce the proportion of official prices. In the sphere of production the scope of fixed prices was substantially reduced: their share was 10 per cent in the total output of industry on 1 January 1968, and this figure fell to 5 per cent by the middle of 1970.

In 1968 the prices of fuel, for instance, were fixed prices; they are now maximized prices. A modification of the price form permits solid fuel to be sold at reduced prices during the summer season. Thus the storage costs of the dealers and the damaging effects of seasonal marketing may be reduced. (Such effects could be observed particularly in 1969 and had an untoward impact on the market situation.)

The issue of seasonal overcharge on fixed and maximum prices of seasonal products elicited violent debates. Viewed purely from the angle of the mechanism, it seemed logical to overcharge in peak season and to reduce prices in the dead season. Finally the competent authorities rejected the overcharge in general, because the product having officially fixed prices are so decisive for producers that the general introduction of overcharges would have resulted in a general movement of prices.

The share of maximum producer prices also decreased during the first years of the reform in spite of the transfer of fuel prices from the category of fixed prices to that of maximum prices. The share of products having maximum prices was about 27 per cent in industry in mid-1970. The reduction regarding prices of products of the machine industry, for instance, was possible thanks to the stabilization of the price level (the products were replaced by new products which then accommodated to the earlier maximum prices). In the case of some products of the chemical industry (e. g. dyes) the transfer of world market prices seemed to be rational and therefore official restrictions on prices were released.

After these changes the share of fixed and maximum prices in industry still remained significant: 32 per cent of the volume of products. Further reduction does not seem feasible, and this for two fudamental reasons:

a. In some fields (e.g. building materials) the market situation is rather strained. Nevertheless trade has been liberalized for an overwhelming part of these commodities. The idea was that the limitation of prices is still more favourable for the normalization of enterprises contacts than a quantitative regulation of the trade.

b. In some larger groups of products (e.g. ferrous metals, heavy metals) market has been consolidated, and the users possess significant stocks. A significant part of output, e.g. of ferrous metals, is exported without causing any trouble in domestic supply. It still seemed necessary to maintain the maximum prices even after the consolidation of the market chiefly on account of the exceptional fluctuations in the world market prices due to the boom. Owing to a sudden rise in foreign market prices, the methods used so far for linking up domestic prices with foreign prices have become uncertain. The methods that would conform to the new mechanism have not yet evolved, and a full liberalization of prices under such conditions would result in a rise. And this is impermissible for staple commodities.

The railway and motor vehicle transport tariffs have been transferred from the category of fixed prices into that of maximum prices where this change has made it possible to pursue a more active price policy and to make discounts in the cases of favourable transport conditions for the transporting company.

In the building industry the share of maximum prices has been diminishing from year to year, because the setting of maximum prices does not affect investments financed from enterprise development funds. Owing to tension on the construction market, a recurring problem in the analysis was whether it was expedient to widen the scope of maximum prices in the building industry. Alternatives that would have made building cost calculation norms stricter were also considered. The conclusion was that a setting of maximum prices would only hinder government efforts made to stabilize the demand-and-supply relations of the building market, and would increase shortage psychosis. Therefore it seemed expedient to promote the stabilizing factors by increasing supply and incentives for investments.

A survey of the domestic and foreign market situation shows that *a further rapid extension of free prices would not be advisable during the Fourth Five-Year Plan.* This, of course, does not preclude the possibility of taking measure for the reduction of the scope of official price forms between 1971 and 1975. The number of maximum prices will mainly be reduced presumably in the processing industry partly because of new products coming on the market and partly because of the stabilization of the market and the development of foreign-trade links. We do not intend to abolish maximized prices of basic raw materials and semifinished goods. Yet, measures for liberalization may turn out to be expedient as a result of a permanent market equilibrium, of a consolidation and successful operation of financial bridges, reserve funds, etc., in fields adjacent to foreign trade. This is invariably the endeavour of our price policy, provided conditions are found to be mature.

A decisive task of the coming years is to consolidate the market situation in fields where free price forms operate, to increase competition there and to ensure material, technological, financial and commercial conditions for a reasonable development of prices.

The retail prices of consumer goods were subject to several changes between 1968 and mid-1970. Earlier the turnover of goods having fixed or maximum prices was somewhat more than fifty per cent of total turnover, but by 1970 it fell below this figure while the share of free prices went up and that of limited prices diminished. Except for some staple commodities the pricing of import goods was made free, fuels were transferred from the category of fix prices to that of maximum prices, some clothing articles and food products, some mass-produced iron and technical goods and spare parts were assigned to freer price categories.

An important step was to raise the upper limit of price fluctuation for products belonging to the limited price category constituting about 25 per cent trade. (The upper limit of fluctuation rose thus to ten per cent against the earlier five.)

At the same time, it became necessary to enlarge the scope of prescriptions on the *compulsory notice* on intended price rises of materials used for producing consumer goods. Experience shows that this protects the consumer price level more efficiently because it enables us to take appropriate measures whenever necessary.

A substantial reduction of the range of fixed and maximum consumer prices in the years to come does not seem to be expedient. Nevertheless we have decided to reduce the scope of the limit prices in favour of free prices.

The revision of the price mechanism also considered to what extent the profit of the manufacturers of products belonging to the sphere of maximum prices was influenced by the fact that a large part of the materials used by them are home-made or imported products having free prices. It was found that various price and financial measures were necessary concerning some commodities, but the profit of products and services having been fixed, maximum prices were found to ensure the fulfilment of tasks expected from the enterprises producing them as envisaged in the national-economic plan. A rise of these prices would not seem advisable considering even the price relations on the world market. In addition, their stabilization largely contributes to the stabilization of the entire price system. And this, in turn, dispenses us from the necessity of raising our maximum prices. The demand-and-supply conditions laid down in the national-economic plan and the market situation evolving from the various changes in the system of regulators are going to have a beneficial effect upon this stability.

The conditions of a successful operation of the producers' price mechanism was studied on a wide scale, the expected effects of import and export prices in our foreign trade with socialist and capitalist countries were assessed. Interest was focussed mainly on the pricing of new assortments, the prices of co-operation products and on the relation to each other of socialist and capitalist prices with respect to socialist contractual prices. The trend of Hungarian price mechanism is to promote technological progress and to extend socialist division of labour.

The capitalist market price changes raised problems for the mechanism chiefly by the price fluctuations due to the boom.[5] The price changes of the products of the processing industry on the capitalist market will, in all probability, continue to transmit the strengthening foreign-market pressure requiring a more up-to-date and better assorted production pattern.

The policy of the entire five-year period to come will bear the imprint of the following tendency: our enterprises will be

[5] See Chapter V.

exposed, more intensively than before, to the international competition of prices, owing to the expansion of exports and the growth of imports. In the processing industry this competition is transmitted through the mechanism of free prices. On the other hand, the changes made in the system of regulators contribute to strengthening the beneficial effects of the price mechanism.

6. THE INDUSTRIAL PRICE LEVEL

There is no denying that the industrial producers' price level is high at present. The asset-proportional total net income realized in the prices of industrial products shows a pay-off period of three years on an average which does not seem in any way to match the efficiency of our productive work. And in the processing industry—where the principle of self-financing has been insisted upon most consistently—the rate of return is even faster. The pay-off norm established by the present income-regulating system is very high for every new investment, and this makes the engagement of new capacities for the market rather difficult (chiefly in exports).

It follows from the above considerations that no substantial reduction in the industrial price level can be effected during the Fourth Five-Year Plan. Among the price reductions so far suggested, decision has been taken only on the sources of energy. In addition, intensification of import competition, the partial introduction of the net principle instead of the exclusive imposition of the gross principle in the system of subsidies may act as further impulses towards price reductions. At the same time, we must be prepared for price rises with many basic materials. *A general and substantial reduction of taxes—permitting the reduction of the price level—does not yet seem feasible.* Such a measure would require a really fundamental modification of the entire system of finances, taxations and interests, that is, a very complex set of changes. It does not seem expedient to undertake such a large-scale alteration for the time being, in fact during the entire plan period to come.

7. DEBATES ON ASSESSING RESOURCES

One of the central issues in the debates on improving the system of regulators was whether or not it was expedient to change the ratios to each other of asset-proportional price factors, that is, a change in the proportions of burdens on assets and wages. Chapter II is devoted to a detailed discussion of this issue.

Eventually the dilemma of assessing the decisive resources led us towards more general questions of our present financial mechanism, to wit, whether the present system of taxing production is indeed the most expedient form of indirect economic regulations. But this could not be decided for several reasons, one of which having been that the changes in the wages and income regulation planned for 1971 were expected to bring about a much more favourable situation in this respect, too. After an analysis of these effects, the issue will have to be re-examined on a wider basis and we have to study possible methods of a better regulation of the asset-proportional and wage-proportional factors, in a way subordinated to complex interests.

8. PRICE RELATIONS OF BASIC MATERIALS AND OF FINISHED GOODS

Since one of the criteria of the correctness of price relations is their distance from or closeness to, world market price relations, and since the prices of basic materials and semi-finished goods showed a substantial rise on the world market in the years of 1968 – 1970, the question of price relations between basic materials and finished goods were becoming more and more acute. Its importance is enhanced by the fact that a large part of our basic materials come from socialist countries. Domestic pricing evaluates foreign currencies on the basis of the average production costs of earning them. The structure of our exports and discrimination in certain relations result in our price system assessing acquisition costs in socialist relations lower than those in capitalist relations. Thus the reason why some of our basic materials are cheaper is that they come from socialist countries (the socialist price multiplier being lower) while the prices of others have become low because the domestic prices set at a maximum on the basis of former world market prices has not followed the changes due to boom of the world market.

The prices of finished goods (machines, clothing) do not change substantially. Most of the capitalist countries have resorted to financial or economic methods, so that the rise of the prices of basic materials and semifinished goods affected those of finished goods to a small extent only. This has mostly been achieved by moderating the taxes on the processing industry and by increasing export price subsidies, etc. On the other hand, the price and financial system introduced in 1968 in Hungary has heavily taxed the domestic values added. These tendencies combined have resulted in a certain conflict: the export of products subject to fewer grades of processing appears to be more economical than that of finished goods. At the same time, the export of the goods subject to less processing would require the import of more raw materials which, on the other hand, can only be achieved at higher prices.

This is obviously one of the major problems of the system of regulators. Enterprise interests are shaped by prices of materials and finished goods in calculations. An expedient interest must be supported by adequate price relations. And it should also be made clear that the price fluctuations on the capitalist market may create situations any time in which the proportions of the consistently developing domestic price system become "disproportional". In such cases, however, it is not a hurried change of domestic prices that offers adequate protection. Instead, the entire regulating system will have to be improved so as to take into account these phenomena (increasing undertaking of risks, reserve formation, consolidation of the market situation are the factors driving the enterprises in this direction). The measures taken make allowance for these circumstances.

9. MAJOR TRENDS IN THE PRICE POLICY OF THE FOURTH FIVE-YEAR PLAN

On the basis of studies the revision found it opportune to adopt the following requirements with respect to price policy for the Fourth Five-Year Plan:

The main task is to stabilize the level of both producer and consumer prices. The annual rise of consumer prices must not exceed 1—2 per cent and the level of the producer prices should be so regulated as to permit the realization of the tasks listed in the preceding. A favourable price trend must be ensured in both production and trade by promoting adequate demand-and-supply proportions and by co-ordinated price, financial and trade policy.

Official measures should also promote favourable changes in producer price relations. Thus the scope and magnitude of foreign-trade preferences (tariffs, subsidies) should be modified in keeping with our interests, and efforts should be made that the modification of price relations shall involve the reduction of unjustifiably high prices in certain fields.

In addition to financial and price measures, the increase of economic competition should be made to promote rational changes in price relations.

In the field of investment goods—mainly in the field of machines—the rise of the price level must be prevented by an adequate competition of imported machines (from socialist countries). In addition to a planned increase of building capacity, prices in certain fields (e.g. of certain types of housing projects using pre-fabricated elements) should be reduced in order to put a brake on the rise of the price level in the building industry.

Consumer price relations must be brought closer to producer price relations. By simplifying the turnover tax system, further progress should be made to bring about closer links between producer and consumer prices.

The price mechanism must be further improved gradually, at a rate required by the consolidation of the market equilibrium, by releasing restrictions that would hamper the development of rational commercial relations.

In some fields substantial changes must be made in price relations in order to lay the foundation for favourable market effects. That is why the price of hydrocarbons were reduced on 1 January, 1971—creating thereby more favourable price relations than those of solid fuels—the relationship between the prices of timber and those of timber substitutes, as well as the prices of alloying materials, will probably be modified during 1971 for the above reasons. The necessity of modifying the prices of plastics and of non-ferrous metals is being examined. Depending on the outcome of the examination, prices in some other associated fields may also be adjusted.

Chapter II

ENTERPRISE INCOME REGULATIONS

by

SÁNDOR FERGE and LÁSZLÓ ANTAL

1. POSSIBILITIES AND REQUIREMENTS

The success of the economic reform has shown that *the profit motive, as the determinant of the nature of our income-regulating system, is an adequate instrument for co-ordinating the interests of the national economy with those of enterprises.* Consequently, profit must remain one of the main tools orientating enterprise economy. The interest system must therefore ensure that—under identical conditions and profit consequences—the enterprises be interested in making decisions and conduct their activities accordingly. On the other hand—and this is decisive for directing further development—the relative magnitudes of profit and the differentiation of the enterprise funds (the sharing fund destined to increase personal incomes and the development fund to be used for enterprise development) will increasingly have to show differences of economic efficiency.

The consolidation of the system based on interest in profits can ensure the expected operation of the income-regulating system, the uniform orientation of enterprise activities, an increased improvement of economic efficiency, a quicker economic growth and the simultaneous consolidation of equilibrium; the strengthening of interest conditions can promote and their weakening would hamper the reconciliation of micro- and macro-interests. These requirements can only be met by a co-ordination of the entire system of regulators (e.g. the requirement that profit differentiation should increasingly reflect efficiency differences is a function of the price system in the first place), but the materialization of the aims largely depends on the system of income regulation.

Our experience gained since 1968 has taught us that the *actually prevailing income-regulating* system—including the minor modification made in 1970—*cannot entirely meet the requirements.* One of the starting points of further development is an assessment of the negative aspects of the current system; that is, clarification of the elements hampering a more efficient operation of the reform.

The system of income regulation applied since 1968 involves two main problems: (a) it does not sufficiently stimulate intensive economy, does not adequately promote the economical treatment of live labour and, — as a practical side of the latter — does not sufficiently encourage productivity and technological development; (b) the positive effects are also damped; compared to its own possibilities the system has a less vigorous effect than it could have on the formation of the micro- and macro-structure, in other words, transformation of the given economic structure is slower than what conditions would permit.

The causes of the above negative aspects could be ascribed to the following:

The problem of assessing the production factors (of the prices of resources) is unsolved. It has not been made clear what the optimal proportions would be between the burdens of live and embodied labour in the field of occasional and recurring (permanent) inputs.

The system is too rigid and complicated; this is due to the obligatory splitting of the profit in proportion to assets and wages (into a sharing fund and a development fund) in the first place, and to the inevitable parallel movement of these funds expressing various interests; but the rigidity and complexity can also be felt in the existing order of wage level regulation, that is, in the way it is linked to enterprise income regulation (e.g., the average wage rise is to be added to the actual profit, this is referred to as "technological profit"); and the progressive tax rates on the part of profit going to the sharing fund have been established to show an annual rise of 2 per cent; (a practice referred to as the "shifting of tax rates" in Hungary).

The relative profit rates of enterprises are not optimal, and economic efficiency still does not sufficiently prevail in the differentiation of enterprises. This is partly due to the above reasons and partly to other causes of regulation, as e.g., the granting of subsidies is not always fully justified.

In addition to eliminating the existing shortcomings, the further development of the system should take into account further requirements. *Our main aim is to increase economic efficiency.* Yet, the speed of progress is limited by the existing economic circumstances: the prices, that is, their profit contents, do not reflect truly the actual efficiency proportions; market conditions are not sufficiently stable, and structural tensions can be observed in various fields, mainly in investments.

The motivation system is not going to exert the expected effects unless the rules relating to and the extent of income regulation satisfy *the major proportionality requirements* not only temporarily but in the long run, i.e. mainly the proportions between centralized and decentralized incomes, between consumption and accumulation, and the distribution of funds between central agencies and councils.

An important objective of ours is to improve the *financial equilibrium*. Therefore no such modification of regulators may be suggested as would weaken the budget equilibrium. The division of incomes between state and enterprises should correspond to the respective tasks outlined in the five-year plan. The amount of money needed by the state is influenced by the final use of incomes by the state (public consumption, accumulation), and by the income redistribution in the form of subsidies. The ultimate effect of the distribution of incomes should contribute to the equilibrium of the budget and promote the creation of conditions maintaining a dynamic equilibrium.

But we must realize that the rational way of maintaining a lasting financial and budget balance consists in increasing economic efficiency, in improving the economic structure, in enhancing the intensity of interest and ensuring thereby the dynamic growth of the economy. It would not be expedient to ensure the long-term equilibrium of the budget simply by increasing the centralized share of incomes; this would not encourage efficiency. Therefore, the mechanism of income collection should be such as to ensure that—in the case of a higher growth rate than planned—the decentralized enterprise funds also expand at a corresponding rate.

Promoting the creation of the desirable proportions between consumption and accumulation is a fundamental condition of equilibrium on the macro-level. It follows that the influencing of the use of profits is a basic element of the model. This does not necessarily mean a compulsory splitting of profits into two predetemined portions, as is being practiced now, but it would be possible to conceive a more elastic solution in which a taxation system would orientate the enterprises as to using their profits for consumption or investment purposes. For the time being, however. we cannot dispense with the present method of dividing profits, even though we are fully aware of all its drawbacks.

The regulation of personal incomes is an important objective also in the long run in order to influence the balance between purchasing power and commodity supply, to keep personal incomes between reasonable limits and to influence wage relations. This is another task of income regulation.

A specific problem of proportions is how to meet the money requirements of local (regional municipal) councils acquiring growing autonomy.[1] The idea is to enable the councils to conduct adequately their economico-social activities. In order to bring into harmony the economic development and the infrastructural standards of the various regions, it is necessary to make the councils interested in the economic activities of all enterprises operating on their territories. What we need here is again a system of income distribution formulae and rates and of measures that can satisfy these requirements over a middle-range period.

The proportionality requirements can be met if the system is built on the principle of *stability and uniformity* in compliance with the nature of the regulators and with the character of the economic process to be regulated. Already at the very beginning of the reform considerable efforts were made to comply with these requirements. The rules destined to ensure the most general conditions of economy—such as the taxation of incomes and profits—will not be able to co-ordinate the tendencies in national-economic and enterprise interests unless they prompt the enterprises to economic activities in keeping with long-term conceptions, unless such formulae are used as do not necessarily involve, from the very outset, a periodic rearrangement of the system. Cyclicality in income distribution would result in similar disparities in commodity distribution, and we would have to consider its effect upon material processes and the price level as well.

Income-regulating, profit-taxing formulae which substantially differ from the general principles of the system have already been found inapplicable in certain fields, although the specific features of certain fields may have to be reckoned with in imposing taxes on profits. (The field of turnover and services, for instance, as specific activities, must be handled separately within the scope of general principles and must be given preference.) The varying extent of the differentiation of regulators in various branches (sub-branches) would, however, result in a varying assessment of economic processes, of their usefulness for the national economy, of their effectiveness, and would put a brake on the increase of efficiency. A wide-scale endorsement

[1] For details, see Chapter XII.

of the different specific traits with the help of a large number of individual regulators or preferences would lend to regulation an administrative character. In further development these approaches should be handled so as to create an optimal harmony — resulting from inter-actions — between a comparative uniformity of regulation, the recognition of actually existing specific features of the branches and the objective and allocation proportions of the national-economic plan.

The principle of uniformity interpreted as above — in addition to ensuring the uniformity of the most general elements of income regulation as regards construction and measure — should be understood to mean a consistent endeavour to create identical conditions for identical activities irrespective of the field or branch of the national eonomy wherein they are carried on. (Thus, for instance, the activities in a subsidiary plant attached to a coal-mining enterprise or to some agricultural co-operative but with a different nature of production, — e.g. air-conditioner production of the mining firm, agricultural machine repair shop of the co-operative — are to be regulated according to the general conditions under which they are carried on and may not enjoy the preferences given to coal-mining or agricultural co-operatives, such as exemption from charges on assets, and so on.)

The above considerations presuppose also the improvement of regulating elements acting outside of income regulation. This applies to the price system in the first place.

The prices and the proportions of profit contents incorporated in them will have to reflect efficiency differences better than they do now. As mentioned in Chapter I, the distortions in the profit content of prices can gradually be eliminated by strengthening market conditions, by letting the value judgements of the international market assert themselves, by giving a wider scope to the price-shaping effects of demand-and-supply conditions. Progress in this respect may also be promoted by a further development of our subsidy system (domestic production subsidies, support to development, system of export subsidies, system of tariffs and import turnover taxes).

Yet, the upward move of the price level is not desirable mainly for considerations of living-standard policies; with due regard to this and to what has been explained above, *the modification of the system of income regulation need not involve fundamental changes*. Modification of significance could only be justified if the present system could be replaced by an undoubtedly better one. Yet, the analysis of regulation with a view to improving it will have to be kept on the agenda of income regulation and profit taxation during the entire period of the Fourth Five-Year Plan.

Corrections in the System of Enterprise Income Regulation

A. *The system of taxation*

Enterprises will continue *to pay taxes on their net income depending on the production factors used and engaged.* The taxes are unchanged: 5 per cent on assets engaged[2] whether fixed or circulating (working on the basis of the gross value as before); and 25 per cent of wages contribution (wages tax plus social insurance rate) on the annual wage bill. The extent of exemptions from these taxes granted for price system reasons and on account of preferences are to be reduced as much as possible.

Various analyses and assessments show that the present rate of taxes on net income is not a satisfactory incentive for an efficient utilization of production factors, because it does not reflect correctly the possible proportions between expanding live labour and material resources, nor does it reveal the proportion between the additional income deriving from these two types of resources. Although modifications of the other elements of the income regulating system have a favourable effect on efficiency requirements and on the use of live labour, they only give a partial solution to the problems arising in the relative weight of production factors, and thus the extent of the (normative) levies on the production factors will probably have to be modified in the present plan period. We shall come back later to the problems involved by a postponement.

Production taxes will have to be imposed in the future too, on high rent-like incomes deriving from different natural and production conditions, from the different effects of the price system, of commodity turnover and of organization (monopoly organization). Yet the system of production taxes must not jeopardize interests in profitable production, in choosing favour-

[2] Artisans' co-operatives and general consumer co-operatives pay these charges on self-financed assets not to the state but to their own regional corporate bodies which pool them into a Common Development Fund. (Co-operative farms are not liable to pay charges on assets engaged.)

able outlets, or reduce the profitability differences arising therefrom. Thus, owing to the imbalance of demand and supply, the building tax introduced in the building industry will remain unchanged.

The production tax is not a normative but a differential category. A type of net income-collection is applicable to minor aggregates, often to individual cases. Its present sphere of application, its weight among the channels for taxing net income cannot be reduced substantially at the beginning of the plan period. Yet, when deciding upon the system of imposing production tax and upon its size, efforts should be made to break away from the individual enterprise character in all fields where economic conditions permit to do so.

In order to make the councils interested in increasing the profitability of all enterprises operating on their territory and to provide them with a dynamic income source, the enterprises pay part of their income to the councils.

All enterprises, artisans' and consumer co-operatives pay a 6 per cent *municipal contribution from their profits shown in the balance-sheet* to the council. At the same time the communal tax (amounting to 2 per cent of the wages in general) paid so far from the development fund is abolished.

The obligation of paying municipal contribution must be deducted from profits when establishing the taxes on the funds. The councils may grant full or partial exemption from paying municipal contribution to enterprises for a definite or indefinite period.

Both profit taxation and the formation of funds from profit will continue to be practiced in a dual manner. The profit shown in the balance reduced by the amount of municipal contribution should invariably be divided in proportion to the production factors used.

Up to 1970, profits had to be divided between the development and sharing funds in proportion to the total volume of fixed and circulating assets engaged, and to the wage expenditures multiplied by a wage multiplier (usually 2). *Beginning from 1971, the payroll expenditure is to be multiplied generally by 3,* when dividing the profit.

The difference between the taxes imposed on these two parts of profit diminishes and—in order to intensify interest—*the progression of the tax on the sharing fund will be moderated.* Accordingly, the average tax rate of the sharing fund growing on account of the changed wages multiplier and of the modified system of wages regulation[3] will be higher in 1971 i.e. about 55–60 per cent. The zones of tax exemption and of low taxes are now abolished in the taxation of the sharing fund, otherwise continued to be determined in percentage of annual wages expenditures, and the progressive taxation moves within a narrower range (instead of 0–70 per cent, between about 40 to 70 per cent now). Owing to the increase of the wage multiplier, a larger part of the profit increment can be used for raising personal incomes than before, in spite of the unchanged upper limit of 70 per cent of the tax rate.

The general idea is to maintain the average size of the sharing funds unchanged and to reduce somewhat the differences in the level of funds. In time, the modifications will result in a more intensive differentiation, and interests in raising personal income will be more intensive.

The comparison below shows the difference between the tax bands and tax rates for 1970 (with the shifting of the tax rates) and for 1971:

1970 Band of sharing fund in per cent of wages exp.	Tax rate, p.c.	1971 Bands of sharing fund	Tax rate, p.c.
0–7	0	0–6	40
7–9	20	6–12	50
9–11	30	12–20	60
11–13	40	20–	70
13–15	50		
15–17	60		
17–	70		

The development fund continues to be taxed on a linear scale, which is 60 per cent in general. Thus the development resources alimented from the profit in enterprises diminish, in compliance with the development objectives of the Fourth Five-Year Plan, compared to what would be formed under the system of regula-

[3] The change consists in the following: what had to be charged against the sharing fund between 1967 and 1970 was the cumulative average wage increment, but since 1971 the payment is based only on one year's wage increment (for details, see Chapter III).

tors in 1970. The share of profit earmarked for development diminishes, namely, on account of the increased deduction into the reserve fund. The reduction of the funds and increased centralization are motivated by the possibility of granting state support to investments, development aims earmarked in the national-economic plan and implemented within the authority of enterprises and also by the increase of the share of non-productive investments financed mainly from central monetary funds in the plan.

As an organic part of the modifications let us mention the provision according to which the enterprise *may transfer*, on their own decision, *means from the sharing fund into the development fund* in a manner that the amount transferred is subject to a lower tax rate. This provision is meant to increase the elasticity of the income-regulating system and the adaptability of enterprises to changing market conditions and also to make up for the shortage of development resources due to the division of the profit in enterprises where incomes and wages are high. Thus we make it possible for the enterprises to promote the formation of development resources decreasing on account of the higher wages multiplier and other measures, if they so decide with a view to their long-term objectives.

The compulsory level of enterprise reserve funds should be established in keeping with giving a wider authority to enterprise economy in a manner that, in addition to the production factors engaged by the enterprise, profitability should also have a say in the magnitude of the compulsory level, so that the reserve fund should be able to level out the annual profit fluctuations in the funds.

The compulsory level of the reserve fund is the sum total of 1·5 per cent of the asset value considered in dividing profits and of 8 per cent of the wage bill. If, however, this is lower than 80 per cent of the sum total of the post-1971 highest sharing and development funds, (the latter without amortization), then the latter should be considered as the compulsory level. (The compulsory level was determined purely by the former criteria between 1968 and 1970.) The simultaneous, joint application of the two criteria ensures a more even evolution of the reserve fund between low-profit and high-profit fields, as well as a more even burden.

The role and volume of enterprise reserve funds should be enhanced in order to create harmony between autonomous enterprise price policies associated with business price fluctuations and the desirable national-economic price policy. The compulsory level to which both funds are to be raised every year is now 12·5 instead of 10 per cent. In order to moderate the unfavourable effects of major business price fluctuations, price *risk reserve funds*[4] will have to be permitted to form.

The fundamental rules governing the utilization of funds remain valid: accordingly, the sharing fund is to be used for raising personal income[5] for consumption type allowances and for maintaining welfare institutions; the development fund, for expanding the fixed and working assets; the reserve fund for covering economic risks.

With the modification of the rules for utilizing the development fund, the communal taxes are abolished and the insurance dues are no longer compulsorily charged against the development fund. The insurance dues can be charged against costs. The enterprises are, in the future too, free to sign property insurance contracts. Like the population and the co-operatives, so also the enterprises and institutions are obliged, from 1971 on, to take out third-party insurance policies for their motor vehicles.[6]

Indemnities for damages to be restituted come, in the future too, directly into the development fund, yet in case of damages to be restituted for which the enterprises could have taken out insurance policies but have failed to do so, the loss must be paid from the development fund or—for lack of such—from their reserve fund under obligation of repayment. Damages requiring only maintenance inputs can be charged to expenses, as before. Such indemnities serve the refunding of expenses.

Owing to the increasing efficiency requirements, to the necessity of undertaking higher risks and in order to attenuate the business price fluctuation, *the rules governing the use of enterprise resources* had to be made more suitable for balancing economic activities. This is why the scope of utilizing the general reserve fund has been extended. It will be possible to compensate price losses due to minor business price fluctuations in connection with export-import activities without compulsory replenishing of the reserve fund and this will encourage the formation of

[4] For details see Chapter V.

[5] For details, see Chapter III.

[6] The compulsory third-party insurance policy is justified mainly in the interest of citizens who are thus covered in an equal measure in the case of an accident or other damage, independently of the fact to whom the car belongs.

other funds. A replenishing system of longer duration and of a smoother continuity (five years instead of three) is being worked out.

The system of forming and utilizing the *export-import price risk reserve fund* destined to level out changes in profits and funds due to major business price fluctuations and created before taxation—apart from the general enterprise reserve fund system—will be described in Chapter V.

B. *The system of government subsidies*

The system of state subsidies plays a significant part in asserting the main principles of income regulation and in increasing the intensity of interest and the differentiation of funds as a function of efficiency.

The fundamental endeavour of income regulation is a distribution of incomes better promoting the improvement of economic efficiency. An integral part of this conception is the system of subsidies which—by influencing the income structure—is to contribute to the implementation of the general aims of the tax system.

The system of subsidies in a given period is an elastic regulator in the hands of the state. If efficiently used, it can promote transformation of the economic structure, mitigation of contradictions between short-term and long-term interests, assertion of social preferences, elimination or moderation of the unfavourable effects due to the price system and income regulation, consolidation of harmony between national-economic and enterprise interests.

Improvement of the system of regulation involves the requirement of more adequately adjusting subsidies to the other elements of income regulation. Enterprises evaluate the result of their activities on the basis of profitability, whereas the orientating impluses of the market rely on the current profitability and not on an expected profitability. Thus one of the basic tasks of the system of subsidies is to combine current and expected profitabilities, to turn activities most effective from the national-economic angles into activities profitable for enterprises and to reduce the subsidies of loss-refunding character stabilizing the outdated structure. Conditions in the system of such subsidies must be made stricter by applying degressive scales and by increasing net subsidies directly to the funds, this being more compatible with the target to be attained. Subsidies relying on expected efficiency will be directed to create a commodity structure determined by objectives of economic policy and development of production, complying with deliberately influenced final demand and strictly associated with the further development of the price system.

Enhanced clarity and deliberate action in the system of production subsidies requires their classification according to their economic content. It is necessary to separate subsidies granted for price reasons from subsidies of a loss-refunding character. This differentiation is a precondition for starting corrections and transformation. Our analyses have shown that subsidies granted under various pretexts, or exemptions from payments due to the budget cannot be radically abolished without a wide-scale price revision, for which the conditions have not matured. It is, however, both necessary and possible gradually to reduce the scope of subsidies.

Most of the price supports will have to be continued, but care should be taken that they go to the vertical stages where they are needed to counteract price system problems and to make up for lack of development resource formation and of possibilities for raising personal incomes. It may also be necessary to take the risk of possible price changes in order to abolish certain subsidies.

Parallel to delimiting subsidies of a loss-refunding nature, we shall have to discontinue the current practice of letting ineffective enterprises have access to (often significant) development means through subsidies. In the case of such enterprises it seems reasonable to refund at most their costs (perhaps by applying depression), or to ensure them a minimum sharing fund through subsidies. Instead of subsidies of a gross character exclusively (for supplementing price receipts) or parallel to these, gradually increasing subsidies of a net character granted directly to the funds may constitute a progressive step on this road. This permits separation of development subsidies from contributions to raising personal incomes and elimination of the drawbacks deriving from parallel changes in these two funds.

Considerations of development policies may justify in certain cases financial support to development programs either by profit tax reductions or by subsidies fed directly into development funds. Such subsidies can substantially accelerate development in certain areas, contributing thereby to the intensification of its effects shaping the national-economic structure. In addition, it is necessary to maintain the system of repayable development loans given for actual development targets, for this increases the weight of the central monetary fund in the financing of developments and the influence of central decision-making on the investment structure. A more detailed description of the system of subsidies for development targets can be found in Chapter VII.

The subsidies are supplemented by exemptions from paying charges of assets and from wage tax. Some of the exemptions are again due to price reasons, because in some fields the charges on assets and the wage tax are not recovered through prices, consequently the relevant enterprises are not liable to pay contributions. (The electric-energy grid is, for instance, exempt from paying charges on assets.) In the other group of exemptions, the tax enters as a factor into price calculation but it is not taxed away for preferential considerations. The exemptions may be associated with certain activities of an enterprise and not necessarily with all its activities. Thus, if an enterprise is engaged also in ancillary activities falling outside the preferential sphere, it is liable to pay the budget dues for certain net income elements. For competition considerations it is important that economic units performing identical activities but not in identical fields or sectors should not operate under unjustifiably different conditions.

Transformation of the structure of subsidies, the elimination or transformation of the loss-refunding subsidies into stimulating subsidies promoting a rapid diffusion of efficient production are tasks that can only be solved gradually, step by step; any forward step in their respect may have price consequences. That is why the transformation of the system of subsidies will not be completed with the entering into force of modified regulators, but further steps will be taken during the plan period for moderating subsidies hindering differentiation according to effieiency and maintaining outdated production. But the aim of reducing or cancelling subsidies is not to tax the surplus results deriving from an improved efficiency of the supported enterprises; the subsidies may only be cancelled with a view to centralize surplus profits.

In addition to subsidies, there are other tools of state intervention with an opposed sign. One of them is production tax imposed on incomes traceable to monopoly positions, prices, etc., evolving irrespective of the efficiency of enterprise activities. Like subsidies, this is also a production-political method affecting proportions of income. Its wide-scale application would have an unfavourable influence on interest conditions and is therefore only exceptionally applied.

2. MAJOR ISSUES OF PLANNING INCOME REGULATION

In compliance with the experience gained in the system of regulators applied and with the requirements set for the new system of regulation, the work of planning the modification of the income-regulating system has focussed attention to the solution of the following problems:

— How to distribute tax-burdens proportional to production factors?

— How to increase intensity of interest and income differentiation according to efficiency?

— How to ease the rigidity and complexity of the income-regulating system?

— What are the possible means of regulation differing from the usual methods and the fields of their application?

The results of this endeavour have been described in the previous section outlining the system of regulators. We shall now survey and explain the modifications.

A. *Distribution of tax-burden related to production factors*

The applied income distribution system proportional to the production factors can be influenced in two ways: one is the normative net income dues associated with production factors, the other being the relative proportions of profit division and the different taxation of the profit parts.

The normative net income payments (charges on assets and wage tax) can be regarded as the most generally acting elements of economy and also as a starting point for income regulation. The relative proportion of contribution burdens, the levying basis and their total volume (determining also the weight of contributions within costs) affect the choice between resources in investments into assets and in their utilization alike. The relative proportion of minimum profitabilities (contribution burdens) expected from operating resources has an impact on the relationship between a unit of embodied labour used (capital engaged) and a unit of live labour input. The profitability of current production is influenced by the extent to which the resources engaged are burdened with income elements taked in a normative manner. All this goes to show that the valuation of live and embodied labour affects the extent to which the profit content of prices reflects differences in efficiency, and reveals whether or not the microstructure evolves in a sufficiently intensive way towards achieving the objectives of economic policy. Our analyses prove that the present ratio between charges on assets and the wage tax is inadequate and cannot be maintained in the long run.

The present rating of resources shows extensive investments involving relatively high amounts of live labour to be profitable and makes technological development releasing live labour appear as less profitable. This has unfavourable effects on both the macro- and the microstructure.

If we intend to change the situation, the proportion between normative taxes will have to be modified. The desirable and necessary magnitude and date of the modification can be determined on the basis of the ensuing redistribution of incomes among the economic units involved, and of its changes in time, with due regard to the relationship between centralized and decentralized resources, as well as to assessment of the expected price effect following therefrom.

An examination of the profit level proportionate to production factors (profits related to the sum total of assets value and wages multiplied by the wage multiplier) as a function of the organic composition of capital at present shows that the profit level of capital-intensive fields is lower than average and that of wage-intensive branches is higher. Instead of changing just one element—which would involve changes not only of extreme values but also of the average—it seems more rational to take measures as a result of which the asset burdens are releaved and the wage burden is increased in a way to compensate one another. This would not change the position and profitability level of the enterprises and branches with average organic composition, but would render profit distribution more favourable at the given time and throughout the given process alike. According to computations, such a step would contribute to co-ordinating the allocation of development resources with the plan objectives, in other words, it would reduce subsidies for the implementation of planned allocations, because it would encourage the formation of development resources in capital-intensive branches, and moderate the resources of more wage-intensive fields.

Such a modification of normative taxation prompting enterprises to evolve product assortments and technologies requiring more capital, and taxing the resources accordingly, would also move the *microstructure* in the direction of more intensive economic management. It would be a step forward also in the sense that the surplus income deriving from saving live labour would increase not only directly but also by moderating the burdens involved by the supplementary engagement of assets necessary for saving. Improvement of economic efficiency, the reduction of prime costs would acquire added importance in enterprise economy, a modified ratio would create a better coordination with the requirements of rationally utilizing resources. From another angle this is also supported by the fact that live labour is obviously becoming a bottleneck of economic expansion, and this is going to be increasingly felt from the mid-years of the plan period. This fact will have to be included sooner or later in calculative factors assessing resources.

The modification of normative taxation in itself is, naturally, no guarantee for the implementation of our economic-political objectives, for the adequate transformation of the macro- and microstructure, or for our expectation concerning efficiency coming true, but the *maintenance of the actual proportions hinders or at least slows down the process of transformation.*

Connected with the modification of the normative taxation of net incomes is the issue of *changing the basis on which charges on assets are imposed in the case of fixed assets.* Analytical investigations and assessments have produced a number of arguments for and against both net and gross values.

An argument against keeping the gross value (original acquisition) as a levying basis is that such important components as the building-to-machine ratio do not come into play in the regrouping, and its effects do not assert themselves in the case of a modified relationship between asset burdens and wage burdens, because the charge on assets is insensitive to differences in the time of amortization. On the other hand, if the rate of the charge on assets is reduced and the gross value is maintained as the levying basis, the burdens on stocks will also diminish, although the ratio of the latter constitutes an acute problem in our economy. The gross value as a basis for taxation raises essentially identical efficiency requirements against both new and obsolete assets. The net value as a basis would abolish the practice, according to which amortization realized earlier in the price of a product —which is also subject to taxation—becomes again assessable, thus driving up prices. It may be said in favour of taxing the gross value that its effect on income regroupment is rather moderate even in the case of a rise in the wage tax. An argument against relying on the *net value* for levying the charge on assets is that such a taxation apparently has a moderating effect on scrapping and can thus become an obstacle to technological development. One may also contend that the budget revenues would increase in such a case at a slower rate since the increase of the net asset value is now slower than that of the gross value. In a net-asset-based taxation, there would be no change against the present taxation system for new installations and working assets if the tax rate were not modified (that is, if it were to remain invariably 5 per cent of the net value).

Since in the years following a new investment the charges on assets would decrease, a taxation system based on the net value would be definitely advantageous for the installation of machines, for improving the building-to-machine ratio and, in general, for improving the accumulation structure (ratio of stockpiling to fixed assets) as against a gross-value-based taxation system in which the charges remain high during the whole lifespan of the equipment.

Whatever the changes in the taxation are, changes in prices will have to be reckoned with, changes that will raise the price level in the present equilibrium situation. These price changes, however,—even though ensuring better income distribution proportions at the time of their introduction—may induce unfavourable—though only transitional—side effects of a multiplying character depending on the economic equilibrium. Thus, even though the necessity of modifying the tax rates is supported by substantial arguments, the choice of the proper date is of paramount importance. Both hurried measures and their postponement might involve significant economic damage or slow down our development. And so the issue of choosing the most propitious moment is not only a very complex one but also pregnant with contradictions.

When assessing price changes, and faced with a possible modification in the taxation system of production factors, it is necessary to realize that price changes and a rise of the price level may also derive from the structural tensions between demand and supply, from shortages in certain commodities, or groups of commodities, or from imbalances on the investment market.

Let us not forget that with the current proportions of taxation, technological development also has a price-raising effect, owing to the high charges on assets. The increase of the organic composition of capital is an all-round objective of national economy. Regulation of incomes —including regulation of wages in particular—is meant to improve productivity and an economical utilization of live labour. With the present taxes on production factors, increasing capital-intensity involves unfavourable changes in our cost structure and cost level and results in rising prices.

Since any changes in the rate of taxes would endanger the stability of prices, which is a requirement of highest importance, it has been found expedient to put off the modification of the rates and of the basis of assessment to a later date.*

* This issue is dealt with briefly in Chapter I. In order to avoid repetition, the editor wishes to add here a few important arguments:

The reduction of the charge on assets can be counterbalanced by increasing the payroll tax only in larger aggregates, yet such a rise would result in a sudden increase of prices in three fields: for consumer goods, in home trade and in more than average labour-intensive branches. Concentration of the price rises in certain sensitive points would be enhanced by the fact that on the export markets this rise could hardly be transmitted in higher prices, and such endeavours would then be directed towards the domestic market. Yet, on these markets the equilbrium between demand and supply is not yet sufficiently stable in more than one respect. Thus, any measure providing for a rise of a fundamental cost factor would provoke a more intensive price rise on the consumer goods market and also with investment goods, not so much because costs have risen on a balance but rather because with looser price calculations it is possible to raise prices in fields where disequilibrium prevails.

From the angle of price policy, the increase of the wage tax is not justified because it has been proved beyond doubt that linear changes in the wage tax would only change the price level in a consistent system of prices, whereas the proportions of wages, capital and their relative weights among costs would after all remain the same as before the rise. At the outset, the expenditure on assets and wages would change but would also involve rearrangements of prices and incomes which, in turn, would again restore the present ratio between assets and wages: If things go their normal course (to be understood as conditions under which a proportional transmission of cost changes is possible), the changes in the proportions between assets and wages, raw-material price and wages, wage costs and selling prices, etc., created by the raising of the wage tax would become soon eliminated (reduced to zero in principle). Consequently, what the decision is to be made upon is the issue whether cost-increasing impulses created in the present market situation are necessary when there are only the following two alternatives to choose from: (1) the positive effects are going to dwindle within a relatively short time, and (2) such measures would anyway create very unfavourable price effects in a rather tense market situation.

Another solution would be to reduce the charge on assets and to leave the wage tax unchanged. This involves problems of an entirely different nature, since a reduction of enterprise costs would only raise profits. With due regard to the interests of the budget, a reduction of taxes would not be a solution without a simultaneous reduction of prices. Under the present conditions this could only be achieved by official price measures on a very wide scale. And there certainly are very weighty arguments against such measures. (*Editor's note.*)

Let us analyze now division of profits and taxes. In a rational choice among production factors, the proportions of the different current costs of resources and the tax burden on additionally engaged resources (conditions of forming development resources and of increasing personal incomes) combine to orientate the enterprises.

Proceeding from here, the ratios between the *burdens of additional resources should be changed in order to achieve a similar one to that of the current costs.* This requirement means that—when taxing the divided profit—the burdens on the development fund are to be brought closer to the taxes on the sharing fund.

The imposed division of profit—in spite of its well known drawbacks—has been and will be necessary in order to regulate the consumption-accumulation ratio with safety. Nevertheless, the division of profits is looked upon as a transitional solution justified, first of all, by the equilibrium requirements, by the short history of the system of regulators and by the necessity of gradual progression. Yet even under such circumstances efforts should be made to allow a widening scope for autonomous enterprise decision in the choice of profit utilization and for profit taxation as a means of influencing enterprise decisions. Accordingly, all such enterprises are granted tax reduction as transfer part of the profit from the sharing fund (Sh) into the development fund (D).

The taxes on additional resources have only an indirect impact on enterprise economy, that is, their effects extended over several years; the enterprises are, as a matter of fact, not entitled to decide on the share of profits utilized for investments or personal incomes. Owing to the fixed rate of profit division, the taxation of the two parts of profit has no directly orientating function. The ratio between the taxes, naturally, has an important part to play in shaping the ratio of the total personal income to the development resources, influencing the differences of development rate in different fields of the economy and thereby exerting an indirect influence also on enterprise decisions. Therefore any change in this taxation influences the economic processes, including the development trends chosen by the enterprises, the technologies appearing to be advantageous in economic calculations, but when dividing the profits achieved, the ratio between the taxes does not exert any direct influence on them.

In the system of divided profit, the choice among production factors is oriented by the *wage multiplier* which influences the ratio between the taxes on the two parts of profit and also the number of unit assets that can be converted into unit wages in the case of identical profitability. Among the means influencing the choice of resources the wage multiplier is obviously the most intensive one; therefore its magnitude and the average taxes are to be established so as to achieve an adequate magnitude for the decentralized funds both statically—at the beginning—and dynamically—during subsequent years.

Computations and experience have shown that a multiplier of 3 for live labour costs instead of 2 induces a favourable rearrangement in interest relations. The shift between the parts going to the sharing and to the development funds makes it possible *to bring the average tax rate of the two closer to each other,* almost to the same level, which is a significant step forward in assessing additional resources in the actual system of income regulation.

With the higher wage multiplier the capital-intensive fields acquire a somewhat more favourable position, while the position of wage-intensive fields of a substantially lower organic composition deteriorates. The rearrangement taking place at the time of the modification of the wage multiplier has a small scope and a favourable direction, mitigating the earlier disproportions of income distribution. As to its time effect: the profitability conditions of enterprises with a relatively rapidly growing and intensively developing organic composition are more favourable in the case of higher wage multiplier, provided the rate of profit growth is otherwise identical. Thus the shaping of the wage multiplier may also constitute an indirect method for enhancing incentives directed towards intensive economy, for influencing the distribution of interest funds among branches and enterprises.

A higher wage multiplier has a favourable effect on those using live labour more efficiently and an unfavourable one on those using it less efficiently. Thus by raising the wage multiplier also *the efficiency requirements concerning live labour increase* and the differences in profitability according to assets diminish, whereas the position of enterprises of average composition remains unchanged.

As a result of these modifications an allocation of the development resources in harmony with the plan can also be promoted.

In practice the problem arises what wage multipliers to apply in fields where the wage multipliers are already differing from average. This should be decided with due regard to calculations laying the foundation for the further development of the regulating system, but endeavours should be made to reduce the number and volume of the differences and—if possible—the problems should be solved within the system of subsidies. If the maintenance of preferences granted in the form of wage multipliers differing from those generally applied proves necessary, then wage multiplier differing from the average value must also be increased by 50 per cent according to computations. This will prevent the level and dynamics of personal incomes from being essentially altered as compared with other fields of the national economy.

B. *Intensity of motivation and degree of differentiation*

By improving the income-regulating system we want to enhance the intensity of motivation for higher profits, for economically efficient activities and to promote the differentiation of enterprise funds depending on efficiency. Differentiation according to efficiency raises various problems.

Experience shows that the present differentiation largely depends on the given conditions; the profit level exceeding the level foreseen in the original calculations has diminished the intensity of interest, the endeavours for higher profit; therefore the transformation of the structure has started at a much slower rate than desirable.

It is necessary to restrict the levelling elements and to increase the effect of elements inducing rational differentiation. From this angle, the issue affects the progressivity of taxes and the improvement of the system of subsidies.

As regards the connection between uniform profit taxation and interest intensity, opinions have been voiced according to which the rapid elimination of distorting effects, a sudden rise in the intensity of interest and also the elimination of drawbacks of a high initial profit level (higher than planned) could be achieved by changing the fundamental conception of the interest system. These suggestions were aimed at introducing *motivation for profit increment.* In such a profit-taxing system, an overwhelming part of the profits would have to be taxed away in the form of a fixed amount, and the surplus profit, the increment above the base year, would be taxed at a lower rate. This would eliminate the existing distortions and enhance the intensity of motivation. According to the partisans of this system, such a taxation would result in a better allocation of the resources.

Investigations have shown that a system of motivation associated with profit increment would have prohibitive drawbacks and very few advantages.

A sharp distinction between taxes on the basic profit and on surplus profit would result in a more dynamical increase of the funds than the growth rate of profit and this would necessitate a periodical rearrangement of profit division between state and enterprise and a frequent transformation of the accumulated "increment" into "basic profit" for taxation purposes. This would introduce a cyclicality corresponding to the periodicity of the system into the enterprise interests and thereby into the economic processes which, in turn, would lead to a lavish handling of resources and, as earlier experiences show, would stimulate the formation of reserves — even in cases when the interest relations are not the exclusive promoters of enterprise decisions.

With the introduction of such a system, in fact, any significant rearrangement would involve a rearrangement of enterprise funds and decision spheres, and this would obviously not be in keeping with our fundamental principle of decentralizing tasks and resources or with the maintenance of continuity and stability.

Identical profitability level in this system would result in different funds depending on the "rate" at which the enterprise attains its results, and the funds would not be favourably allocated even if the profit content of prices were to incorporate more objective efficiency differences, because the dynamics of the funds would no longer follow the efficiency differences reflected in the given price and profitability conditions but rather more the momentary fluctuations of business cycle boom. Such a high business-sensitivity would aggravate some problems that exist anyway under the present interest conditions. In such a system, the structural changes would not promote economic efficiency but only reflect the actual boom. This would eliminate the automatic mechanism under the impact of which profitability ratios — and distribution processes related to them — reflect efficiency differences to an increasing extent.

All this would make it impossible to interpret a uniform assessment of the resources. An enterprise could, for instance, be interested even in the reduction of profitability (profit/assets engaged) and of production if this were to result in a relatively rapid growth of profits, since earlier profits and profit increments are assessed differently in the system. This could lead to an abatement of the selective effect of motivation, to a lavish treatment of resources and to a deterioration of equilibrium conditions. A modification of motivating conditions would also have an impact on the price system.

The elimination of existing potentialities — and of the changes turning into new potentialities in the wake of later rearrangements — from the motivator-system attached to profit increments is achieved at the price that the incomes absorbed in the form of basic taxes are incorporated, accumulated in the profit content of prices, and the prices lose their power to induce an efficient utilization of resources. While the present system of interest drives, in principle, toward the equilization of motivation intensities — and thus of the efficiency of the resources engaged — the incremental system is meant to equalize the growth rates. And such a target could in no way be justified.

The obvious drawbacks of such a system make it clear why we continue to look upon profit as a homogeneous whole and tax it accordingly, resting contented with less spectacular achievements in the increase of interest intensity while avoiding an orientation at variance with our long-term objectives. The problems that the partisans of the increment interest want to solve really persist, but only a mechanism based on a uniform evaluation of resources is capable — in our opinion — of eliminating distorting effects.

We wish to tell some words about *progressive taxation*. If we want to increase the intensity of motivation for higher profit, we must moderate the progression of taxation. This can be achieved by moderating the progression and size of the tax rates and not by reducing the average taxes on rising personal income. The lack of incentive towards increasing profit is not due to high taxes on personal income but to the following reasons:

— owing to intensive progression, the effect of higher profit on increasing personal incomes has diminished;

— a considerable volume of profit and particularly of profit increment is in the highest tax zones;

— owing to some negative effect of the actual income-regulating system, more effective methods than increasing profit have been found by enterprises for increasing personal incomes (e.g., the boosting of relatively low-wage new staff has made it possible to raise the average wages of the former staff);

— effects of a similar direction have been produced also by subsidies and other state preferences.

In keeping with other modifications of the regulating system the progression of the tax on the sharing fund may move within

40 to 70 per cent, remaining in zones determined by the percentage of wages. In 1970, the progression of the tax rate moved between 0 and 70 per cent. Another method of moderating progression is to assign a smaller share of profit to the 70 per cent tax band. In the first years of the plan period not more than 30 to 35 per cent of the sharing part of the profit will come in the 70 per cent band against almost 50 per cent in 1968–1970. The maximum tax band is attained at a much higher value of the ratio of the sharing part of profit to wages (P/W) than now. Under the impact of these factors the progression is considerably reduced, and the average tax rate shows a minimum of change over the years. Thus, considering the raising of the wage multiplier, in spite of an unchanged 70 per cent maximum tax band, the incentives to increase profits become much more intensive since a larger part of profit increment may turn into personal income.[7]

On the strength of the modified progression scale, the gap between the taxes of enterprises with low profitability and those with high profitability diminishes and thus their interests in surplus profit do not essentially differ.

In conclusion, the wide-spread system of preferences modifying profitability conditions created by general regulators (including subsidies, exemptions, production taxes, wage preferences, preferential and restrictive or even prohibitive development fund tax rates, etc.) is also a brake on interest in increasing profits, inevitably equalizing the income differences between economically efficient and inefficient enterprises. Therefore the increase of the intensity of interest must also be encouraged by shaping and modifying other regulators—chiefly by establishing their extent. In the case of branch preferences, regulation must, naturally, take into account the objectives of the plan.

C. *Possibilities of a simpler and more flexible income-regulating system*

An important step in this direction is the *moderation of the strict correlation between enterprise income regulation and wage*

[7] While with wage multiplier 2, an enterprise of average organic capital composition in the 70 per cent tax zone could save 6 forints out 100 of profit increment for its sharing fund, now the same enterprise can allocate 8·40 forint from the same amount of profit increment. This, in itself, shows that in the system of profit division the incentives attached to profit increment do not exclusively depend on the ıate of taxes but also on the rules of profit division and its changes.

regulation without impairing the efficiency requirements raised against wage increases. In the system of personal-income regulation valid up to 1970 considerable problems derived for the sharing fund from wage increments accumulating since 1967 as the basic year; it has led to an annual upward shifting of the tax rates on the sharing fund.

Since the accumulation of the wage increments in the sharing fund will be discontinued, the evolution of the profit-taxing system directed to increasing efficiency and productivity has gained considerable impetus. Without this, the differences and tension among enterprises regarding possibilities of raising the wage level, that still seem insignificant, would accumulate to an extent that the financial system could not keep them limited without a strong progressive and differentiated tax system. Such a system could not be operated indefinitely. The maintenance of the system unchanged would make the intensity and dynamics of the motivation dubious and would require regularly recurring to the tax bands or some other solutions of equal value, any of which would provoke price-raising tendencies.

With due regard to the above considerations we have reckoned with a modification of wage regulations and have attached—in order to avoid a cumulative taxation—to enterprise income regulation (the formation and utilization of the sharing fund) only such consequences (tax burdens) as are associated with the given annual wage level increment. This is the only way to liquidate the contradictory situation according to which

— the wage increase is attached to formally very high profit requirements making an unjustifiably sharp distinction between the components of live labour costs (that is, staff increase and average wage increment; the change also induces the enterprises to desist from an irrational staff number policy), on the one hand, and, on the other,

— thanks to the adjustment of the tax rates, it was possible to increase the personal incomes, including average wages, with decreasing profits; if this contradictory situation were to be preserved, the progression could not be reduced substantially, although strong progression is an obstacle to the wage increase precisely in the most dynamical enterprises.

A non-recurring progressive levy on wage rise (see Chapter III) gives a wider scope for enterprises to pursue an autonomous wages policy and for a stronger differentiation of wages within the enterprise. This taxation channel actually regulates the relationship between non-recurring profit share payments and wage rises resulting in a lasting surplus of personal income. (This distinction is of importance mainly because the level of wages once attained cannot be essentially reduced.)

In the last analysis the new system strengthens the collective interest because—owing to the elimination of contradictory elements and to the decrease of progression—the interest in profit is allowed to prevail more intensively. At the same time, owing to the cancellation of what is referred to as technical profit,[8] the new system makes the calculations less complicated and also reduces the complex indirectness of the economic effects.

Switching over to the new system involves certain problems because the wage increment accumulated in the sharing funds differs from enterprise to enterprise, that is, different amounts have been charged on these funds before distributing the shares at the end of the year. The tensions deriving therefrom should be so eliminated as not to permit an all too heavy rearrangement in total personal incomes and in the sharing funds.

When centrally and uniformly determining the taxes to be imposed on the sharing funds, the average wage level increment of the first three years (1968 to 1970) has been considered. This inevitably involves a certain kind of income redistribution, which, however, is, according to computations, much smaller than a rearrangement that would result from a transition to a new basic wage level.

The other problem of the income-regulating system is its rigidity. The enterprises have had no opportunity to exploit business fluctuations requiring minor investments in a given moment, because their facilities are unequivocally limited by the magnitude of the development fund formed in a given year. This restriction is to be mitigated by *permitting a regrouping between the funds*, which, true enough, is only a one-way street leading from the sharing fund into the development fund for the time being.

The possibility of regrouping contains also an element of stimulation; an adequate choice of tax burdens may influence the enterprises to transfer money from the sharing fund (Sh) to the development fund (D), whereby an exaggerated wages outflow can—indirectly—be prevented.

The practical solution is that the part of income transferred from Sh into D is taxed at a lower rate than D, whereby the

[8] The addition of the amount of the average wage increment to the book-keeping profit before taxation.

enterprises — in the case of favourable development possibilities — are prompted to renounce the annual increment of the personal income. The preferential taxation means that the amount of net income of regrouping inter-prises (post-taxation income) becomes higher than it would be otherwise, that is, they obtain "additional" funds.

The requirements of stimulation are satisfied by a tax reduction, thanks to which the development fund so obtained is some 50 to 150 per cent higher than the extent to which the sharing fund would have grown. Considering the 60 per cent tax on the development fund, the gain equals a reduction of about 20 per cent.

One of the major advantages of these elements acting through the taxation system is that they stimulate a far-sighted economic policy, require the combined evaluation of results expected over several years and promise the possibility of regroupment into the development fund in the case of boom profits. The levy associated with wage increments, to be dealt with in Chapter III, has a similar effect, stimulating to think in terms of long-range policy.

Modification of the formation of the reserve fund and mainly of the system of utilization is also meant to mitigate the restrictions of the system. The obligation to form reserves during the plan period influences the dynamics of the available funds and therefore reacts also upon the extent of taxation.

The current regulation has established the compulsory level of forming reserves in percentages (1·5, resp. 8 per cent) of the value of assets engaged and of the wages paid. This regulation does not comply with the economic function of the reserve fund which is primarily meant to counteract the reduction, due to boom reasons, of the level of funds attained earlier and to solve problems necessarily deriving from the nature of interest associated with annual achievements, as financial coverage of economic risks. The gradual evolution of market conditions, the necessity of undertaking increasing risks enhance the significance and extend the functions of the reserve fund. Accordingly, the possibilities of utilizing the reserve fund are extended also to levelling out the price changes in international economic relations.

This enhanced function requires the modification and improvement both of the compulsory level and of the rules governing utilization.

In establishing the obligatory level, it is necessary to consider — in addition to the production factors used and engaged — also the side of utilization because the extent of the reserve fund to be formed is determined by the needs for its use in the first place. Depending on the nature of the economy, the character of risks is different in the various fields of the national economy, the growth of profits may be steady but it may be achieved also at the price of annual fluctuations, possibly between wide extremes. Temporary difficulties concomitant to initiatives and bolder business policies could be solved with a system of forming and utilizing reserve funds, in which reserve formation is adjusted to a profit level corresponding to the nature of enterprise economy. It is the annual volume of profit, the sharing and development funds that the enterprises can use for expanding their activities and to increase the personal income of their workers, depending on the standard of their economic activities. The funds depend on the annual business fluctuation of profits, as well as on measures taken to improve economic efficiency and to enhance long-term interest. All this requires a system of reserve fund formation in which the building up of reserves and the resulting financial means are adapted (proportional) to the volume of the sharing and the development funds. According to calculations the optimum level of compulsory reserve formation seems to be 80 per cent of the total volume of the funds. The compulsory level should be determined with due regard to the volume of these funds evolving under conditions maximum Sh/W[9] and D/A[10] ratios attained in the given period. In other words, the earlier compulsory level (1·5 per cent of the assets and 8 per cent of the wages) is to be considered as the minimum of the compulsory level.

This system of determining the compulsory level—beside imposing identical burdens on enterprises in forming reserves—makes it possible to determine, much more exactly than before, the date when the funds are replenished on the macroeconomic level. Disregarding utilization, the enterprises will have their funds replenished at about the same time.

The annual compulsory level of feeding the reserve fund changes from 10 to 12·5 per cent for both funds. This will keep

[9] $\mathrm{Sh/W} = \dfrac{\text{Sharing fund}}{\text{Wages}}$, that is, the ratio of the taxed amount of the sharing part of profit to wages.

[10] $\mathrm{D/A} = \dfrac{\text{Development fund}}{\text{Assets engaged}}$, that is, the ratio of the taxed amount of the development part of profit to the value of (fixed and working) assets engaged.

the outflowing purchasing power balanced. Parallel to this, the time for refunding the reserve fund for utilized sums increases from three to five years.

D. *Exceptions to the general rule*

It has been found necessary to consider to what extent it is justified to subject certain activities to regulations differing from the general rule and what methods to use in such cases.

Uniformity in both structure and degree, originally aimed at, guarantees an identical, uniform evaluation and favourable allocation of resources engaged in production. This, however, does not exclude that in a few justified cases certain activities should be regulated in compliance with their specific traits. In a given case this may even contribute to the establishment of uniform and identical conditions for assessing resources.

The main groups of activities entitled to specific regulation are as follows:

(a) Unusual economic conditions, specific circumstances in which certain economic resources operate, whose impacts are to be mitigated or neutralized to ensure a safer satisfaction of social needs. Thus:

— in the commodity supply of the population it is necessary to consider the specific aspects of stockpiling ensuring a distribution of commodities required by the increase of turnover satisfying growing needs;

— the limited possibilities of a profit-oriented management in public transport;

— the market-bound monopoly positions of different significance of certain activities. It is not necessary to liquidate or strongly restrict certain monopolies (e.g. foreign trade).

(b) The preferential development of public services directly promoting the supply and the living standard of the population in order to put into practice our social objectives. Since there is much to be done in this field in Hungary, the preferential treatment of services is an important task justified within the scope of income regulation.

(c) A special field of implementing our social objectives is that of cultural policies. Economic and not administrative methods are applied to lead the activities of the affected enterprises in the direction required by our cultural policy. This, of course, can only be achieved if exceptions are made and preferences granted. Care should be taken to prevent material interest from overriding or jeopardizing the achievements and objectives of cultural policy. The enterprises concerned are similar in their internal structure to the mechanism of productive enterprises, and it is therefore justified to induce them more efficiently to exploit the available means—within certain limits—to undertake risks and to make themselves more familiar with market conditions. The guidelines of the present regulation, together with planned modifications, are applicable in this field, too.

Chapters IV and VI deal with the specific regulation of enterprises of foreign and domestic trade, as well as of enterprises providing for the cultural and other needs of the population. Let us add here that in regulating the activities of *transport and telecommunication* enterprises the following characteristics are to be taken into account:

The public character of transport and telecommunication requires individual regulation.

The adequate proportion between the funds shall be ensured by wage multipliers differing from the usual.

In municipal mass transportation (buses, trams, underground) state subsidies shall be continued to ensure the formation of at least a minimum of profit. Subsidies for non-mass transport enterprises are to be determined at fixed rates, and possible surplus expenses are to be covered from the own financial resources of the councils.

In both long-distance and local passenger transport an important objective is to ensure the conditions of civilized travel. For this purpose a growing annual amount of 120 to 250 million forints is earmarked in the budget for subsidies.

Railway passenger transport is to receive consumer price adjustments to cover first costs. Since railway passenger transport earns no profit, the negative effect exerted by artificially low prices upon wage increment is to be set off in the form of tax refunds in order to help the formation of the sharing fund for the overall activity of the railways. The cost effect are to be taken into account in determining the extent of subsidies until the settlement of the tariff for goods transport.

Since third-party insurance has become compulsory for all motor vehicle whether private or state-owned, it is necessary to examine whether or not road transport enterprises need preferential treatment in taxation.

Except for motor vehicle transport, partial or full exemption from municipal contribution should be granted.

The further improvement of the regulating system relies on the existing conditions, on the plan objectives. The modified system as a whole will be able—in spite of certain problems—with increasing centralized share--to create more favourable conditions for incentives by a better distribution or burdens and by a more intensive prevalence of differentiating elements.

The coming years will have to evolve a strategy for the further development of the regulators. The present modification creates a favourable starting point for further changes eliminating the surviving problems. But such changes can only be worked out after thorough economic research work in full compliance with economico-political objectives in the complex sense of the term.

Chapter III

WAGE REGULATION AND MANPOWER MANAGEMENT

by

ISTVÁN BUDA

1. GENERAL OBJECTIVES

The objectives of the economic reform concerning income regulation and material incentives were as follows:

— material interest shall be centred on actual profits;

— the magnitude of material means available for enterprise development and raising the personal income of enterprise employees shall depend on profit, and profit shall function as the major source for attaining these objectives;

— the employment level shall not fall in the national economy, not even temporarily;

— the incentives to reveal internal resources, to a rational employment of labour, to raise the technical and technological standards and finally to increase productivity and economic efficiency shall be intensified;

— differentiation of personal incomes as a function of labour efficiency shall be increased.

In compliance with the above principles, profit is divided in the current profit interest system according to centrally established rules into a part earmarked for development and one destined for increasing personal incomes. These two parts are taxed in a different manner (see Chapter II) and the increment of the enterprise wage-bill due to the rise of the wage level (or part thereof) is detached from the sharing fund according to central prescriptions.

The system of income regulation and of material incentives —together with the effects of factors other than regulators— have not worked entirely as envisaged. An analysis of the experiences in the first two years of the reform shows that —*compared with favourable results in general—there is hardly any progress in organizing the rational utilization of live labour.* This is reflected also in the stagnation of industrial productivity in 1968 and 1969 (calculated on the basis of the gross production per man-years), in the unjustifiably high demand for labour—resulting sometimes in harmful by-products—in lively manpower migration, in the relaxation of labour discipline, in a rise of the wage level exceeding performance, and so on. (Let us also remember that working hours were cut down in industry and in the building industry during this period.)

The causes of these *unfavourable phenomena* are as follows.

The personal material incentives have lost much of their impetus, and the improvement of enterprise productivity permits only a small increment in personal incomes.

The wage-regulating system has hampered the evolution of a rational labour and wage economy and has—in more than one respect—opened the road for explicitly unfavourable processes detrimental to productivity

The incentive system has been sensitive to changes in the composition of staff, giving strong preference to the employment and keeping of low-wage and low-qualified workers. This sensitivity has also influenced the development tendencies inasmuch as the enterprises found unfavourable most of the investments requiring—in addition to the raising of the technical standard—the employment of highly qualified workers and the dismissal of low-paid (unqualified) workers.

The controlling and checking activities of the supervisory authorities of enterprises were not satisfactory, especially at the beginning. This was manifest in the absence of guidelines promoting the laying of long-term foundations for income and labour economy in enterprises, in the liberal treatment of the material incentive system of enterprise managers appointed by the supervisory bodies and in the relaxation of checking enterprise activities.

The labour management in enterprises did not even attain the expectable level. The practice of giving preference to the immediate enterprise collective interests over the interests of the society as a whole became widespread. By exploiting the shortcomings of some regulators, enterprises solved additional tasks by increasing their staff at a much quicker rate than would have been necessary. The revelation and utilization of the today still considerable enterprise reserves were neglected. Work- and business organization slackened, norms were not maintained on the efficiency level and the lack of discipline was tolerated. A large part of the available material means was used for acquiring manpower, for the maintenance of unreasonable staff numbers. At the same time, the income policy encouraging the increase of productivity and the improvement of economic efficiency was neglected.

The modification of wage regulation in 1970

On the basis of experiences gained in the first two years of the reform, the system of wage regulation was subject to significant but not fundamental changes in 1970. The aim was to reduce the difference between the burdens of wage level increment and staff increase, to moderate interest in unreasonably raising the employment level, in "inflating" the staff,[1] to create favourable conditions—by reducing requirements—for raising the wage level, for introducing more stimulating wage forms. The enterprises should turn their attention to rational staff economy and a situation should be brought about where they consider more thoroughly than before whether or not a rise of the staff is justified and necessary.

According to a modification introduced on 1 January 1970, an increment of the average wages over the 1969 level—up to a 4 per cent increment—is charged to the sharing fund only up to 70 per cent instead of the previous 100 per cent. Thus the amount of profit required for raising the wage level was reduced. As to the higher requirements concerning staff increase, the new provisions obliged the enterprises to transfer one-third of the wage increment due to the staff increase to the budget from the sharing fund part of the profit before taxation. The provisions gave a moderate preference to staff reduction.

This modified wage-regulating system was established *under restricting conditions*. Since the other regulators determining the financial, economic position of enterprises remained unchanged, it was impossible to make a more intensive step forward.

In spite of the advantageous economic results of the year 1970 (with a 7 per cent increment of production in state and co-operative industry, the per capita production value increased by more than 6 per cent), the current regulation cannot be maintained over the entire period of the Fourth Five-Year Plan, because its efficiency is not satisfactory. Nor could it be maintained unchanged even if we were convinced of its capacity of intensively encouraging the increase of economic efficiency of labour, of

[1] The employment of low-wage workers reduces the average wage and makes it possible to raise the wages of those already employed (within the average wage level attained, that is without tapping the sharing funds). This, naturally, results in a redundant boosting of the staff and of the wage-bill. The dismissal of low-wage workers involves an opposite tendency, encouraging the retention of the workers engaged even if their efficient employment is not ensured.

productivity, for a long time. The basic wage level of neither 1967 nor 1969 can be preserved as a reference basis during the whole plan period. The cumulative charging[2] of the wage level increment to the sharing fund cannot be continued because, even with improving economic achievements this would sooner or later consume the entire sharing fund in some enterprise. Nor can the shifting of the tax rates be continued *ad infinitum*, as explained in Chapter II.

Wage regulation requirements in the Fourth Five-Year Plan

An overwhelming part of the increment of national income – 80 per cent in industry, 70 per cent in the building industry and 100 per cent in agriculture – must come from enhanced productivity according to the Fourth Five-Year Plan. With diminishing material inputs this can only be achieved by a rapid growth rate of productivity of social labour and with a moderate rise of those engaged in material production branches. And demographic factors make it definitely imperative that the increase in employment should be moderate. All this requires a substantial improvement in the efficiency of economic management. Within the complexity of economic regulators it is necessary to work out a system of wage and personal-income regulation which,

— enhances the interest of enterprises in a more efficient utilization of live labour, promoting a more rational and planned labour management;

— combined with other regulators, creates more adequate interest in intensive investments;

— substantially reduces the possibility for enterprises to acquire advantages by "inflating" their staff;

— determines such ratio between increasing efficiency and the wage level which enables higher economic achievement to cover the wage needs for increasing efficiency;

— ensures resources for raising the wage level and personal incomes even in highly efficient enterprises where the profit increment is small and it is much more difficult to increase profits than in low-efficiency enterprises possessing considerable reserves;

— establishes closer ties between the wage level increase and increasing efficiency, gives a wide scope for a more intensive

[2] That is, increase related to a fixed basis (e.g. to 1967).

differentiation of incomes as a function of achievements, promotes manpower migration in the desirable direction and a more rational utilization of the production factors;

— ensures the continued interest of the collective in increasing profits;

— by encouraging higher productivity, promotes that the utilization of the wage volume making up an overwhelming part of the purchasing power should serve the raising or real wages more effectively, in keeping with the objectives of the living-standard policy.

The improved method of wage regulation is destined to act in the direction of satisfying these requirements.

The fundamental principles and objectives of the new system of economic management invariably apply to the period of the Fourth Five-Year Plan. The modified system of wage regulators remains closely linked to the other regulators, especially to income regulation.

The modified system of enterprise wage regulation

Chapter II makes it clear that

— the centrally regulated division of profit into enterprise funds remains in force;

— in the profit-dividing formula the wage multiplier changes;

— the method and extent of taxing the sharing fund are modified;

— the "technical profit" is eliminated from calculations;

— in addition to the new method of wage regulation (to be described in detail below), both the extent and consequences of wage level increases are to be related to the wage level of the preceding year as from 1971.

(The foregoing considerations make it clear why it was necessary to raise the average tax on the sharing part of the profit. The necessary budget revenues, as well as the balance between purchasing power and the commodity fund must be secured. In the case of identical economic results, the modified regulators must not permit, in general, higher sharing funds, and thereby a higher level of personal incomes, than prior to the transition to the new rules.)

We shall now describe the wage-regulating system in the strict sense of the term, relying on the methods to be applied in state and cooperative industry and the building industry:

1. An important principle is that the major part of the increase of personal incomes is to be charged to the sharing fund in the future too.

2. A new feature is that the average wage increment can be charged to costs, but the wage level increment—as far as its charging to the sharing fund is concerned—shall be made dependent on the increase of the per capita wage plus profit

$$\left(\frac{W + P}{E}, \text{ the wage increment indicator}\right).$$

The value of this indicator increases if profit grows quicker than employment. This relation creates interest in higher profit, in rational employment policy and, in the last analysis, in increasing productivity.

This indicator, however, does not take into account capital investments. Whether the improvement of this indicator is achieved by investing more capital or by mobilizing internal reserves, the possibility of raising the wage level is not influenced. This deficiency of the indicator is partly offset by a levy on the sharing fund on account of wage-increases and by the fact that the sharing fund is dependent also on the efficiency of asset utilization. At the present stage of our development the property of the indicator which lays greater emphasis on live labour has a beneficial influence also on enterprise decisions on investments.

If higher profit is attained by capital investment, the indicator shows a higher value and also the increment of the wage level which can be used preferentially is greater. But, owing to the engagement of increased assets, the compulsory division of profit permits a smaller part thereof to go into the sharing fund, and the obligation of preferential tax-remittances also becomes a considerable burden. Yet, if the same amount of profit is attained without new assets engaged—that is, by a better utilization of internal reserves, by a better organization of labour, without increasing employment —a larger part of profit goes to the sharing fund, and an identical sum of levy involves a smaller ratio than in the previous case. In the last analysis, then the *enterprise is only interested in capital investment in the case of a corresponding improvement of economic efficiency.*

For every 1 per cent increment of the wage increment indicator over the previous year, the enterprise is entitled to raise the wage level (average wage) by 0·3 per cent over the actual wage level of the previous year, with a non-recurring preferential remittance obligation.

The preferential levy on wage increment means that 50 per cent of the additional wage-bill due to wage level increment permitted by the indicator in question is to be transferred to the budget from the sharing fund after taxation and the deduction of reserves.

If, for instance, an enterprises raise the value of the indicator of per capita wages plus profits by 10 per cent from one year to another, it is entitled to making a 3 per cent rise in the wage level simultaneously transferring 50 per cent of additional wages to the budget. (If, then, such a 3 per cent rise equals 3 million forints of additional wages, for instance, the levy to be paid from the sharing fund will be 1·5 million forints.)

In order to promote more efficient wage forms on a wider scale and corresponding to the characteristics of the *building industry and of the building-material industry*, it seems more expedient to use a higher coefficient than 0·3 per cent in defining the wage level increment entitled to the preferential 50 per cent non-recurring levy. Consequently, it was decided to establish three limit values for the annual increment of the indicator of per capita wages plus profits and—after attaining each individual degree—to apply a 0·4—0·5 and a 0·6 per cent coefficient to the entire increment instead of the usual 0·3 per cent. (The coefficient is 0·4 up to a 4 per cent rise of the per capita wages plus profits value, 0·5 between 4 and 5 per cent, and 0·6 per cent above this value.)

In the building-material industry the linear application of a 0·4 per cent coefficient seems to be reasonable with a moderate wage preference[3] granted for 1971.

Within *food industry*, the cold-storage industry and the sugar industry, the system of relative wage volume regulation needed only minor modifications. This system consists in the following: the wage volume available for utilization depends on the production value calculated at unchanged prices and on a centrally established coefficient. (For instance, the wage volume available increases by 0·6 per cent after every 1 per cent increment of the production value.) If the enterprise pays more wages than allowed, it pays a progressive remittance from the sharing fund.

It may justly be asked why these few industries need a regulation different from the usual. Wage *volume regulation* is applied

[3] Referred to as wage preference are such central provisions as permit — with a view to adequately modifying wage proportions — enterprises to raise their average wages beyond the limits of the regulation and without charging it to the sharing fund.

in state farms on account of the dependence of agricultural production on the weather and the ensuing fluctuation, on account of its seasonal character and of the decrease in the number of agricultural workers. The above branches of the food industry are influenced by similar factors and are very closely linked to state farms. Therefore the relative regulation of the wage volume is more expedient in this field.

Nevertheless, an overall application of wage volume regulation would not be expedient because

— it is definitely more advantageous to stagnant enterprises or to those reducing their production than to the progressing, developing ones;

— the production value (especially at unchanged prices) as an assessment basis—beside the uncertainty and the distoring nature of the indicator—could clash with the general profit interest of the enterprise;

— in this manner it is more difficult to establish the objective foundations of the coefficient production per wage volume, and enterprise differentiation, corrections and ulterior exceptions are almost inevitable;

— the distribution among enterprise workers of the available wage volume without average wage prescriptions would lead to a substantial distortion of relative wages.

3. The enterprise will, naturally, have the right, also in the future, to raise the wage level higher than "permitted" by the wage increment indicator as described above. The national-economic plan does reckon with enterprises raising wages higher than the level determined by the said indicator.

The increasing efficiency of incentives may also justify higher wages than can preferentially be attained. Although an enterprise temporarily taps its sharing fund by further raising the wage level, it may be worth doing so in a suitable economic environment, since incentives enhanced by the rise may advantageously affect profits in the following year.

But the levy on the wage rise higher than "permitted" shows a progressive rise, as tabulated on the next page.

If, for instance, an enterprise raises the wage level by 1·5 per cent above the extent determined by the wage increment indicator (a wage volume, say, of 1·5 million forints), it has to pay from the taxed sharing fund 150 per cent after the first half per cent (a wage-bill of about 0·5 million forints), that is, 750 000 forints, 200 per cent after the next half per cent, that is one million forints, and 250 per cent after the next half per cent,

For a rise of			per cent of levy
from	0	to 0·5 per cent	150
	0·5	1	200
	1	1·5	250
	1·5	2	300
above	2		400

that is, 1,250 million forints (3 million forints in all, that is, an average of 200 per cent).

4. The *levy* described above *is only due after the wage level increment of the year under consideration*, that is these payments do not cumulate over the years. Since the sharing fund in the next year (or years) is relieved of this non-recurring burden, the enterprise may again raise wages without a substantial cut in the sharing fund, even though profit shows a minimum of growth compared with the previous year.

For instance: if an enterprise, where the gross sharing fund is equal to 10 per cent of the wage costs, raises the wage level by 3 per cent—out of which 1·5 per cent is treated preferentially and 1·5 is progressively taxed—and therefore pays a levy on wage increment corresponding to 3·75 per cent of the wage costs, it is entitled to pay a share corresponding to 6·25 per cent, in different forms. In the following year, provided it raises neither the profit nor the wage level, its available sharing fund will be 10 per cent because it will be exempt from the levy on wage increment. Thus the personal income of the workers will rise even in this case by more than 3 per cent. If the enterprise increases the wages by 1·5 per cent (with unchanged profits), it has to pay from the sharing fund a levy corresponding to 3 per cent of the wage costs, yet the available part will increase from the earlier 6·25 per cent to 7 per cent. And even in this case the average of all personal incomes will be by some 3 per cent higher than in the previous year. But an enterprise having a small sharing fund on account of its low economic efficiency has, of course, no such choice.

5. In order to extend a rational practice of wage economy, an enterprise is entitled to a preferential levy on wage increment (50 per cent reduction) even if it does not avail itself of the possibility of higher wage rise in the current year but does it in the following year (years).

If the value of the indicator of per capita wages plus profits decreases compared to the previous year, the enterprise is levied progressively even within the wage level already attained. The point is that in such cases the actual wage level is higher than the one "allowed" by the indicator, and the difference is therefore to be levied progressively in the same manner as if the situation were due to the rise of wages and not to the decrease of the indicator.

Within the system of regulation described under items 2 to 5, the enterprises become interested in increasing from year to year the value of the per capita wages plus profits indicator. This is a condition without which the raising of the wage level is not treated preferentially.

The inclusion of the per capita wages plus profits indicator into the system of regulators *enchances long-term interest indirectly but palpably*. The annual increase of the value of this indicator requires the evaluation of the current year and the possibilities of the following years alike in development policy, in revealing internal reserves of enterprises and in the rational engagement of labour. Every year serves as a basis for the next with respect to both the per capita wage plus profit indicator and the average wage. If for lack of well-founded economic activities, an enterprise exploits its possibilities in the current year in a manner involving harmful effects for the future, it may raise wages in that year but this will tell on the following years. It is also to be realized that wage costs—even when other factors are unchanged—diminish profits, yet an efficient wages policy may increase output and this, in turn, may increase profit.

The changing values of the wage increment indicator will result in a *more intensive differentiation* of personal incomes in industries and enterprises than in the past. Differentiation will be enhanced by higher efficiency and productivity, yet also by the differences in the conditions under which enterprises can increase their profits. In general, the workers of enterprises operating with higher efficiency will obtain higher income than those working in less successful ones. Substantial differences in wages and personal incomes may, however, result also from factors other than economic efficiency.

We wish to ensure the realization of about three quarter of the possibilities available for raising personal incomes outside of agriculture in 1971 - 1975 by enterprise (co-operative) regulation. The rest is to be used for ensuring the increase of wages (incomes) of workers in budget-financed organizations at a rate essentially identical with that of the wage rise of enterprise workers, on the one hand, and, on the other, for preventing or eliminating undesirable distortions of wage proportions by central intervention, especially to make up for lags of earning conditions in branches of particular importance. The methods of central intervention (wage preference) are: permission to raise wages irrespective of the value of the wage increment indicator and without charging it to the sharing fund; granting higher preferences for wage increases on the basis of the wage increment indicator; taking special regulatory measures for raising the sharing fund (raising the wage multiplier, etc.). Within annual planning, the socialist state can exert control over wage policy and promote planned proportions in general by imposing lasting provision in wage regulation and by the operative application of special regulators. But part of the regulation are also such prescriptions—discussed in this chapter —as the regulation of wage tariffs, as well as the consistent and purposeful implementation of wage policy by the leading state authorities and enterprises.

6. In the per capita wages plus profits indicator and in the average wage (wage level) indicator, the number of employed must not include (as earlier) the part-time workers, which would distort the average wage level of the enterprise. The increase of the number of part-time workers would "delute" the staff and would offset the effect of the real wage increase on the wage level. The harmful "diluting" tendencies have had to be hampered, yet it has been important to maintain the interest of enterprises in employing part-time workers (pensioners, women, etc.) in jobs where this is economically efficient and where it meets the employment requirements of the society.

For the solution of this problem the regulation prescribes

(a) the wage components of the wage level as

— all amounts paid as wage costs to those employed full-time (basic wages, bonuses, allowances and other wages) and

— all other payments to part-time workers charged to the wage costs;

(b) the staff components of the wage level as

— the average annual number of staff consisting of those employed full-time and

— the fictitious staff number resulting from the quotient of all other payments charged to the wage costs and the average wage of the full-time workers.

For example: The total wage-bill is 20,020 thousand forints, including 18,200 thousand forints paid to full-time workers.

Since their number is 700, their average wage is 26,000 forints. The remaining 1,820 thousand forints divided by the average wage of full-time workers yields 70. This will be the fictitious number of part-time workers.

Thus the enterprise wage level (average wage) is obtained by dividing the wage costs by the average staff number of full-time workers plus the calculated fictitious number of part-timers.

7. For the sake of continuity it was an important task to *prevent excessive changes in the level of personal incomes from being elicited by the re-arrengement deriving from adopting the new wage regulation.*

For calculating the average wage increment in 1971, the actual wage level of 1970 is to be taken as basis, except for the case when an enterprise has raised the average wage with a reduction of the available per capita sharing fund compared to 1969. In this case, the actual wage level of 1970 is to be adjusted—up to a 3 per cent increment—in compliance with the decrease of the per capita available sharing fund. If, however, the average wage increment over 1969 does not exceed 3 per cent, the actual average wage of 1970 should be taken as a basis, irrespective of the changes in the per capita available sharing fund.

The adjustment method described here is used in calculating the 1970 basis so as to avoid glaring injustice. Without it, there would be a risk that some enterprises would raise the wage level in 1970 without well-founded economic reasons and thereby considerably reduce the per capita available sharing fund. This would permit some enterprises to create a favourable position for themselves and to acquire undeserved advantages over others.

The enterprises forming average wage reserves in 1970, that is not making maximum use of their possibilities of raising average wages do not come to grief, for they can raise the wage level in 1971 preferentially to a larger extent.

Beginning from 1972, the previous year will be taken for basis of calculating the wage level every year, without such correction, yet taking into account what has been explained under item 5.

8. Basic-wage and classification system (wage-tariffs) will be further developed to ensure correct income proportions better than now and to permit a wider differentiation of basic wages according to performance, individual results, vocational training, practical experience and the responsibility involved.

The tariff system ensures a relatively wide range but has relatively few categories. The enterprises have wide possibilities for differentiating individual wages according to performance, faculties, responsibilities, conditions of the place of work, and so on.

The basic wage and the tariff systems are known to constitute a factor influencing income proportions. The enterprises are meant to be given correct orientation and possibilities for achieving the income-political objectives outlined above. Owing to scarce economic resources, further development of the basic wages and tariff system is not coupled with central wage-political provisions. Consequently this step is not meant to bring about changes in the actual income proportions right at the beginning.

Wage- and income-regulation outside industry

The main endeavour is to ensure, as far as possible, a homogeneity of the economic regulators also outside of industry and of the building industry. Considering the special conditions of certain branches, however, it may be necessary to apply unusual solutions in all the fields where this seems indispensable.

We shall not describe every particular trait of the various branches, because Chapter IV is anyway devoted to special regulations in foreign trade and Chapter VI to those in domestic trade, as well as in the industrial and cultural services. Here we shall only explain some specific features of wage regulation in a few other branches.

(a) As far as *transport and telecommunication* are concerned, the wage volume regulation introduced in 1970 for the *railways* must be maintained in addition to financial regulators adapted to this specific field. Preferences are also necessary in this field.

In other fields of transport and telecommunication the per capita wages plus profits indicator should be applied with due regard to the reduction of working hours; the preferential wage level increase should perhaps be made dependent on other indicators characteristic of the individual special branches. In these fields it is not always possible to raise such requirements (e.g. reduction of working hours to be achieved by utilizing inherent resources) as have rightly been prescribed for industrial enterprises and enterprises of the building industry in the past years.

In addition, considering the trends in profit dynamics, differentiated wage preferences must be granted in average wage development depending on the objective conditions existing in the respective branches.

In urban transport the so-called relative wage-volume-regulating system seems to yield the best solution—in view of the expected profit development—simultaneously maintaining the wage preferences.

(b) In state farms (including experimental, model farms, fisheries and forestry and timber-processing farms), and in the purchasing and industrial activities of consumers' co-operatives (including co-operative enterprises and centres) modified wage volume regulations are applied (modifications may be expected regarding the working out of basic figures and various other values).

(c) A special income- and wage-regulating system is to be evolved—in compliance with the general principles—for designing and investment enterprises, for technological research (development) institutes operating in the enterprise economy system, for budgetary plants, for savings co-operatives and communal estate management enterprises.

In both industry and the building industry, as well as in other branches of the national economy care should be taken that production development should not influence the personal income of workers in an unjustifiably disadvantageous manner in the case of developments involving *substantial changes in the assets-to wages ratio.* In such cases the modifications and preferences should be established on the basis of individual assessment, in compliance with the development-political decisions.

Prospects of wage regulation

Preliminary computations indicate that the economic regulators valid as from 1 January, 1971, are a great step forward. The modified system of wage regulation makes enterprises better interested in a more efficient utilization of live labour, in a more purposeful and more rational manpower economy.

The new system requires annual development from enterprises working at low efficiency, for without this the expected increase in personal incomes is impossible. The high-efficiency enterprises, on the other hand, enjoy a certain advantage—mainly for raising wages—on the basis of their higher productivity and economic efficiency.

A decline compared to the level already attained may involve grave consequences for an enterprise because the maintenance of the income level is not ensured. An even and gradual development of wages and personal incomes is thus the most expedient. In particularly successful years it is worth forming reserves in personal incomes because it is more difficult to make further headway over and above high efficiency and an increased wage level turned into basis.

The effect of the new regulation system is also beneficial for implementing long-term tasks. The neglect of technological devellopment hits the enterprise more severely than the old system, because — especially with a low-efficiency enterprise — the stagnation of economic efficiency makes it impossible for personal incomes to rise beyond a certain point.

This regulation system indirectly encourages the evolution of the mechanism within enterprises, as well as the further development of incentives applicable to factory units, work groups or individuals. We may justly expect the enlivening and improvement of work and business organization activities, the observation of norms and the consolidation of labour discipline.

Personal incomes may be *expected to become more differentiated* on the basis of efficiency of enterprise work. This must also contribute to the differentiation of trades, professions, work groups, and so on. Yet the differentiation of personal incomes has a socially tolerable limit. Justified expectations will not be accepted in wider circles unless wages really rise in enterprises working better, with higher efficiency. And differentiation within the enterprise will not become an accepted practice unless higher achievements are indeed appreciated, work involving higher responsibilities and devotion to the enterprise are recognized and kept in higher esteem than before.

Thus the differentiation of incomes up to now has involved a desirable process, as well as an opposite one. The latter manifests itself in differences resulting from differences in the initial position or in development conditions and not from differences in achievements, economic results. Such disproportions of incomes need adjustment and we have the means to solve this task.

Unjustified, excessive differentiations can be corrected by preferential regulation or by central measures of wages policy.

The system of regulators could have created more intensive incentives. This, however, would have enhanced differences, the dispersion of incomes. We have tried to establish an optimum yielding *acceptable proportions and incentives alike*.

The past three years unequivocally prove the success, the viability of the new system of economic control and management. At the beginning of this chapter, however, we have mentioned the untoward tendencies that came to light in 1968 and

1969 in both labour economy and productivity and which can be attributed to the following causes:

— shortcomings of economic regulators basically determining the economic, financial circumstances under which the enterprises work;

— insufficiencies in the central managerial and controlling activities;

— shortcomings in the management of enterprises.

Experience shows that economic regulators *in themselves do not ensure satisfactory results.* Their modification is only one of the conditions of more efficient and more economical work. The modification must be coupled with the improvement of control, of management, and of checking activities. Accordingly:

1. *The functional leading authorities* —the Ministry of Labour in the first place—besides shaping the economic regulators, will have to make the circumstances clearer for the sectoral ministries and for the enterprises:

— concerning national-economic and regional changes in the employment level, actual questions of labour economy, concerning the training of new manpower, especially of qualified manpower;

— concerning the conceptions of correct income policy and income proportions;

— concerning the choice and application of adequate methods promoting efficient economic activities.

2. The *sectoral ministries* and other directly controlling organizations must intensify their labour management activities in their fields. This includes such tasks as

— to plan demand for labour required by the development of the various branches with due regard to the composition of the labour force according to qualification, trades, regions etc.;

— to work out branch wages policy (income proportions etc.);

— to work out forms and methods for material incentives to be applied in the branch;

— to work out rights and obligations of enterprises and workers in a way as will best promote production in the branch;

— to work out measures promoting the organization of work in the most up-to-date manner;

— to participate in the branch implementation of certain central labour measures (e.g. realization of the reduction of working hours).

The employment conditions—with due regard to the above considerations—should be incorporated in the planning of middle- and long-range development conceptions for each branch and in the planning of measures necessary for implementing the objectives in the national-economic plans. The sectorial authorities should see to it that the enterprises supervised by them elaborate *complex employment conceptions* organically associated with the middle- and long-range conceptions of enterprises and with their tasks to be fulfilled. They must analyse and control enterprise work more intensively. It is important that the *evaluation of the work of enterprise managers appointed by the supervisory authorities should be reflected in the personal income and bonuses* determined by the leading authorities. This should also be used as a means for differentiating personal incomes on the basis of a complex evaluation of activities.

3. The drafting of a complex employment conception for a longer term, as well as for every year within this term, closely connected with a more efficient and economical solution of the tasks ahead would greatly contribute to the foundation of labour economy of the *enterprises.* Within this conception:

(a) such *wage and income-regulating enterprise tasks* can be determined as will guarantee

— appropriate incentives — in compliance with the principle of distribution according to work—for individual faculties and capacities to develop, for increasing output, individual and collective achievements in keeping with the tasks of the enterprise;

— the evolution of adequate wage and income proportions along with the stimulating function of the wages;

— adequate income differences on the basis of the performance of individuals and enterprise collectives and of the time spent with the enterprise;

— an income policy promoting the development of staff necessary for the successful implementation of the planned tasks of the enterprise, including the keeping of those employed as permanent staff, the acquisition of the necessary new manpower, their professional training and the regrouping of manpower within the enterprise, and the disposal of redundant labour;

(b) such *labour force economy* is necessary as relies on an adequate programme endeavouring

— gradually and intensively to utilize the labour reserves of enterprises;

— to get rid of redundant labour, to establish the minimum staff necessary for complying with production tasks as a function of the employment situation in that branch and of the nature of the sector; to ensure the acquisition of new staff resulting from minimum requirements;

– to co-operate with the regional employment organizations;

(c) measures can be aimed at for the improvement of labour conditions, which can reasonably reckoned with, in order to contribute

– to the intention of workers to stick to the enterprise employing them;

– to the improvement of the factory atmosphere;

– to a reasonable satisfaction of social and cultural needs;

– to the evolution of an economical and acceptable system of work;

– to taking into account the opinions of the workers on enterprise and labour conditions.

(d) such up-to-date labour and factory-organizational activities are to be planned as guarantee the best utilization of all production factors.

All these tasks are to be accomplished for the Fourth Five-Year Plan in working out the five-year plans for the enterprises, because this is the only way to ensure that enterprise activities will successfully contribute to the implementation of the national-economic plan.

Chapter IV

REGULATORS IN FOREIGN TRADE

by

SÁNDOR CZEITLER

1. FOREIGN-TRADE REGULATORS AND THEIR IMPROVEMENT

Foreign trade — and also its regulation — have an outstanding place in the national economy, because it is through foreign-trade relations that we take part in the international division of labour. Owing to our economic endowments, our country is heavily dependent on the international division of labour, and foreign trade exerts a vivid effect on every branch of the economy. It transmits the demands of foreign markets, the economic-technological development in other countries and thereby assesses the up-to-dateness and qualitative standard of domestic products, influences the structure of production and consumption, stimulates to raise efficiency, affects the domestic prices and incomes, and so on. This, of course, is not a unilateral effect, since all processes taking place on an internal market affect foreign-trade relations and influence the efficiency of our participation in the international division of labour. Therefore the participation of enterprises, economic units in the international division of labour is not entirely influenced by the direct foreign-trade regulators (price multiplier, refund, customs tariffs, etc.). Other active influencing factors are also some general economic regulators (prices, taxation, credit mechanism) and also the economic environment determined by their consistent system.

The importance of foreign trade for our national economy can be characterized by a few data of our Fourth Five-Year Plan for 1971 - 1975:

— by 1975 exports, that is imports will make up some 40 per cent of the national income;

— every per cent of the increment in the national income is accompanied on an annual average by a 1 – 14 per cent increment in foreign-trade turnover;

— the share of foreign trade with rouble countries in the overall turnover expected for 1975 is to be 69 per cent;

— the composition of foreign-trade turnover for 1970 and earmarked for 1975 compares as follows:

	Rouble countries		Dollar countries	
	1970	1975	1970	1975
Exports:				
Materials and semifinished goods	21·5	20·9	39·3	37·7
Machinery and equipment	37·3	39·7	8·5	9·9
Industrial consumer goods	24·1	24·2	19·5	20·3
Agricultural and food products	17·1	15·2	32·7	32·1
	100·0	100·0	100·0	100·0
Imports:				
Materials and semifinished goods	58·8	59·6	58·2	58·8
Machinery and equipment	26·9	24·3	14·3	15·2
Industrial consumer goods	10·3	12·4	5·7	6·0
Agricultural and food products	4·0	3·7	21·8	20·0
	100·0	100·0	100·0	100·0

The regulation of foreign-trade activities presupposes a complex analysis of the economy, the examination of interactions. This means that in establishing the general regulators, the conditions of our participation in the international division of labour are to be taken into account, and the direct foreign-trade regulators cannot be determined without due regard to the primary interests of the national economy. It is the duty of central management to make sure that

— foreign-trade activities are adjusted to the complex development of our planned economy,

— the trade-political interests of the state are observed extensively in import and export activities.

Accordingly, the foreign-trade regulators to be applied in the Fourth Five-Year Plan have been determined on the following bases:

— the objectives of economic-policy of the medium-term plan conception;

— the analysis of experiences gained in the course of the operation of the existing regulators;

— the weighing of comparative advantages resulting from international division of labour;

— the expected trends of foreign markets.

The introduction of the new system of economic management has had a beneficial effect on foreign trade already during the first years. This positive influence is noteworthy because smooth transition was the primary requirement to be satisfied by the foreign-trade regulators in the initial period. Before the introduction of the reform it seemed that the changeover would involve major difficulties in exports to socialist countries (in fulfilling international commitments) and in imports from non-socialist countries (by an increment threatening the balance of payments). But contrary to forecasts, what lagged behind the desirable level was the growth of socialist imports and not exports to rouble countries. This made it necessary to modify the regulation in order to make enterprises interested in making better use of possibilities inherent in foreign markets. These modifications—coupled with a boom on capitalist markets in 1969 and 1970 and with the increasing readiness of our socialist partners to deliver in 1970—have resulted in a foreign-trade turnover more dynamic than ever.

Export demand has had a beneficial effect on production background, boosting output. Growing interest in production and investments, the differentiation of productive and consumer demands —parallel to the abolition of almost all restrictions on imports—has simultaneously led to a sudden rise of import. Export could not keep pace with this rate and is not likely to be able to cover growing import demands with receding boom or in case of depression unless comparatively rapid changes can be introduced into the export pattern and the efficiency of export enhanced. Promising signs in this respect could be registered in 1969 and 1970; the efficiency of export increased in relation to both country groups; the export of the machine-building branch to non-rouble countries showed a rapid improvement after several years' of stagnation; many enterprises took successful measures for rendering the international product pattern more economical, and so on.

Yet the main carrier of export dynamics is still the export of basic industrial materials and of agricultural products which are exceedingly sensitive to business fluctuations, while the light industry, a very important branch in our country, is unable to meet the increased demands for quality on both domestic and foreign markets.

Under such circumstances, the dynamic development of foreign-trade turnover—in spite of favourable initial results achieved under the effect of regulation—has taken place with a deteriorating commodity pattern. This makes it necessary for regulation to keep an eye on requirements of economic efficiency. In the period of the Fourth Five-Year Plan, the emphasis on quality is justified—in addition to the fact that the economy has entered from an extensive stage into an intensive one—also by the expected recession on capitalist markets and by the slower growth rate of demand for investment goods on socialist markets.

The conditions under which the regulators are to be improved could be summed up on the basis of recent experiences and of the plan objectives as follows.

The entire system of regulators should enable a dynamic expansion of foreign-trade turnover to guarantee an unhampered reproduction process in the fields of realization and purchases alike (at a rate exceeding that of national income.) The regulators will be able to do so if they encourage the improvement of the competitiveness of our export products, increase the efficiency of production, especially of goods meant for export, and contribute to a more rapid development of enterprises capable of internationally efficient output by securing them higher income.

Efficiency should be improved by a transformation of the export structure, increasing the share in exports of finished goods that can be economically manufactured, particularly of the products of engineering industry. The best way to achieve this is a differentiated export expansion concentrating resources in enterprises closest to international productivity level and ensuring an especially strong motivation for profitable exports.

The international value relations transmitted by foreign-trade regulators present a basis for income differentiation according to efficiency and for development concentration. The allocation of "convertible" commodity stocks built up as a result of this selective development policy and well marketable on all markets (domestic, socialist and capitalist) could be regulated with due regards to the equilibrium requirements of the three markets.

Import should contribute to increasing assortment, to the intensification of competition on the domestic market within the range allowed by the balance of payments, to the acceleration of technological development and to the formation of a more up-to-date structure of material consumption.

The regulators should encourage the enterprises to refine foreign-trade work, to adopt contemporary methods of marketing and to expand the lasting market contacts (co-operation, specialization).

The above considerations require certain changes in the system (qualitative ones) and the establishment of new standards (qualitative alteration). In both cases several preconditions must be reckoned with in relation to both rouble and dollar countries.

Mutual commodity turnover is more strictly determined in relation to rouble countries between 1971 and 1975 than in other relations. This is due to the established internal production and consumption conditions of the socialist countries, which do not permit substantial changes in the main structural proportions of turnover within a medium-range period. On the other hand, the composition of the commodity turnover with the CMEA countries is favourable for Hungary, and no changes are required in these proportions either by our economic conditions or by economic efficiency. The improvement of economic efficiency would require, in the first place, modification of the composition of certain groups of commodities. This is a reasonable requirement because there is a rather wide dispersion by efficiency between enterprises belonging to the same industry. The demand for most raw materials and for many consumer goods generally exceeds and is expected to exceed supply for a long time to come on the socialist market, but we may reckon with increasing requirements for quality and up-to-dateness of the products of the light industry.

Market relations have so far had a moderate effect on socialist commodity turnover, but now this situation is undergoing a certain change. Partners are beginning to enforce their trade-political conceptions, based on the assessment of the market, in the course of interstate negotiations and this may lead mainly to structural clashes as far as turnover increment is concerned. (This means that quality requirements will be set higher for commodities offered as counterparts for import increment and such balances can no longer be offset within the existing export pattern.) An interstate linkage of export and import possibilities and requirements is, of course, an obstacle to an entirely free choice of decision alternatives on the basis of the internal objectives of the given country. The co-ordination of possible conflicts between interstate agreements and enterprise interests is also the task of regulation. Consequently, the general effects the regulators are expected to bring about (the improvement of the structure, the reduction of subsidies, the enhancement of import competition) will be partly limited by the quotas fixed in interstate agreements.

And another problem is that the progress of the integration process within CMEA will not attain the extent before 1975 which would generally create a direct interest of productive and foreign-trade enterprises in commodity turnover by coupling foreign and domestic markets through the internal mechanism of the individual countries. Yet in some fields of integration certain practical results will obviously be attained in the second half of this five-year period. An expanding international co-operation may be expected.

In advanced capitalist countries the foreign-market situation can be expected to develop at a less intensive rate than now and to become better balanced. This means that foreign markets are not expected to evolve factors hampering the growth of turnover, and the capitalist countries are likely to be ready to expand turnover for a further increase in their export. The trade-political attitude of the capitalist countries, as well as the fact that not even on capitalist markets is it possible to purchase unlimited quantities of whatever material at any time, make it recessary that a more intensive trade-political management should coordinate activities on foreign markets and exploit the possibility for foreign-trade enterprises to conclude long-term private-law delivery contracts for certain basic materials and semifinished goods.

It is a fundamental political interest of the socialist camp to reduce the unilateral economic depencende of developing countries on, and to support their endeavours to transform their relations with, imperialist countries. The small socialist countries struggling with their own development problems, can offer assistance in this respect by intensifying their contribution to the implementation of the industrial development objectives of these countries. Else, it is the interest of Hungary, too, to participate in the industrial development programs of developing countries because she possesses significant export-oriented capacities in her machine industry exceeding the needs of her principal foreign markets, the socialist countries. The increase of machine exports to dollar countries is also one of the preconditions of transforming the export structure. In earlier periods, the expansion of exports to developing countries was hampered by these countries being unable to deliver sufficient amounts of commodities satisfying Hungarian demands. Nevertheless, on account of the economic development in these countries and owing to the growth and diversification of Hungarian import demands, our purchases (mainly basic materials, semifinished goods, agricultural and industrial consumer goods) have since largely increased and can be increased in the future, too. Therefore the expansion of foreign-trade relations is determined by the politico-economic situation in developing countries, that is, in connection with this, by the possibilities of increasing import, on the one hand, and, our own conditions for granting credit on the other.

2. REGULATORS INFLUENCING EXPORT

In order to ensure a solid link between domestic and foreign prices, the reform of our economic management system has introduced uniform foreign-trade price multipliers for export and import alike. This was an important part of the economic reform for it guaranteed the incorporation of foreign-trade interest into the general interest of enterprises in profit. The price multiplier tells us the value in forints—calculated at domestic factor cost—to be exported for earning one rouble or one dollar in the actual Hungarian export structure. The uniform foreign-trade price multipliers, as fundamental foreign-trade regulators, remain unchanged. Other direct foreign-trade regulators ("financial bridges") have a modifying effect on the uniform multiplier depending on whether greater or smaller efficiency should or can be required from enterprises, as the case may be. Therefore it is advisable to revise their functioning from time to time. In exports, such a fundamental regulator is the system of state refunds.

State refunds

In the new system of economic management, the state refunds have been established on the basis of the following main principles:

— as an instrument of export regulation, state refunds should ensure the continuation of such exports as are still indispensable for the national economy, yet are no longer economical for enterprises when the price multiplier based on average cost of earning foreign exchange is applied—with special regard to the requirements of the balance of payments;

— in keeping with the other economic regulators, state refunds should exert their influence through the general interest of enterprises in profit, should act as a long-term regulator and should be granted to enterprises in association with the price multipliers broken down into the two main spheres of accounting (dollar and rouble areas) and should be addressed to enterprises;

— state refunds should influence enterprise profits in a manner to put the producing enterprises in a position where exports—calculated by the 1 January, 1968 prices—are as profitable as domestic realization;

— state refunds should gradually promote an improvement in the commodity pattern of exports mainly through changes within the enterprise and also—by creating special conditions (setting degressive rates)—between the enterprise.

The system of state refunds and the rates of application have, in their overall effect, complied with the requirements initially established. A positive feature of the system is to stimulate the producing enterprises to improve foreign-market prices, to reduce domestic inputs, to rationalize production, and to improve the product pattern. The favourable trends in commodity turnover, the improved ratio of refund-supported turnover to unsupported turnover, as well as the improvement in specific currency-earning capacity, can be registered as positive results.

Beside these results, however, some shortcomings must be pointed out. Some of these are due to the fact that the incipient system could obviously not have aimed at the complete solution of individual problems since the main task was to ensure undisturbed transition, while other problems could not be foreseen.

One of the main shortcomings of the system of state refunds is that the refunds established for three years (1968 - 1970) on the enterprise level to ensure in principle profits identical with domestic realization—though guaranteeing the necessary export volume—do not comply with the long-term objective of granting possibilities of quicker development to economically exporting enterprises. The profits earned through exports reflect much more the position of the refund-supported enterprise on the home market rather than their position related to international economic efficiency. Thus state refunds have had a differentiating effect on the product pattern within an individual enterprise only and not between enterprises, that is, have not encouraged the improvement of the national-economic structure. In extreme cases it also occurred that the export profit of an enterprise supported with substantial state refunds was higher than that of an unsupported exporting enterprise earning foreign currency at a cost close to the price multiplier. This circumstance is detrimental even in the short run because it does not ensure sufficient stimulus for economically prosperous enterprises, and in the long run because successful enterprises do not obtain more development funds, whence development is not directed toward concentration, towards increased efficiency. Another shortcoming is that the volume of state refunds on the enterprise level — necessarily established for a wider sphere than expected — contained (willy-nilly) many subjective elements involving the possibility of loss refund and thereby limiting the selective character of the support.

It is necessary to maintain the state refund system in the course of the Fourth Five-Year Plan, and that without any substantial changes, though certain improvements are indispensable for achieving the plan objectives and for gradually eliminating the contradiction outlined above.

The operation of the *improved system* is to be based on the following principles:

— export profitability should be more distinctly differentiated according to economic efficiency, the enterprises exporting more economically should obtain better possibilities of development, the development possibilities of enterprises earning foreign currency less economically should be restricted;

— the improved system should discourage uneconomical exports and encourage the reduction of inputs and the improvement of sales prices in terms of foreign exchange; and in socialist relations, it should guarantee the fulfilment of inter-state commitments.

This can be achieved if state refunds are established uniformly for larger economic aggregates than enterprises. This is why the level of state refunds has been raised, as from 1971, from the enterprise level to the sub-branch level. This is the basis upon which the system is being further developed.

One sub-branch generally comprises several enterprises of similar trade structure. The domestic price system and income regulation handle the pertinent enterprises uniformly, the products of enterprises belonging to one sub-branch can usually be substituted (fungible goods) and thus it becomes possible to pursue a refund policy in support of a differentiated industry policy. It is therefore obvious that the larger unit benefiting from refunds should be a sub-branch and not the branch as a whole.

The sub-branch refund system means that the enterprises within it are selected according to their relation to the average currency earning capability of the branch[1]—in compliance with the basic principles. This system provides increased export incentives to enterprises more favourably exporting within the sub-branch and brings the uneconomically exporting ones closer to the average level of the sub-branch, that is, it results in a differentiated regrouping of export subsidies to enterprises within the sub-branch.

Although the establishment of sub-branches has relied on the statistical classification of enterprises, this has had to be disregarded in some justified cases, by excepting certain enterprises or by assigning them to another sub-branch. Studies have resulted in discerning sixty sub-branches, seventeen of which are in agriculture and in the food industry. Assigned to sub-branches are now 91 per cent of industrial enterprises producing for export, yet the state refund system established on the basis of average earning capability of sub-branches could be applied for a smaller sphere, to about 72·8 per cent of the exports of an industrial nature. Where the transition to this system has not been possible, the practice of handling enterprises individually has been preserved.

Within the new system, the granting of refunds has been centred around the average currency earning capability of the branch, calculated on the total export turnover of the sub-branch, whether subsidized or not. Yet these levels have not been handled mechanically either: in justified cases there are upward and downward deviations from average. The qualification of the sub-branches relies on several factors, such as the development conceptions for the Fourth Five Year Plan (also on the general enterprise level), outlets on foreign markets, their weight in the balance of foreign trade, the interrelations of the three markets, with due regard to home supply; certain individual, enterprise conditions, the domestic price and support policy to be applied.

In view of export activities, the enterprises can, accordingly, be assigned to the following groups:

1. Enterprises exporting without being supported by state refunds (the lucrative ones) which can be granted tax reductions for developing their economical production and exports.

[1] The earning of foreign currency is invariably calculated on price/price basis, that is, by collating the domestic price of production augmented with export costs with the actual foreign-currency price.

2. Enterprises requiring state refunds can be assigned to two groups according to their relations to the average production level of the sub-branch they belong to:

a. Enterprises earning an export value between the uniform price multiplier and the average currency-earning level of the branch are accorded support of a sales receipt character in compliance with the sub-branch refund level.

b. Enterprises requiring refunds higher than sub-branch average are to be treated individually and so judged for granting them refunds.

Within the latter group:

— enterprises exporting on a level close to the average sub-branch refund level are granted refund on an annually decreasing scale;

— enterprises exporting far below the sub-branch refund level are to be treated restrictively.

In justified cases their sharing fund can be increased with the net method (that is, the exports of such enterprises do not increase their development funds). Besides, this support of a "net nature" (that is, one not increasing sales receipts) is, in a sense, a kind of step forward when viewed from the angle of the compulsory division of profit (cf. Chapter II), since formerly a sharing found could *not* be created *without* a development fund, and this had had to be taken into account when deciding on state grants.

Selectivity in the sub-branch level treatment consists in the fact that the pertinent enterprises requiring no state refunds can be granted tax reduction under certain conditions in order to accelerate their development. At the same time, the expansion of uneconomical exports (earning foreign currency under unfavourable conditions) has had to be restricted by measures reducing or cancelling the possibility of increasing the development fund by export activities, though without unduly affecting the workers of the enterprises concerned. This can be bridged over by granting net sharing fund ("loss refund"). The enterprises earning foreign currency less favourably than the uniform price multiplier yet sharing values somewhere around the average currency-earning level of the sub-branch continue to be granted state refunds in the gross system (as sales receipts).

Since the further development of the system is centred around the sub-branch average, it is of high importance to calculate average as exactly as possible and to approach it from different angles.

The enterprise refunds for 1968—1970 were generally calculated on the basis of export prices in 1965 and 1966. The earning of foreign currency was calculated by collating the net currency income achieved (minus transport and commission at the Hungarian frontier parity rate) with the calculated domestic production price level inputs, again converted to the frontier parity rate.[2] These indicators were not applied mechanically but with due regard to the conditions under which the enterprise operated.

The 1971 – 1975 system is based on the data of the years 1965 – 1969. The currency-earning indicators have been calculated from the data provided by the enterprises for each year, each export product, each enterprise and each sub-branch. In order to be consistent with the 1965 – 1966 data, the computations have relied on the calculated domestic prices, considering, naturally, also the trend in home prices.

The currency-earning time series thus obtained have revealed the effects of the structural changes and of the price trends. They have provided a basis for adequately judging the degression to be applied, and confrontation of price developments on export markets with home price trends has enabled us to tell the fields where and the extent to which we can approach prices showing foreign-market value judgements.

The other approach to the actual situation started from an analysis of enterprise balances. By using the method of proportionally distributing the undividable and the general expenditures, it has been possible to approximate the profitability of sales to various countries, and by considering the general enterprise profit rates it has been possible to undertake currency-earning calculations for control.

Proceeding from the above data and relying on the economic-political objectives listed above, and relating to the future, the essential aspect of the state refund system for 1971—1975 is differentiation, consisting of stimulation and restriction, with a greater emphasis on stimulation in the initial period.

One of the substantial pillars of the system so established is constancy without which the expected effects will not materialize. The acquisition and consolidation of export markets are known to take time. It is indispensable for enterprises to calculate for perspective development, for acquiring markets and for transactions of long return alike, a precondition of which

[2] C.i.f. and F.o.b. on Hungarian frontier prices.

is the constancy of state refunds. Yet, constancy cannot be looked upon mechanically as an absolute factor for it may sometimes become harmful to the national economy (therefore the rules governing the state's right of giving notice remain in force, consisting of a six months' warning (of withdrawal) and of the right of instituting new procedure). The essential changes in the economic environment, whether due to external or internal regulation or to boom, are to be taken into account.

3. STIMULATING THE DEVELOPMENT OF COMPETITIVE EXPORTS

It has been said that enterprises exporting without state refunds can be granted tax reductions. This is an essential part of differentiation export-promoting policy, enabling the favourably exporting enterprises to engage in more intensive development and resulting thereby in improved export efficiences and structural transformation.

This stimulation extends the favourable effects of the tax refund system introduced so far as an experiment and acts as its substitute.

The experimental tax-refunding system covered only part of the exporting enterprises. But owing to the high share of those requesting state refunds, enterprises enjoying high state refunds on exports also benefited from the tax-refunding system up to 1970.

The system introduced as from 1971 has set a higher standard; it only applies to enterprises not requiring state refunds or exporting at a branch refund rate below a certain limit value. The beneficiary enterprises pay a reduced profit tax-rate after a certain part of their proceeds. To ensure intensity, the rate of tax allowance becomes higher after an annual rise of exports.

Since the experimental tax refund system usually applies to a period of five years (1969 - 1973), the problem of the relationship between the two systems arises. The choice lies with the enterprises participating in the experimental system: they can decide which system they want to take part in. They have to make their decision aware of the fact that double incentives are excluded.

The tax-refunding system makes the enterprises interested in expanding the production of "convertible" products (that is, such as can be economically sold on any market), and supplies part of the investments necessary for developments. An efficient and rapid structural improvement and the concomitant expansive export policy also require that the enterprises having established a favourable currency-earning production and those planning further development may join the competition for investment credits. This is not the first time that the mechanism of *investment credits* applies such a preference.

From the annual volume of credits that may be granted by the bank, the directives of credit policy detach a certain part for export development. Thus the investments of otherwise credit-worthy enterprises profitably producing "convertible" commodities may draw credit therefrom on more advantageous conditions than the average—longer repayment period, lower interest rates.

The construction of foreign-currency credits is a well established practice of financing investments requiring foreign currency and promising relatively quick returns in same. The advantage of this practice is that the enterprises can use additional credits if the nature of the investment promises quick return in foreign currency. This construction is to be preserved for expanding efficient export capacities.

Other regulators affecting exports

The granting of export credits (that is, credit for a foreign buyer) is to be placed at the service of structural objectives in the Fourth Five-Year Plan. This requires an elastic practice of credit floating adaptable to the changing market conditions, and endeavours should be made to intensify prudent market-minded enterprise attitudes. The granting of export credits must be in keeping with the load-bearing capacity of the country, and aspects of economic efficiency should play an outstanding role. The enterprises should be made interested in evolving credit conditions. We must see to it that favourable credit conditions shall promote business that can be transacted under otherwise favourable conditions (good price, larger volume, solvent market, etc.), but shall not permit a less efficient transaction. The granting of export credit is a natural condition for selling machines on markets in developing countries. Beside home market and markets of socialist countries, the enterprises of our engineering industry find growing possibilities of marketing in developing countries. But while ensuring the usual conditions on these markets, we must also reckon with the intensification of market competition and the fact that the products of Hungarian engineering industry are new-comers on the markets of developing countries. As far as the conditions of payments are concerned, these transaction may involve certain sacrifices.

The *production tax* imposed on exports yielding regular high profits to certain enterprises having the character of a rent is a regulator affecting exports. Exceptionally such a production tax cannot be dispensed with during the Fourth Five-Year Plan either. Its magnitude should be established with due regard to the dual consideration that profits emerging independently of the activities of the enterprise owing to specific trends in the price level should be tapped, yet, since these exports are—by the nature of things—the most economical, the magnitude of the tax must be prevented from putting a brake on the endeavours of enterprises resulting in economical and convertible capacities in the course of export development.

In order to ward off unwanted effects of strong business fluctuations, the export price risk reserve fund has been introduced as a new regulator as from 1971 (for its functioning, see Chapter V).

Regulators affecting imports

The link between domestic and foreign prices is secured by making the users of the selling enterprises pay forint prices calculated in general on the basis of *foreign-trade price multipliers* for imported means of production and consumer goods. Thus modification of the prices calculated in this manner—provided the necessity of changing the effects of foreign markets so requires—is achieved by the following economic or financial regulators:

- official price regulation (unification and mixing of prices);
- import turnover tax or import price subsidy;
- tariffs.

In the import phase prices have been fixed officially only as exceptions but, at the same time, it had to be taken into account that most of the products can be acquired from different sources (home production, socialist or capitalist import). The prices of products coming from different sources may be substantially different, for buying at various prices cannot be regulated centrally (for instance, to decide which enterprise is entitled to less expensive or to more expensive imports).

This has raised the problem of making prices uniform in the phase immediately following import. This has usually been carried out in enterprises trading in means of production. The prices have been adjusted, fixed or limited at a maximum either in compliance with the most expensive source or on the basis of the weighed average of the prices of the different sources of acquisition.

The import turnover taxes and import price subsidies serve the adjustment (skimming or support) of import prices calculated with the price multiplier to protect the domestic price level. They are applied to prices of both means of production and consumer goods imported.

The new tariff system is to be looked upon as the most important economic regulator of imports. The customs duties as economic regulators have a double function: they serve trade-political objectives in inter-state negotiations or practice, on the one hand, and, on the other, have economic-policy functions on the home market (restricting imports, protecting industries or the domestic price level).

These functions can, however, not be detached from each other. Trade-political results in tariff negatiotions, that is, customs reductions for Hungarian exports cannot be achieved without relying on an efficiently functioning tariff system, that is, one actually influencing enterprise decisions on imports.

For establishing import regulators, the new system of economic management relies on the *following principles.*

The users are supposed to pay a uniform price for foreign currency spent on imports, as much as the earning of the given currency costs (on the price/price basis) through export activities on the national-economic level.

Within the possibilities, but in a widening scope, it is necessary to grant the freedom of decision to the users whether to acquire at home or through imports the raw materials, semifinished goods, spare parts and machines necessary for production.

The free choice among the main sources of acquisition should intensify competition on the home market but not to an extent crossing the fundamental industry and development policy.

Import activities should ensure a smooth flow of the production process, a wider assortment for home consumption and timely fulfilment of export deliveries.

Freer import possibilities must not impinge upon our foreign-trade and foreign-exchange interests or prevent the state of equilibrium in our balance of payments.

With the introduction of the reform these objectives could not be achieved exclusively by making the economic regulators operate, but regulators of an administrative nature had to be introduced temporarily into the system (e.g. import quotas, deposits and allocation of foreign currency). Most of these, however, affected only a smaller part of imports, and their elimination started already in 1969 and resulted in reducing them to a minimum in 1970.

It is difficult to measure the effect of individual import regulators, for they exert their influence in combination. This has been found satisfactory. The meeting of export demands contributed to the favourable results achieved by the national economy in 1968—1970. The increasing import of consumer goods has eased the tensions on the consumer market. The linking of external and internal prices with economic regulators and the subsequently improved import activities of enterprises—even amidst the price rises on the capitalist markets in 1969–1970—have contributed to the improvement in the terms of trade.

The magnitude and pattern of imports is determined by enterprise interest influenced by economic regulators. In 1970, the expansion of production, the differentiation of the needs in production and consumption and the investment propensity resulted in a substantial growth of imports. Yet the import policy evolving under the effect of economic regulators is not exempt from contradictions nor does it as yet completely conform to the general objective of economic policy to increase the effect of the impulses coming from external markets upon home production. Nor does enterprise interest yet orientate import decisions in keeping with economic efficiency and with the requirements of the balance of international payments. These new developments of import regulation, relying on the measures taken in 1968—1970, encourage imports from rouble countries, as well as more efficient investments and a more economical treatment of materials by enterprise management.

The system of import regulation (the sphere of price adjustments and unification, the import turnover and the import price subsidies) needs no general supervision. The modifications of the values applied and other flexible adaptations to market conditions have anyway been carried out according to necessities. With relation to rouble countries this is associated with the trends in prices regulated in inter-state agreements after 1970.

As from 1971 the allocations of foreign currency by the Investment Bank have been abolished. The precondition of imports payable from the development funds of enterprises and requiring convertible currency is to engage the forint coverages of orders from the development fund with the bank financing the investment when requesting the import licence. The idea is to secure the forint value of import demands. This now replaces the system of depositism[3] which is now suspended but remains in force with a zero extent of application until further notice.

The system of deposits established for investment machine import requiring convertible currency, and exceeding the purchase price of products remains in force. The extent of the deposits (their reduction or suspension) is to be determined by economic measures associated with the annual plans.

In order to ensure undisturbed import supply at balanced prices, the system of import price risk reserve fund is preserved for certain products exposed to heavy business fluctuations (see Chapter V).

4. OUTLOOKS OF THE TARIFF SYSTEM

The tariff system was introduced simultaneously with the reform of economic control and management as an instrument mainly influencing and regulating demand for imports. An analysis of its operation from the angle of import regulation was a task of particular importance when preparing the further development of the regulators of the Fourth Five-Year Plan because the price reform and the customs tariff were worked out practically in parallel in 1967. Some of the final values of the customs tariff were established after fixing the prices and, therefore, in such cases the effect of the tariff could not be considered in the prices and *vice versa*. This has led to the neutralization of a relatively large number of customs tariff rates by various methods applied in international trade, such as tariff suspension, tariff quotas, customs exemption, when the reform was launched. The actual tariff level accordingly turned out to be lower than the nominal tariff level for different main groups of commodities, yet it ensured on average the adaptation of imported products to the domestic price level.

[3] In machine import financed from the enterprise development fund and acquired for convertible currency or currency of equal value, 150 per cent of the machine price had to be deposited in 1968 for two years, free of interest, irrespective of the payment of the purchase price, and 50 per cent in 1970.

Relying on an analysis of the imports of 1968, a large part of tariff suspension, etc., were later abolished, which increased the efficiency and import-regulating function of customs duties, yet they still did not fit the economico-political requirements. This necessitated the updating of customs tariff with regard to trade policy, the protection of industry and technological development since it has been realized that an active trade, import and industrial policy could not be pursued without efficient tariff rate prevailing without fail. Therefore, the sphere of neutralizing customs had to be narrowed down and the acknowledged exceptions institutionalized.

Modernization is motivated by the following considerations:

— the customs tariff established at the beginning did not fit into the domestic price and income regulation, the tariff rates showing substantial dispersion and their relative magnitudes often showed irrational traits;

— this was why tariffs did not sufficiently encourage emergence of a more rational import pattern as far as technological development or up-to-date processing structure were concerned;

— the international aspects of the customs tariff system (namely, Hungary's intention to join the GATT) require a system to be efficient and stable in the long run.

Concerning tariff, the following main aspects were considered:

— the efficiency of the customs duties should be increased so as to prevent the effects produced by other regulators and by customs from crossing one another;

— the tariff, as a factor of price calculation, should be adapted to the domestic price system and should have a promoting or delaying effect —as required by the needs of differentiated regulation.

The average customs level for raw materials and semifinished goods is satisfactory; the application of low values is allowed even with regard to the protection of industries. It is, however, necessary to reduce the dispersion of tariff rates and to better co-ordinate the customs to be levied on fungible goods. The customs should promote development of up-to-date material consumption patterns in every branch of the national economy, for this is an important instrument of enhancing international competitiveness and of stepping up technological development.

In the case of industrial consumer goods several requirements must be considered, namely that the imported products must not exert a price-raising effect, should enliven competition on the home market and enlarge assortments, but must not counteract the measures taken for updating production in the light industry. This is to be ensured, among other things, by applying appropriate tariff rates.

An important function of machine tariffs is to raise efficiency requirements for up-to-date investment goods, to prompt enterprises to pursue more rational development policies, to promote acquisitions more favourable for the balance of payments and to prefer important equipment for technological development to less modern products.

5. SPECIFIC FEATURES OF INCOME REGULATION IN FOREIGN TRADE

The income-regulating system has already taken into account the specific features and aspects of enterprises belonging to the foreign-trade branch.

Profit formation has several specific features in foreign trade as compared to the other branches of the national economy. The specific circumstances for income regulation are as follows:

— the profit of foreign-trade enterprise represents an insignificant magnitude compared to the foreign-trade turnover, profits constituting not quite 2 per cent of the gross price receipts;

— the factors of the external market have a much greater effect upon profit here than in the other branches of the national economy;

— the favourable possibilities due to the boom on foreign markets played an important part in boosting foreign-trade turnover in 1969 – 1970, and that contributed to a relatively steep rise of profits;

— within the foreign-trade branch, enterprise activities are affected to different extents by the conditions of the external markets.

Since the income-regulating system has not taken duly account of the differences in conditions, substantial profit differences have arisen between enterprises.

A specific income-regulating system continues to be applied from 1971 to foreign-trade enterprises, with special regard to enhancing economic efficiency of foreing-trade work, to paying more attention to the specific traits of the branch and to further refining the regulators on this basis.

The income of foreign-trade enterprises derives from commission receipts, from price margins realized in their activities on own account, from higher prices achieved than the contracted ones and from the profit distribution of associations. Added to this are profits derived from various foreign-trade constructions.

The keys governing commission receipts (price margins) actually valid for the relations between foreign-trade and domestic enterprises have been revised with a view to differentiating according to the requirements of foreign-trade policy. The commission keys continue to be indicative permitting the foreign-trade and domestic enterprises contractually to determine the commission fees.

Owing to the more favourable profitability of the branch, it has been found necessary to introduce a *trade tax* of an adequate magnitude[4] in order to increase centralization required by the budget and to co-ordinate the wide dispersion within this branch due to the different conditions under which the enterprises operate.

The *division* of profits in foreign-trade enterprises *into sharing and development funds* continues to differ from the usual practice. But the division into sharing fund (S) and development fund (D) will now rely on the ratio of wages to the foreign-trade price margin instead of on the ratio of wages to costs. Thus the formation of the sharing fund—which could so far be moderated only by a very high tax progression and which has shown an extremely wide dispersion between enterprises—is expected to become somewhat more levelled, and the incentive to an exaggerated cost reduction to be mitigated. Another thing the regulation is expected to achieve is that the initial level of sharing funds ensuring the increase in personal incomes and their rate of development in the subsequent years will better adapt itself to the national-economic average than it has so far been able to.

The system of wages regulation in foreign-trade enterprises also takes into account the specific traits of these activities. The wage increment indicator introduced in industry (cf. Chapter III) is applied in consideration of the fact that the achievements of the foreign-trade enterprises may also deteriorate for reasons other than their own activity, that is, owing to causes emerging on foreign markets. This is why a 0·2 per cent additional price increment is permitted up to 10 per cent of the generally applied wage-increment indicator $\frac{W + P}{E}$ and another 0·1 per cent for the increase above 10 per cent for each one per cent rise in the indicator. The privileged wages rise must not exceed

[4] The trade tax is payed from the profit before taxation.

4 per cent which the enterprise achieves by a 30 per cent increase of the above indicator.

The part of profit used for forming the *development fund* is the difference between the taxable profit and the part set aside for the sharing fund. As far as utilization of the development funds goes, it is necessary to maintain the differentiation of two parts—practised so far—one used for development purposes by the foreign-trade enterprises themselves, and another that can be ceded to other enterprises for purposes of export development. Foreign-trade enterprises use the development fund for financing the expansion of their working assets, for satisfying their mechanization and construction demands, for covering part of expenditures associated with maintenance and development of foreign-market organizations, and so on. In addition, they have even so far used a substantial part of their development funds for attaining export development objectives of importance for the national economy by yielding part of their development funds to domestic enterprises associated with them or by setting up joint enterprises in co-operation with industrial and agricultural enterprises. The utilization of development funds ceded to other enterprises for purposes of export development must be co-ordinated with the principles of our credit policy, as well as with the objectives of the national economy in the field of export development. Therefore the part of the development fund exceeding the needs of the foreign-trade enterprises earmarked in the national-economic plan, as well as the demand for expanding the circulating fund, are to be paid by the enterprises into a bank account serving the purposes of the *investment credit fund for the development of export*. In this manner the development fund centralized in the bank is becoming a special source of investment credits for developing exports. In the course of utilization care should be taken that the creditor enterprises have an intitiative and effective role in passing judgements on demands for credits and in allocating them—provided their projects and conceptions are in keeping with the principles of our credit policy and with the national economic objectives in the field of export development. Should the contributing enterprises fail to initiate proposals to that effect within a certain time limit, the given amount in the fund can be allocated for carrying out proposals submitted by other enterprises for developing export—on the basis of a common decision made by the National Bank of Hungary and by the Ministry of Foreign Trade.

Chapter V

WORLD MARKET PRICES AND DOMESTIC PRICES

by

LÁSZLÓ RÁCZ and IMRE VINCZE

1. INTERRELATIONSHIPS

While revising the system of regulators and examining financial, foreign-trade and price problems, the economists unvariably came up against the recurring issue whether the financial and price policy is capable of transmitting the business trends of foreign markets to our economy in a manner to maintain or even widen the economic pressure deriving from the development of the forces of production in the world, to enhance the interest of enterprises for exploiting market conditions but to permit, at the same time, only lasting world market price changes to assert themselves in our economy.

From the very outset, this problem had been handled as a complex financial, foreign-trade and price problem and repeatedly discussed on the basis of extensive studies and analyses by the leading authorities concerned. The conclusion was that the above-mentioned objectives could not be achieved with the instruments used so far by foreign-trade, financial and price policies unless the capacity of enterprises for undertaking risks was increased and the existing system of import price risk reserves improved.

The final outcome of the investigations must by no means be interpreted to imply as if an increase in the import price risk reserves and in the readiness of enterprises to undertake risks were to threaten the existing practice of permitting the lasting world market price trends to prevail in our price system or to put a brake on our activities for a better exploitation of market conditions. We have so far successfully warded off the price-boosting effects of market booms and can see no reason why the fundamental principles of our control system should be altered in this respect. Nor are any changes warranted by the price measures foreseen in the Fourth Five-Year Plan or by considerations concerning the relative stability of prices. Nor is it our intention to neutralize entirely the effects of business trends on our price system. This would not be possible, all the less because the boom effects and the positive effects embodied in the lasting trends of world market prices (increasing market pressure on technological development, on adjusment to trade, etc.) can hardly be distinguished from one another with any degree of certainty; and the prevalence of the above-mentioned positive effects is an important objective of our new management system. In addition, the price trends emerge, as a matter of fact, also from price fluctuations.

The problem to be solved is, in fact, to find the methods by which domestic and the foreign price systems can be linked up in a manner to satisfy the requirement of price stability and to permit the lasting world market price trends to assert themselves in the domestic economy. What are the ways and means by which to increase the responsibility of enterprises both for price formation and for a better exploitation of conditions on foreign-trade markets and to persuade the enterprises not to expect the budget to solve their problems?

In our new price system the link between domestic and foreign prices is ensured by the foreign-trade price multipliers and by the financial bridges. The latter are destined to bridge the lasting differences between internal and external prices and make it possible for the changes on the world market to assert themselves in domestic prices. But the multiplying effect of these changes depends whether or not their impacts are limited by price policy through fixed or maximum prices.

It should be noted that in the present price system, owing to a relatively wide range of maximum prices of basic raw materials and semifinished goods and staple consumer goods (mainly food), the transmission of business trend fluctuations into the Hungarian price system is the task of the authorities. It should also be remembered that the impact on turnover of price fluctuations due to business trends (and thereby, naturally, the price effects, too) are, to a certain extent, damped by the foreign-trade quotas and also somewhat by the system of issuing permits.

The requirement that the prices should be proportional to inputs and adjusted to market value judgements makes it necessary to *take into consideration the lasting world market price trends* (the changes in price proportions) *also in the official prices.* Accordingly, the producer price relations, even in the field of officially limited prices, have been modified more than once since 1968. (Thus, for instance, leather prices have been cut, the price of industrial coke raised, and so, have the prices of some chemicals, paints, caustic soda, etc.). There will be changes also in official prices during the Fourth Five-Year Plan.

In a large part of turnover within the productive sphere, the world market price fluctuations —under the conditions of the existing price mechanism—will be transmitted by way of *enterprise decisions*. The establishment of maxima for certain consumer prices and the contractual price set by enterprises (mainly through their export commitments) have, in themselves, a damping effect on the multiplying transmission of price changes due to business trends. Thus domestic prices follow foreign-prices with a certain lag which, in the case of short-range fluctuations, has itself a mitigating impact. Such damping of price changes is a natural phenomenon in every market economy. Accordingly, the problems to be solved by the revision of the economic regulators were as follows:

— is it necessary to establish official prices and instruments for the trade in some goods and in what fields, that is;

— is it necessary to apply—in addition to the above means—other regulating instruments for reducing the unwanted effects of price fluctuations due to boom on foreign markets upon the domestic economy, and also;

— whether we can apply more *elastic* and *expedient* means instead of the comparatively rigid ones used for controlling price and product turnover?

In 1968 we managed to steer clear of the deterioration in the terms of trade under conditions of foreign market price changes unfavourable for us. On the other hand, the price trends in 1969 were definitely advantageous for us as can be demonstrated numerically. The favourable changes in foreign prices resulted in those two years in a saving of about one thousand million forints by the Hungarian national economy.

The price changes on the world market and the foreign-trade activities of our enterprises earned an income above the planned one for our economy. This resulted in a surplus budget revenue and partly increased the enterprise funds.

The positive impacts of business trends on capitalist markets upon Hungarian economy were, naturally, not restricted to an increase in budget revenues. The favourable changes in the balance of payments and the expansion of exports are also connected with boom fluctuations and benefit the economy. In addition, our enterprises were more readily responsible to changes in demand and prices on foreign markets, and a large part of profits in many enterprises should be ascribed to these factors.

This is, for instance, what explains the fact that the producer price index was 106 in 1969 in the total exports of our industrial enterprises. These are the positive symptoms which—beside the negative ones to be mentioned below—indicate that no substantial new intervention in the economic processes is necessary. Nevertheless, certain negative phenomena could also be observed that might have been considerably mitigated by better organized work.

The business fluctuations of capitalist market prices were particularly embarrassing in 1969 in the trade in producer goods and in material supply. This affected mainly certain raw materials wherein domestic supply was strained. The price fluctuation elicited unexpected trade decisions in exports: when rising world market price suddenly made it economical to export certain products, such goods were also involved as were indispensable for domestic supply and their repurchase often involved considerable losses. The "suction" effect of export growing on account of boom involved such problems in connection with high-alloy steels, basic alloying materials (vanadium pentoxids), several products of the lignit industry, poplar wood for paper mills, etc.

Another unfavourable phenomenon was the growing export of products requiring non-ferrous metals. Exporting enterprises endeavoured to increase their export because this earned them about 60 per cent higher sales receipt than the maximized domestic prices. Owing to the fixed maximum of the domestic price, even a 300 to 400 Ft/$ multiplier in comparison to value added was unable to stop exports. There were cases when the sales receipt of semifinished goods exported to capitalist market failed to cover the price of the material necessary for export (ferrowolfram) imported from capitalist market.

World market price fluctuations had a certain impact even on consumer prices in spite of measures taken to mitigate them.

Contributing to the fact that the boom impacts could be favourably balanced were the administrative measures considerably mitigating the negative effects of price changes due to boom (these measures included the above-mentioned price prescriptions, restrictions on the turnover of products, percentual skimming in the case of non-ferrous metals as mentioned before, and introducing export licences). In the case of some basic raw materials, the import price risk reserve fund operating within the self-accounting system of enterprises was also intrumental in moderating the domestic effects of foreign price fluctuations.

During the revision of the regulators and their adjustment for the period of the Fourth Five-Year Plan we endeavoured to reduce the number of the statutory quantitative administrative provisions (price maxima and quotas) and to improve our regulators permitting a later liberalization of prices. The correctness of this endeavour was justified by experiences gained in financial and price formation methods used in capitalist countries. We also assessed the expected price changes on external markets. The conclusions concerning the improvement of domestic regulators were drawn after an evaluation of the above factors.

2. METHODS OF COORDINATING INTERNAL AND EXTERNAL BUSINESS TRENDS

Capitalist market commodity economies also employ means for restricting, to a certain extent, the parallel changes in foreign-trade prices and in domestic prices in spite of the fact that the capitalist internal price systems usually permit a higher rise of the domestic price level than what we regard as permissible for the safety of management. The internal price changes of the leading capitalist countries of Europe are characterized by the table below:
Internal price changes in western countries over eleven years between 1957 and 1968. (From *UN Statistical Yearbook* of 1967 and 1968.)

Country	Price index for 1968/1957	
	Industrial and wholesale prices	Consumers' prices
Austria	120	121
Belgium	106	129
France	138	160
UK		140
FRG	112	128
Italy	111	144
Sweden	123	145
USA	110	124

It should be emphasized that these are not foreign-trade prices; but domestic market prices, this is the "price medium" into which the capitalist countries admit the world market price fluctuations. In 1969, several countries devaluated their currencies and this increased the rise in domestic prices.

While internal prices in capitalist countries are rising considerably, the world trade prices are rather stable, as shown by the table below:

Changes in foreign-trade prices (UN data)

Products	Commodity exchange price indexes 1968/1957		Export price indexes in the turnover of non-socialist countries
	Moody	Reuter	
Total	88	92	101
Raw materials			94
Finished goods			108
Non-ferrous metals			149

The contradictions between domestic and foreign-trade prices are characterized by the following data:

Price changes in advanced capitalist countries between 1957 and 1968

Countries	Producer price index in per cent of export price index	Consumer price index in per cent of export price index	Consumer price index in per cent of import price index
Austria	135	136	150
Belgium	115	140	140
France	105	121	133
UK		114	130
GFR	107	122	147
Italy	128	166	169
Sweden	114	134	138
USA	107	121	124

The method of subsidizing exports and skimming imports are used also in capitalist countries for bridging differences between domestic and world market prices. This is one reason why domestic prices within capitalist regional integrations show different relations from those prevailing on world market (cf. the prices of agricultural products and those of the food industry in the countries of the Common Market). Specific financial constructions are also employed as, for instance, the agricultural skimming system in the Common Market countries, as mentioned above.

Among the other methods let us mention, for instance, interventioning sales at state-dictated prices lower than the prevailing ones to industrial branches (e.g. in the USA), the conclusion of long-term contracts for meeting demand, with price clauses differing from the exchange prices or free-market prices. (As a consequence, the processing industry often operates with basic-material prices by 20 to 30 per cent lower than the quoted exchange price; commonly known, in this connection, are the oil manipulations, but such phenomena can also be observed in other fields.) A case in point was when we could purchase non-ferrous rolled metal products at prices lower than the exchange block prices quoted.

Beside trade and financial instruments used by the state, capitalist enterprises pursue their own business policies in a manner enabling them to adjust themselves to the predictable business fluctuations where these regularly occur. Here is one example: it is characteristic of the price policy of the Canadian nickel monopoly INCO that the cycles of signing the collective labour contracts are preceded by cycles of rising prices, and before signing those, during strikes, the prices often soar up four to five-fold. Since this is a phenomenon the capitalist enterprises are well acquainted with, they accumulate reserves at times of low prices for meeting the needs at times of soaring prices. This means that part of the cyclical effect can be moderated by an adequate business policy. (Such endeavours of our enterprises are meant to be strengthened by measures prompting them to pursue more flexible purchase policies, enabling the state to make market-supporting purchases and to solve the related financial problems).

In the last analysis, the fundamental difference between the comparative stability of world market prices and the price trends of basic materials and finished goods is meant not only to keep the international monetary system and the value of the dollar stable but also to protect the advantageous positions of the leading capitalist powers and can, as such, be looked upon as a lasting trend. Consequently, the linking up of the system of domestic and foreign-trade prices by a purposeful and differentiated bridge system will continue to be an indispensable instrument of capitalist countries.

World market prices, especially those of raw materials—when examined in a long time series—appear to be surprisingly stable.

Nevertheless, there are substantial price deviations in both directions behind this stability, as is shown by the following table:

Prices of some products on the capitalist world market

Product	Annual average price from previous year, percentages		
	1967	1968	1969
Cokeable coal	83·5	100	104·4
Rough steel plates	85·2	97·5	163·0
Copper	68·6	118·7	107·8
Natural rubber	82·2	98·2	131·6
Sulphur	113·6	108·0	74·1
PVC powder	89·3	102·2	116·0
Polyethylene	78·5	58·8	122·5
Cotton	85·4	93·4	88·5
Cow hides	64·5	93·9	128·8

These price fluctuations are not permitted to entirely penetrate into the internal markets even in capitalist countries maintaining a moving price system, as shown above.

Domestic price policy cannot be built mechanically upon the changes on the world market under our conditions either. Let us mention that the prices of basic raw materials have been established with due regard to trends in the past five to ten years, that is, they do not take into consideration the fluctuation "peaks" in either direction. The problem in the case of basic raw materials is that it is not expedient for domestic prices to follow even one-to-two-year fluctuations in every case. That is why we use the import price risk reserve fund for eliminating the inpacts of price changes not favourable for basic raw materials exposed to regular fluctuations.

3. EXPORT AND IMPORT PRICE RISK RESERVE FUNDS

Studies have convinced us of the necessity of creating import and export price risk reserve funds for maintaining a relative price stability, for clearly distinguishing between financial obligations and responsibilities of enterprises and of the budget, as well as for safeguarding domestic supply.

As regards imports, the regularly changing foreign-trade purchase prices are linked up in a large field with fixed or maximum domestic prices. An automatic parallel change of the foreign prices and of the domestic prices of these products cannot materialize. This is why it is necessary to create, in addition to the financial bridges, a price risk reserve fund to act as a regulator between foreign and domestic prices in case of need.

The price risk reserve funds created on the side of imports and on the side of exports alike make it possible for a substantial part of foreign-trade gains earned through higher prices to be channelled into such funds and for a smaller part (some 30 per cent) to go to enterprise profits and thereby into the sharing and development funds.

The import and export price risk reserve funds constitute an additional part of the general enterprise reserve system. The main reserve instrument of enterprises continues to be the reserve fund separated from taxed profits.

Together with the system of import and export price risk reserve funds, enterprise reserves make it possible to maintain the financial bridges relatively stable and exempts the authorities dealing with a change from the volume of occassional interventions. Rules govern the decision of enterprises on using the sums accumulated in the import and export price risk reserve funds. The authorities of economic management obtain, from the observation of funds, appropriate signals, on the basis of which they can undertake the necessary measures. A lasting surplus of deficit of the fund indicates changes in the international price level which require adequate price or financial measures at home.

Import price risk funds have been created in several fields since 1968. An analysis of these funds has led to the following conclusions.

(a) The instruction regulating the setting up of import price risk funds makes their creation dependent on enterprise initiatives. Experience has shown that the creation of price risk reserve funds is required by the necessity of reasonably directing the economic activities of enterprises and of pursuing a rational price policy with regard to import price gains.

In the first years of the reform enterprises did not feel inclined to form funds from their import price gains because they failed to realize the significance of long-term enterprise interests and of reserves for price-risks. Nor did the authorities take adequate initiative prompting enterprises to form price risk reserve funds.

In 1969 and early 1970 the unexpected boosting of prices on the world market together with the state and social requirements related to the stability of domestic prices, had the combined effect that enterprises started to recognize the significance of price-risk reserves with a view to long-term economic policy. In spite of this, it seems necessary to promote reserve formation centrally by improving the relevant regulating methods.

(b) The regulations were not entirely unequivocal in interpreting price gains and the associated practical procedures. The authorities were inclined to restrict the ground upon which reserve funds could be increased.

(c) The various authorities established different ratios to calculate and set different limits for the amounts that could be paid into the fund and for the sum affecting the fund. The maximum of the fund was fixed too low in certain instances, and this rendered some funds inoperative.

No adequate stability prevailed in creating and using the funds. In several cases the money reserves were collected by budget, and in others, an annual statement of accounts had to be submitted to and the remainder withdrawn by the budget—a procedure contradicting the purposes of building up reserves.

(d) The setting of maximum prices for material acquired from different sources and the funds set up in connection with them sometimes (for instance, in the case of chemicals) resulted in forced paths, unnecessarily lengthening the course to be travelled by the commodities and increasing the costs of turnover. What is more, in some cases the reserve funds had been established for purposes of simple price mixing[1] and these could, therefore, not meet the requirements of import price-risk reserves.

Owing to price trends—in some fields advantageous for our exports—observed on the world market in 1968 and 1969 and to increasing enterprise profits under their impact, it also seemed advisable to create export price risk reserve funds.

Since the utilization of export price gains was not regulated, some enterprises were prompted to act, in several instances, in contradiction to the interests of the national economy. In 1969 regulations affecting only a part of export price gains in the meat industry were issued ordering the creation of reserve.

No adequate measures have been taken so far to ensure the

[1] Products acquired from different sources and at different prices are marketed at home at uniform prices.

coordination of import purchase price policy with our export price policy. In cases when identical or similar or replaceable commodities are both exported and imported (by the same body), it would seem logical to use the surplus gain from exports due to price boom on the world market for covering the increasing costs of imports or else to use the fall of import prices for subsidizing exports (where this is possible and necessary).

4. PRINCIPLES UNDERLYING EXPORT AND IMPORT PRICE RISK RESERVES

Relying on the above-outlined considerations, studies and experiences, the price risk reserve funds have been submitted to new regulation with due regard to the following principles.

a. *Import price risk reserve funds*

The fundamental purpose of their creation and operation is to permit only lasting foreign-market price trends to have a multiplying effect on the domestic economy; promoting thereby a comparative stability of prices, exempting the budget from the necessity of frequent occasional interventions and encouraging enterprises to pursue a long-term price policy with full responsibility.

Import price risk reserve funds can preferably be formed within a definite scope of basic materials or semifinished goods with fixed or maximum domestic prices, as well as for materials used for manufacturing products with officially fixed prices.

In the field of products belonging to the free-price category reserve funds may expediently be formed if this is required also by economico-political and for price-political interests.

Permission to create an import price risk reserve fund can be granted when purchase prices on foreign markets fluctuate within a very large range so much so that the fluctuations cannot be counteracted by using the regular reserve fund under the new regulations, or when a separate import price-risk reserve fund becomes necessary on account of the differences in purchase prices on different foreign markets or owing to changes in the sources.

In agreement with the authorities concerned the minister of finances may order the compulsory formation of an import price risk reserve fund or grant permission to form such on the initiative of enterprises. The mode of creation and utilization to be determined prior to its formation.

Price gains constitute the source of import price margin reserve funds. Price gain is to be understood to mean such enterprise income associated with imports as exceeds the domestic basic price to be determined. Changes in the frontier parity purchase price (cif frontier) as well as changes in the proportions of quantities to be purchased from different countries may become sources of price gains under the import regulations in force.

In the case of import products yielding no price gains under the prevailing conditions of foreign and domestic prices and the import regulations in force, yet an operative import price risk reserve fund would seem expedient for economic-political considerations, the financial cover of such funds may exceptionally be secured by one of the following methods:

— reducing the import turnover tax;

— separately calculating it among cost;

— budget crediting with definite terms of repayment;

— introducing or increasing import price subsidies (granted from the budget).

Whenever an import price risk reserve fund is set up, the interest of enterprises in pursuing purchase price policies favourable to the national economy must be ensured. This can be achieved by letting the price gains increase, to a definite extent, the profit of enterprises, i.e. their funds. In the case of price losses, the funds can usually be resorted to in the same degree as the price gain has been divided between the reserve fund and the profit.

In compliance with the rules applying to funds, the enterprises decide themselves on the utilization of the import price risk reserve funds.

By modifying the import regulators and the import price risk reserve funds, the import products must be prevented from being compelled to follow forced paths—for instance, from going to enterprises trading in means of production and capable of price mixing. Yet, at the same time, care should be taken that import price risk reserves be appropriately ensured in fields earlier included into price mixing.

By regularly analysing the situation of the import price risk reserve funds, the leading economic authorities will have to take the price and financial measures that become necessary in the light of the analyses.

b. *The export price risk reserve funds*

It is expedient to create such funds in enterprises exporting in large volume such products as are particularly exposed to frequent price fluctuations on the world market. With these enterprises, the boom gains deriving from the general market conditions, that is, substantially exceeding the extent reasonably attainable by reliable marketing should be distinguished, according to predetermined rules, from the regular profit and loss accounts of the enterprise and be used for forming a purpose-oriented separate export price risk reserve fund from the surplus gain. This is meant to act as a direct financial cover for losses due to negative price changes on the world market.

The formation of export price risk reserve funds does not cover all exporting enterprises or all countries. This fund is associated exclusively with exports to capitalist countries: in socialist relations no boom-type price changes are to be expected to occur, owing to the stable contractual prices.

Several degrees should be distinguished in forming the export price risk reserve fund associated with exports to capitalist countries:

— within a relatively narrow scope of enterprises trading in characteristically boom-sensitive commodities the formation of such funds is to be made compulsory by official instructions;

— in the presence of certain preconditions permission can be granted to create such funds if the enterprises so request;

— whenever the effects of greater than usual price changes can be warded off by utilizing the general reserve (see Chapter II), it is not expedient to form a special reserve fund for price risks.

The sphere where the formation of export price risk reserve funds is compulsory is determined by the minister of finances with the consent of those concerned. Requests for setting up such funds on the initiative of enterprises are approved by the minister of finances.

The creation of export price risk reserve funds must be made compulsory or may be permitted in enterprises where substantial market price changes frequently occur and affect a substantial part of their export products compared to their total export turnover with capitalist countries. When an export price risk reserve fund is formed, care should be taken properly to observe and check the price changes.

Such funds should be formed in enterprises undertaking a substantial part of risks of export to capitalist countries, that is, in producing enterprises in the first place. If a foreign-trading enterprise carries on activities on its own account, it may form the fund directly from this part of its turnover.

It may happen that the formation of reserves is justified only for certain groups of products within the export turnover of an enterprise. In such cases it may prove expedient to define these groups.

Viewed from the angle of fund formation, boom gains should be interpreted as consisting of the part of the profit deriving from substantial changes in foreign prices exceeding a certain extent (the "threshold price")—officially determined before establishing the fund—compared to the price basis set for the products (or groups of products) under consideration, including the export state refund pertinent to the price difference. When an enterprise is entitled—whether by the decision of the authorities or by permission granted on request—to form price risk funds, the basic price upon which accounting is to rely is to be fixed preliminarily.

The price gain earned above the threshold price is to be divided according to a definite proportion between the price risk fund and the enterprise profit. The proportions of division should stimulate enterprises to attain a favourable foreign price.

The part of profit going into the risk-fund is separated from the annual untaxed profit shown in the balance. By considerations of expediency—when a further increase of the fund is no longer justified—the obligation of fund formation may be terminated. The fact that this fund is formed from untaxed profits—unlike the regular reserve fund which is fed from taxed profit—indicates that the state has a share in undertaking risks deriving from changing export prices in an indirect manner.

In the case of losses compared to the threshold price, the enterprises are entitled to resort to the reserve fund in the same proportions as underlay its formation. A precondition of utilizing the fund is a loss in the combined balance of products (or groups of products) included in the system of fund formation.

In the case of a substantial quantitative and lasting surplus or the exhaustion of the funds, or when substantial and lasting price losses occur, the authorities of economic control take appropriate measures.

In the case of fungible, related products or such as undergo identical processing methods, exported and imported regularly by the same enterprise and the preconditions for establishing price risk funds exist, it seems expedient to create a common price risk reserve fund for both imports and exports and use it to cover losses due to foreign-trade prices.

Enterprises may associate for establishing funds.

The amounts accumulating in price risk funds are to be deposited with the bank and can only be withdrawn when the enterprise is entitled to use the fund. This provision is meant to ensure that the enterprises may dispose of these funds without additional bank (credit) control, in compliance with official regulations.

The enterprises obliged to form export and import price risk reserve funds are officially listed.

Chapter VI

REGULATIONS CONCERNING PRIVATE CONSUMPTION

by

MRS. JÁNOS KESERŰ

1. CHANGES IN THE CONSUMPTION PATTERN

The improvement in the living conditions of population provided for Hungary's Fourth Five-Year Plan is significant both in relation to prior development in this country and in the light of international comparison.

Consumption will grow by 29–30 per cent in five years, that is, at the same rate as national income. Residential construction, one of the most important factors of improving the living conditions, will develop at an even higher rate. In five years, 400 thousand new dwellings will be built, against 300 thousand in the preceding five-year period; within this, government housing construction will increase by 50 per cent. Taken together, these plan indicators basically determine the extent of improving living conditions. Their combined growth rate exceeds that of the national income. In other words, *the proportion of national income utilized directly for the purposes of population will considerably increase.*

One of the most important objectives of the Fourth Five-Year Plan is the *quantitative and qualitative improvement* of private consumption. The patterns of the supply of goods and services must change according to requirements set by the growing income and improved living conditions of the population. A shift in the pattern of consumption is expected towards industrial consumer goods and, in general, towards goods and services of higher quality.

It is to be expected that the consumption of kinds of food containing mainly carbohydrates and fats will grow slower than of those containing animal protein or vitamins (as a matter of fact, the per capita consumption of the former will even decrease). According to the plan, annual per capita meat consumption will grow from the present 55–56 kg to 65–69 kg, that of fruits and vegetables from the present 160–162 kg to 190 kg.

The plan intends to facilitate household work by considerably increasing the supply of processed and canned food, as well as by developing the facilities of catering (restaurants and plant canteens).

As regards clothing, a 36—37 per cent increase of consumption is expected, its pattern changing in favour of up-to-date quality goods, which are also easier to handle as regards washing, ironing, etc.

The greatest increase in demand is expected in the field of household machinery, furniture, building materials, motor cars, as well as in the sphere of industrial services. According to plan provisions, between 1970 and 1975, the stock of the major industrial consumer goods per 1000 inhabitants may increase as follows: passenger motor cars from 21 to 47; TV sets from173 to 240; electric refrigerators from 98 to 208; washing machines from 170 to 210.

The supply of building materials and of furniture may increase by almost 50 per cent, the volume of industrial services available to the population by 45—55 per cent between 1970 and 1975. As regards the latter, development will be quickest in the fields connected with the maintenance and repair of residential buildings, passenger cars, communication equipment and electric household machines, as well as in laundering and chemical clearing services.

The objectives of economic policy set high requirements against all the branches of the national economy called upon to supply resources for the development of up-to-date private consumption and residential building, at the rate and according to the patterns provided by the plan, that is, in harmony with the expected demand of the population. This task can be fulfilled only when productivity of labour and economic efficiency will improve at a faster rate than they did in the past.

According to the plan, about 85—90 per cent of the increment of the national income must derive from improved labour productivity and from the above average rate of development in the branches of high productivity.

The materialization of the latter objective, which is decisive for the improvement of living conditions, has required from the system of economic regulation to insist increasingly on economic efficiency. In a certain context, the development of the system of economic regulations is closely linked also with the objectives of economic policy in the field of living conditions.

2. SOME MACROECONOMIC CORRELATIONS

(a) In the interest of a fast improvement of labour productivity the personal incomes of people engaged in productive and servicing enterprises[1] must be closely linked to the economic results obtained by these enterprise. In other words, *the planned increase of personal incomes should take place only when also the planned improvement of enterprise efficiency is achieved.* This is why the regulation of incomes is centred around the efforts aimed at increasing the interest of workers and employees in the profit of their enterprises, and the stimulating effect of this interest.

This aim is served by regulating wages in a way that increase in personal incomes depends mainly on how the requirements regarding the efficiency of the enterprise are being met. The workers and employees are interested in raising of the "per capita profit" (enterprise profit per employed person), in the saving of live labour, in the rational limitation of the working staff.

The regulation is such that, if labour productivity develops according to plan, the per capita earnings of the workers and employees may rise at a higher rate than they did in the past. This regulation links the interest of the enterprise with the general objective of welfare and social policies, that in the improvement of living conditions *a greater role must be given to the increase in the per capita real wages of people employed*, in order that everybody directly participating in the work should feel more conspicuously the advantages of rational management or the drawbacks of a poor one. The national economic plan estimates that the five-year increase in the per capita real income of the population will amount to 25—27 per cent, whereas real wages per employed person will rise by 16—18 per cent.

This improved rate of rise in real wages conforms with another objective of welfare and social policies, aimed at reducing the existing differences between per capita family incomes. Namely, the increment in national income—the production of which is being stimulated by the differentiation of personal earnings according to profitability—makes it possible to increase the pensions, family allowances and other social benefits called upon to moderate such dispersion of per capita family incomes as is due to the varying number of dependants and, especially,

[1] For simplicity, "enterprises" will mean here both the state-owned enterprises and the co-operatives.

to the varying burden of families that may come into consideration in connection with the replacement of labour force.

(b) However, the system of regulators must be developed in such a way that it serves the *rational management of embodied labour* as well.

According to the Fourth Five-Year Plan, the proportion between consumption and accumulation will be about the same as it was in 1970 throughout the period. However, the planned high rates of increase in residential construction and technological development require a relatively rapid growth of *fixed assets*. In compensation, the plan provides for the *development of stocks of materials, intermediary and finished goods* a somewhat lower rate than for the growth of national income as a whole and of its portion destined for accumulation. If the growth of stocks exceeded the planned rate, it would divert funds either from personal consumption or from the development of fixed assets, although even the planned growth of the latter is believed to be insufficient. Thus, there is a close interdependence between living conditions and the regulation ruling that any permanent increase in the enterprise stocks connected with the expansion of enterprise activities must be financed exclusively from enterprise funds. In this way, enterprise decisions will tend to favour acceleration of stock circulation, diminishing the relative amount of stocks needed by production or turnover and rationalizing the activities of purchase and sale.

In the last analysis, the same objective is served also by measure which relegates an increasing part of decisions regarding the development of fixed assets to the competence of enterprises or —if bank credit is required—of a selective credit policy.

3. CONSUMER PRICE POLICIES

An important objective of the Fourth Five-Year Plan is aimed at stabilizing the price level and its mechanism, thereby serving to improve both efficiency and general atmosphere of society. The policy of stable price means that any increase of enterprise income (both the income of the enterprise as a whole and of the persons employed in it) must derive from rationalization, improvement of productivity, prudent and circumspect business policy, a better satisfaction of the demands of the population, that is, from better work. In our economy, higher profits must not be obtained from price rises, only from increased production and supply, from adequate development measures, etc. It follows that the stability of the price level depends on certain conditions which have to be created by economic policy and control. Such conditions are, on the one hand, the gradual improvement in the relation of supply to demand, abundancy of commodities, the materialization of the plan provisions aimed at enlivening economic competition and, on the other, further improvements of the price system, including the supply of informations and the apparatus necessary for an efficient control of prices.

A policy aimed at maintaining price stability, however, *does not mean complete rigidity of the price system and the price mechanism* or a prevention of socially justified changes in the prices determined either by the authorities or by enterprises. This relates even to the consumer prices.

In spite of measures which, in the last few years, tended to develop a more realistic pattern within the system of consumer prices, tensions between producer prices and consumer prices survived, they even became more acute in certain fields. In a considerable scope and to a relevant extent, consumer prices still deviate from what would be proportional to social inputs. When consumer prices deviate—owing to state subsidies or to turnover taxes—from what they should be on the ground of social inputs, they are likely to hamper the transformation of the national economic structure. All this requires—while ensuring an adequate supply of commodities—*a gradual reform of the system of consumer prices*, the final aim of which is to part with state subsidies and to virtually equalize the rates of turnover tax—apart from the cases where social preference or dislike will be intentionally and lastingly asserted.

In the framework of this policy, also in the period of the Fourth Five-Year Plan there will occur:

— the closing of the gap between some consumer prices and the level justified by social inputs, both in the case of official prices and of those determined by enterprises, this, however, will involve not only price increases but also reductions;

— a further simplification of the turnover-tax system in a way that within the various commodity groups the different tax rates prevailing for more or less similar or mutually substitutable products will be made uniform or contracted to a few rates; this process must be, however, a gradual one.

With a further improvement of the market equilibrium, it may become also possible eventually to reduce the number of products for which "limited prices" are now prevailing (Group III), in favour of Group IV, where prices may develop freely while maintaining the major proportions of official prices.

All this, however, must take place in such a way that the *annual average rise of consumer prices is maintained somewhere between 1 and 2 per cent.* This is, namely, the rate of price rise figuring in the plan calculations of real wages and incomes. Of course, also the requirement continues to prevail that any rise in official consumer prices affecting wide layers of the population must be compensated by government measures aimed at increasing incomes, *so that the established real-income levels of the various strata might be maintained.*

Under the new system of economic control, higher requirements emerge against the system of *price information and price control.*

An improved supply of *information* is needed for national and enterprise planning. Furthermore, the fact that our consumer prices became more sensible to changes in producer prices and even in world-market prices, requires us to ensure more reliable information on how a price change affects the living conditions of the various population strata.

It is necessary for the enterprises to be adequately informed regarding the macro-economic motives of the government's price policy, and, conversely, the price authorities must be kept informed on the price intentions of the enterprises, and on the relation of supply to demand motivating these intentions. Improvement of this two-way flow of information requires a well-organized co-operation between official, scientific, market-research and enterprise agencies, as well as—with the participation of all these—the creation of a forecast system.

We need also better information on how enterprises, possessing a greater freedom in pricing, observe the basic normatives of socialist economy, and establish their prices in harmony with the interests of society as a whole.

Adequate guiding principles and normatives must be worked out to help the activity of the price-control apparatus, in order to establish uniform criteria for the judging of violations, and also to guarantee security for enterprises observing these norms of pricing.

According to recent experience, *the most important guiding principles as to pricing policies of enterprises and the control of such prices,* might be formulated as follows.

It should be acknowledged by society that enterprises producing more up-to-date, technologically superior or more fashionable articles do so also in order to increase their profits, and that they are entitled to sell such products at higher prices. At the same time, society expects that part of the gain obtained from producing and selling such articles comes to the benefit of the consumers (or processors) in such a way that either the price of the less up-to-date article is reduced, at the same time, or the price of the new, up-to-date article is less than what would be justified by its improved use-value.

The authorities of price control must assess the behaviour of a given enterprise *as a whole;* the general tendencies of its price policy are to be evaluated, not restricted to some isolated price changes.

Society expects enterprises to meet the domestic demand for the various products in an adequate range of quality and price and, especially, that the producing and trading enterprises ensure a supply also in the relatively low-priced sorts of adequate quality, sufficient to meet actual mass demand. The narrowing-down of the supply of such goods in order to achieve a more "profitable" product pattern is condemnable also from the viewpoint of price policy.

It is also expected that enterprises should not raise the prices of staple consumption goods until there is a possibility of keeping them constant, e.g., by re-distributing of overhead costs of their various products and by differentiating the profit rates by products. A producing enterprise is condemnable if it realizes high profit in the price of a product subsidized by the state. The same applies to a trading enterprise, if it charges a price margin exceeding the officially set margin when selling a subsidized product.[2]

Society does not approve the behaviour of enterprises which, exploiting their monopoly situation, do not reduce their prices proportionally with diminishing costs, acquire extra income and accumulation over and above what is necessary for developing their production in line with market demand. Even more severely is judged the behaviour of an enterprise which endeavours to raise its prices by artifically bringing about a scarcity of supply or by restricting competition. (Such endeavour may

[2] For trade in products with prices not established officially, the price authority may set "normative price margins" which, however, are not obligatory.

materialize, e.g. in an unjustifiable reduction of stocks, in narrowing the range of choice, in unlawful price conventions with other enterprises, etc.)

A circumspect enterprise price policy may be expected to back up its decisions by long-term contracts regarding sales and purchases. It may be also expected that it renounces to changing sales prices immediately at every insignificant, short-term fluctuation of its purchase prices or in the conditions of production; in such cases the possibilites offered by the reserve fund of the enterprise and by the import price risk reserve fund should be utilized.

A correct enterprise price policy must take into consideration the unity of interests manifesting themselves in the different interdependent phases following one another in the process production and use. When establishing their sales prices, economic units are recommended to regard also the interests and competitive power of their buyers, since their own economic gains depend on the extension of their sales, in other words, on the prosperity of their buyers.

In trade, reasonable business policy aims at raising turnover and to increase profits in this way, through a growing sum of trade margin. If a growing turnover is accompanied by cost reduction, profits grow within the trade margin.

An enterprise—either producing or trading—is gravely condemnable if it generally fails to perform its tasks connected with domestic suppply; if—in order to obtain better sales prices at home—it exaggerates its exports and causes scarcity on the domestic market of an important article or fails to eliminate an existing scarcity, thereby conjuring up the danger of price rises in the home market. It is equally condemnable if an enterprise seeks compensation for the fall of its export returns by raising the domestic sales prices. If a foreign-trade enterprise—in order to obtain undeserved economic advantage—establishes unrealistically high "orientation prices" for the domestic purchasers of imported goods and causes thereby a rise in home prices, its behaviour is liable to sanction.

If an enterprise sells a commodity at its originally established price but in a poorer quality than for what the price has been established, this behaviour is liable to sanction. Such behaviour is condemnable even if no extra profit is being obtained through the sale of the inferior commodity.

If an enterprise purchases a certain kind of material or other commodity at different prices, the *average* purchase price must be entered into the calculation of the production costs, in conformity with the method prescribed for, or actually practised by the branch in question. Deviations from such prescription or established practice—e.g., calculating the cost on the basis of the highest purchase price—is objectionable.

If at the time of establishing the sales price, an expected rise in the purchase price of a material, etc. had been calculated but subsequently this expectation did not prove justified, the sales price must be reduced accordingly. A failure to observe this is objectionable.

Enterprise price policies must always be in accordance with the legal prescriptions regarding taxes and other liabilities against the state budget.

4. SPECIAL REGULATORS IN DOMESTIC TRADE AND IN SOME SERVICES

Both the objective level of the living conditions and the subjective feeling of satisfaction of the population depend on the extent to which consumer goods and services are available. One of the central objectives of the Fourth Five-Year Plan relates to further improvement in providing the population with commodities and services.

The achievement of this objective depends essentially on how the system of economic regulators will succeed in asserting the targets regarding labour productivity, production volume and distribution set by the Fourth Five-Year Plan. *It also depends, however, on how the system of regulators will stimulate the activities and even (if necessary) assert social preferences to the benefit of trading and servicing enterprises ensuring the population's supply with commodities and services.*

5. DOMESTIC TRADE

The system of economic regulators applied since 1968 proved to be suitable also to control trade activities. It has been possible to increase sales at rates much exceeding past development. The turnover of domestic trade increased by 7 per cent in 1968, by 10 per cent in 1969, and by about 13 per cent in 1970.

At the same time, supply difficulties showing up in 1969 and the insufficient growth rate of services in that year were a warning that some elements in the system of economic regulators introduced in 1968 acted—under the given relation between supply and demand and the existing price relations—unfavourably on the trading and servicing enterprises. Therefore, though uniformity and stability of the regulating system was thought decisive for economic policy, experience has led to certain *modifications in 1969 and 1970*.

Such were introduced partly in order to enhance the security of domestic trade in its purchases and stockbuilding, and partly to stimulate an increase in its turnover.

The development funds of the trading enterprises built up during 1968 and 1969 were not sufficient to finance the expansion of the commercial network and of commodity stocks required by rapidly growing turnover. Therefore the government has empowered the National Bank of Hungary to finance, by short-term credits, part of the (permanent) increment in commodity stocks, if it was justified by an increase in turnover. Thus, in contrast to the regulation concerning productive enterprises, the development funds of the trading enterprises were partly relieved of financing the increase of their stocks. In addition, in 1970 trading enterprises having increased their stocks were granted a special tax exemption, facilitating to build up their necessary own working assets.

Since in trade the commodity stocks represent a significant portion of the totality of enterprise assets, their change influences strongly the development of the profit-sharing fund. Of course, also the trading enterprises must be made interested in the correct management of stocks; it happened, however, that under the general provisions concerning the division of profits a reduction of stocks was advantageous to the enterprise even it was undesirable from the viewpoint of the national economy. In 1970, this problem was solved in such a way that, instead of the actual value of stocks, the average of the years 1968 and 1969 had to be entered into the profit-dividing formula applied for calculating the profit tax (see Chapter II).

In addition to the personal motivation coupled with profits, in 1970 the retailing enterprises serving consumers were made directly interested in the expansion of the turnover through wage-policy measures. Namely, their profit-sharing funds are charged with a lower wage levy than those of other enterprises. Thus it became possible for their leaders more extensively to apply the wage forms suitable to stimulate their personnel to increase sales, that is, to improve the supply of consumers.

By modifying the pricing principles regarding consumer goods, the price gain obtainable by selling imported goods (which was substantially higher than average rate) was reduced, in order partly to stimulate the sales and partly to increase the competitiveness of these goods.

In the last analysis, all these modifications of the system served (1) to enhance enterprise interest in the profits obtained and to create an interest in augmenting sales, (2) to enable trading enterprises to increase their development funds, as well as to follow a safer policy of purchases and stockpiling.

References accorded to servicing enterprises served mainly to improve their possibilities in raising wages and developing their fixed and working assets.

From 1971 on, considering also the former modifications, *the following deviations from the general system of regulators* are to be found in the sphere of trade and services.

a. The *trade tax*, which has been applied in certain cases even in the past, extends to every economic unit engaged in trading activities, i.e. also to such enterprises for which trade is a subsidiary or auxiliary activity. In this case, the trade tax applied depends on the extent of such activity.

The general—but differentiated—application of the trade tax makes it possible:

— to ensure trade income levels and growth rate proportionate with those prevailing in other branches of the national economy;

— to apply, also in trade, the general principles and taxation methods aimed at income regulation with an adequate stimulating influence (e.g. without the trade tax, it would have been necessary to raise the profit tax of trading enterprises and this would have involved some undesirable consequences);

— to reduce such differences in the profit-earning possibilities of the various trading units which are due to conditions not controllable by them;

— trading units may be stimulated (mainly by differentiating the trade tax) to co-operate in achieving determined objectives of the state's commercial and consumption policy.

The general rate of trade tax is 1·5 per cent of the sales returns. Partial or total exemptions are, however, granted to certain branches of trade, or in order to serve some policy objectives (e.g., to improve the position of units operating seasonally or under disadvantageous economic conditions; preferences in favour of applying vending-machines, of home-delivery services, etc.).

b. The following measures serve for *backing rational enterprise policies as regards purchases and stockpiling.*

In connection with dividing the *profit* (see Chapter II) the value of stocks entered into the formula is the average of stocks in 1968 and 1969, multiplied by the rate at which turnover has grown against the base period. This enables the development fund of the enterprise to grow in proportion with the growth of turnover; this increment of the fund can be used for financing an increase in commodity stocks. (In the case of a decreasing turnover the *actual* value of stocks must be entered into the formula, of profit-sharing.)

Enterprises engaged in domestic trade—provided they utilize their development funds entirely for increasing their working assets, and that even this proves to be insufficient for financing a justifiable permanent increase—*are entitled to retain a portion of the profit tax* equalling 10 per cent of the part of profits due to the development fund, *and to use it for a further augmentation of their working assets.*

c. Whereas in general the rise (with a reduced tax-rate) of the average wage level of the enterprise is determined by the per capita sum of wages and profits (see Chapter III), *in the state-owned and co-operative domestic trade it depends on the increase of both the total and the per capita turnover.* First, every one-per cent rise in the total turnover of commodities enables the retailing enterprises to raise wages by 0·2 per cent, and whole-sale enterprises to raise them by 0·1 per cent. Second, in addition, every one-per cent rise in the per capita turnover (that is, annual turnover divided by the annual average number of employees and workers) entitles these enterprises to a *further* wage rise of 0·2 or 0·1 per cent, respectively (with a reduced single levy).

To connect personal economic interest with the development of total turnover seemed advisable because in this way all workers of home trade (regardless of their operating in centres or networks) are stimulated to meet consumers' demands at the possible maximum level. But this incentive had to be complemented by another, acting in favour of the general requirement of saving live labour, in view of the strong tensions present in the balance of manpower. The combined action of the two incentives is expected to prevent the enterprises both from using live labour wastefully in order to increase turnover and from neglecting their standards of services in order to save live labour.

d. *The officially fixed price margins relating to some imported consumer articles* continue to remain in force.

e. *State subsidies granted for development* purposes, aimed at influencing enterprise decisions in this field (see Chapter VII) are applied now also in trade. The far-reaching decentralization of trading units and the relatively moderate possibilities of accumulation deriving from it limit the decisions of individual enterprises regarding the construction of such large-scale magazines, supermarkets and catering units as would be needed. In addition, the rapid growth in the turnover of some articles (motor vehicles and their parts, petrol, etc.) requires the state to subsidize the creation of new branches of trade, new enterprises, as well as to contribute to supply them with fixed and working assets.

f. When regulating the *taxation of development funds* it had to be considered that, from 1971 on, the retail trade enterprises and, from 1972 on, also the catering enterprises will be entitled to retain the whole sum of depreciation allowance for their own development purposes.

6. SERVICES

Considerable preferences will be accorded here, even in and after 1971.

a. In the field of industrial and commercial services, the charge on assets will figure in the price calculation but the part proportionate with services performed directly for the population need not be accounted as costs. Thus in the enterprises operating in these branches the charge on assets, instead of directly flowing into the development fund (as it was the case formerly), augments the profits of the enterprise. This measure increases the profit-sharing fund, that is, accentuates personal interest. However, to ensure the creation of a development fund comparable to what could have been built up under the former system, in the case of consumer services and maintenance of residential buildings it was necessary to grant full tax exemption for that part of profits which is due to the development fund in proportion with sales returns.

The former state subsidies on the prices of laundry and shoe-repair services have to be continued.

b. In the field of communal services the scope of assets for which a charge on assets is payable remained unchanged.

Similarly, the wage multipliers differentiated by branches have been maintained. The tax rate on the part of profits due to the development fund was reduced. The obligatory minimum of the *reserve fund* was determined as 8 per cent of the annual payroll, and the former obligation of increasing it proportionately to the development fund has been cancelled. This latter measure was due to the consideration that, first, in this field the requirements of developing fixed assets, that is, the strain on the development fund, are excessively high and, second, that in view of the obligations of local councils towards the enterprises operating in this field, the role of the reserve fund has to be interpreted otherwise than in general.

State subsidies granted on communal services continue to be necessary. However, in the period of the Fourth Five-Year Plan, local councils must be made interested in granting such subsidies.

c. As regards *wage regulations*, for state-owned enterprises and industrial co-operatives performing industrial and commercial services, as well as for the communal services, a system of preferences was worked out which, while ensuring adequate incentives to develop the services directly affecting consumers, raises the personal incomes of people employed in these branches in conformity with the plan objectives of raising the wage level in the rest of the national economy.

d. The former system of state subsidies, tax exemptions and other preferences aimed at promoting *cultural activities and services* was maintained, in view of the decision that, in general, the prices of services and products belonging to this sphere must not be raised. In addition, it seemed necessary to elaborate a preferential system of wage regulation. Moreover, the part of profits due to the development fund of such enterprises is taxed according to what extent they succeeded in achieving the aims set for them by the state's cultural policy, with a view also to actual requirements regarding the increase of working assets. For the purpose of regulation and ensuring the aims set by cultural policy, it is necessary to maintain the system of "cultural funds" and allowances due to them. (This means that enterprises are allowed to raise the prices of certain services in order to create, from the price differences, a fund from which the prices of other services may be subsidized).

Chapter VII

REGULATION OF ECONOMIC GROWTH

by

IVÁN BEREND, ISTVÁN DANCS and LÁSZLÓ SZABÓ

1. THE OBJECTIVES OF GROWTH REGULATION

Regulation of development activities is one of the most important tasks of economic control in socialism, since any development measure may have long-lasting influence on production, consumption, on the place where and on the extent to which incomes are created, in short, on the whole of economic structure. In every planned economy, development policy must deliberately and circumspectly initiate such long-term effects, rather than to seek solutions for momentary or short-term problems; thus, its measures are not wholly subordinated to present interests. Regulations affecting development must, in a way, lift investments out of their actual economic environment, they have to reconcile reasonable insterests of the present with those of the future.

In Hungary during the last quarter of a century the methods of state control exercised in the field of investment and development have changed much similarly to the whole system of economic control and management. We are able to distinguish the reconstruction period between 1945 and 1949, when experimenting with central planning was intertwined with essential elements of war economy, the rigid centralization tendencies of the early fifties; on this followed the hesitating application of administrative measures between 1953 and 1956, then the gradual (but by no means decisive) efforts at the introduction of economic incentives between 1957—1968 and, finally, the switch to the "new economic mechanism" in 1968. The transitory period beginning with 1 January 1968 ended by 1970. In 1971, with the beginning of our Fourth Five-Year Plan, further development of economic control and regulation is needed, and we must do away with the transitory arrangements of the recent past.

Seen from the aspect of ideas to be dealt with here, the *concept of development* is partly wider and partly narrower than the generally accepted notion. We may understand by development any increase in the value produced, regardless of its being attained by new investment, by increasing the stocks of working assets, by an improved utilization of the existing ones, or even merely by a better organization of production processes, by savings in the input of materials and energy, etc. In some of these cases, development does not depend on investment or even on the management of fixed assets.

In the present chapter we restrict the concept of development to what may be attained by fixed capital investment, notwithstanding that enterprise development funds are destined for increasing both the stocks of fixed and working assets. Since, however, our discussion is centred around investments, our concept of development is, in a sense, also wider than the commonly accepted one—at least from the point of view of regulation. Namely, regulation embraces, as a rule, every investment activity, regardless of whether it is aimed at "genuine" development (that is, at increasing the productive capacity) or only at replacing what has formerly existed. Let us remark here that in practice it is very difficult to distinguish between these two categories. Thus, the concept of development comes very near to that of investment, since it includes also investments serving replacement. In principle, replacement should not belong to this scope, but practically every "replacement" involves some features of "development". As a rule, it almost always consists in the purchase of machines having improved technological and economic parameters, that is, able to produce either a greater quantity per unit of time, or to produce at a lower cost, or in a different or superior quality, etc.; and all this belongs to our concept of development.

It has to be remarked also that development does not simply mean creating a possibility to increase production, and even less to increase it in physical terms. Let us take a plant producing refrigerators. Development of such a plant does not necessarily mean that its daily production of a given type of refrigerator (say, with a capacity of 150 litres) shall rise from 100 units to 120 (i.e. by 20 per cent). It is possible that

– only 100 units per day will be produced even in the future, but each of these will contain a deep-freeze compartment of 25 litres, and this improvement raises the value (and the price) of a unit by 20 per cent;

– the absorption system may be improved sufficiently to replace the former compression system (that is to ensure at least the same time-rate of cooling) so that, by eliminating the motor, a noiseless refrigerator and one less sensitive to defects could be offered for sale, at an adequately higher price;

— new possibilities also belonging to the sphere of development may be opened by extending the range of types from the present choice of 4 or 5 types to 8 to 10, ranging from 50 litres to 230; the widening of choice would necessarily involve an expansion of sales;

— also the technology of production and the productivity of live labour engaged in it may be improved, new materials applied, the weight and the external dimensions of the refrigerator reduced; it may be made available in different colours, etc.

All these lines of development, as far as they are connected with investment, can be achieved either by the aid of new machines or by improved utilization, or replacing, of the existing ones, by means of new constructions, etc.

Starting from such a concept of development, we might state that the aim of its regulation consists in creating such an economic environment of the microsphere where the interests of the productive units and of society as a whole are reconciled, and where present and future interests of society are brought to a common denominator.

The *methods of regulating* development may be direct or indirect, but in each case they are indispensable instruments of economic planning. At the time when centralistic and administrative elements predominated in the system of economic control and management, development decisions were almost exclusively taken by the central organs; accordingly, they were responsible for ensuring the physical, technological and monetary conditions of their implementation. Under such conditions, indirect regulation as now understood was not necessary, since virtually the development of each economic unit was subject to central decision.

The model of economic control and management was then as is shown in Figure 1.

Since enterprises came possession of investments free of charge, they were not much interested in investment costs. And although depreciation allowances were part of their current costs, even these did not affect their interests since the amount and rate of profits had hardly, if any, role in the development of personal incomes or of enterprise accumulation.

Thus, there was not—and could not be—any possibility of checking the correctness of central development decisions on the part of the enterprises. The correctness of such decisions

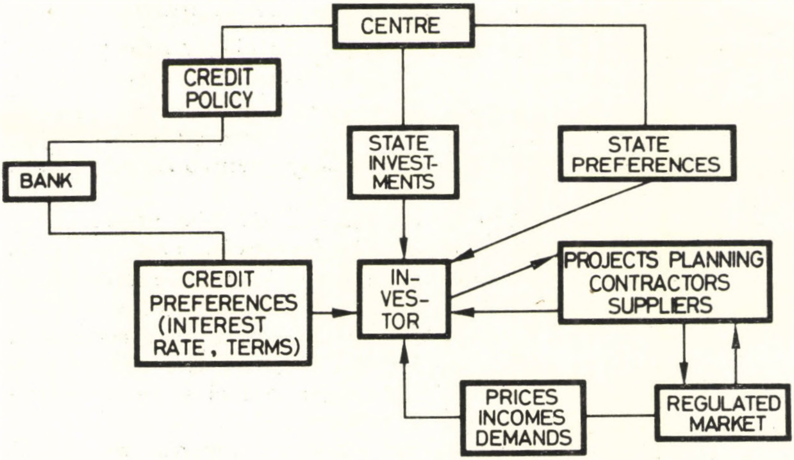

Fig. 1

could be verified only several years later with the aid of synthetic analyses, when the direct effect of a single decision could no more be measured, only the global outcome of many decisions, some of which might have had effects opposed to one another. Under the then prevailing value and price conditions it was not possible to investigate which decisions were economically correct, only the cumulated effect of their totality could be stated.

In the framework of the 1968 reform the economic interest of enterprises and of their workers in profits, the new way of dividing incomes between state and enterprises, as well as the price reform which came nearer to the value relations, have made it possible to relegate a considerable part of investment decisions (affecting about half the value of all investments) into the sphere of competence of the enterprises. This proportion amounts to 55—58 per cent if also spending aimed at increasing the permanent stock of working assets is considered. The economic correctness of enterprise decisions can be evaluated earlier, and separately for each case; development risks are, in a sense, divided between society and the enterprise; within the latter, the risk affects mainly the development fund of the enterprise but to an extent also the receivers of personal incomes.

Also the relationships between the economic organizations participating in investment have considerably changed. In principle, their model can be drawn up as follows (cf. Figure 2).

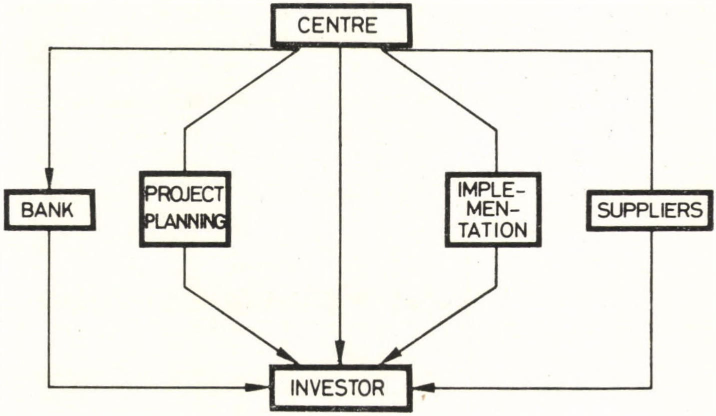

Fig. 2

This model is conspicuously more complicated than the former. The intricate network of relationships is intervowen by a uniform system of economic regulators. Regulation embraces all enterprise activities, and the various regulators influence development decisions to a greater or lesser extent. Each regulator has its specific task but almost all are—at least indirectly—affecting development decisions.

The system of regulators seizes the most important elements of economic reality, much similar to how a piano score contains, instead of all parts of the orchestral score, only the tones characteristic of the composition.

The history of development regulation shows a tortuous way until 1968 when the methods of indirect control came at last to perform a significant role. Experience accumulated in 1968–1970, especially regarding the inability of price relations (however "correct" they may be) to reconcile present and future interests, as well as the presence of recognized but yet unsolved price problems have led to the conclusion that further improvements in the essentially well-operating mechanism and in the regulator system were needed. The improvement of the system of regulators is based on the former, well-proved methods; as a matter of fact, it is not the methods that have changed; only the extent of their application. In other words, the new system regulating development is expected to serve a better implementation of the centrally set plan objectives, without increasing the number, proportion and role of central investment decisions; it continues to depend on enterprise decisions determined by enterprise interests at least to the same extent as in 1968–1970.

When seeking to determine the "necessary and sufficient" extent to which development has to be regulated, we must deal partly with the spheres of competence of the central authorities and of the enterprises, and partly with the financial funds available to the two.

2. DISTRIBUTION OF COMPETENCE AND FINANCIAL FUNDS BETWEEN CENTRAL AUTHORITIES AND ENTERPRISES

Character and methods of regulation must evidently differ in the various fields of national economy. For instance, in the non-productive sectors it seems more expedient to regulate most developments by direct methods; here, efficiency requirements may be met mainly by an adequate division of competence among the central and local organs of state administration. Development in this field requires in most cases decisions to be taken by state organs, but the *levels* of decision-making (government, ministry, county, municipal or local council) must differ according to which level is most likely to ensure the maximum of relevant information, that is, the maximum of efficiency.

In the sphere of production, the scope of central decisions is necessarily smaller, but there are important differences by branches. In the industries producing raw materials and energy and in infrastructure the weight of central decisions is conceivably greater than in the manufacturing industries. Within the latter, the scope of enterprise decisions is greatest where market influences and competition are most relevant. The main proportions (according to the Fourth Five-Year Plan) are outlined as follows.

In the average of the five-year period 1971–1975 the share of central investment decisions will be 48 per cent, but it will amount only to 36 per cent in the sphere of production, to 35 per cent in industry as a whole, to 30 per cent in manufacturing industry, and to 12 per cent in agriculture. (Evidently, in the groups not figuring separately, i.e., the non-productive sphere and the extractive industries, the relative scope of central decisions is greater.)

Let us examine now the changes in the scope of decisions between 1970 and 1975. The tendencies are unequivocal. As for the whole of the socialist sector, in 1970 some 50 per cent of development decisions were affected by direct measures; this share will be reduced to 48 per cent in the average of 1971 - 1975 and to 46 per cent by 1975. Accordingly, the share of decentralized (enterprise) decisions grow from 50 per cent in 1970 to 52 in 1971 - 1975 and to 54 per cent by 1975.[1] Of course, all these percentages reflect only how the right of deciding on investments is divided among the various organizations, and not the shares they are taking in the financing of investments. (As a matter of fact, even the right of decision might be shared between two or several co-operating organizations.) Changes in the scope of competence depend substantially on the relative importance of branches regarding which investment decisions are being made centrally.

In view of the fact that the relative share of the non-productive sphere in total investment is going to increase from 15 - 16 per cent in 1966—1970 to 20 per cent in 1971 - 1975, the share of investments depending on enterprise decisions is not likely to increase more rapidly than the planned rate. Substantial change in proportions may occur only in the manufacturing industry. Here the share of central investment decisions is expected to be reduced from 40 per cent in 1970 to 20 per cent in 1975. As regards agriculture, the five-year plan does not provide for any substantial change, since, even now, about 80 per cent of all investments depend on enterprise decisions and a further relative increase is not likely to take place.

Of course, the high share of enterprise decisions does not mean that all of them are autonomous: to a great extent they depend on the conditions of bank credits and state subsidies. They are autonomous mainly in the sense that enterprises are free to choose among some alternatives set from them by the system of central regulators, in the general economic environment created by the latter.

Changes in the proportions of financial sources will be similar to those regarding the competence of decision, but they will be somewhat smaller. In 1971 - 1975 the state budget's share in the development of the socialist sector of the national economy will amount to 54 per cent (including both the state investment

[1] To give an idea on the orders of magnitude, let us remark that in the period 1971 - 1975 the volume of investments depending on enterprise decisions will exceed by about 50 per cent the sum of amortization allowances payable during this period.

purposes). This share amounts to 52 per cent regarding industry as a whole, and to 47 per cent for the manufacturing industry. The changes in the structures of financial sources will correspond to the increasing proportion of decentralized incomes within society's total net income: but changes in proportions exceeding what is provided for in the five-year plan can hardly be expected.

3. METHODS OF REGULATION

Development must be regulated essentially in order to maintain the planned proportion between the parts of national income used for investment and consumption by limiting investment, and in order to help accomplishing the essential objectives of the five-year plan.

Since requirements against regulation arise from several aspects, various regulation methods must be applied. *Direct regulation* may take the form of a government decision, stating the objective of a major investment project, the time of its implementation, the technology to be applied, the sources of financing, and designing the organizations that will design, project and implement the investment or perform supplies. Direct central regulation may be applied also to a homogeneous group of investments, in order to determine the amount of financial sources available for the totality of such investments ("target-wise aggregate limits or "lump-sum investments", see below). Similarly, aggregate financial limits for some non-productive state investments may be set; within these latter limits, individual investment decisions are being taken by decentralizing the scope of administrative competence.

Indirect methods of regulation are much diversified. Some of them serve objectives outside of development policy but are acting the demand for investment goods; others are directly connected with the government's development policy. Enterprise investment policies are governed by the tendency of profit maximization and, therefore, they depend on central measures like pricing (officially fixed prices or prescriptions regarding price formation by the enterprise), the wage system, the measures regulating enterprise income as e.g. the charge on assets, the rules relating to the building of reserves, to the distrubition of profits between the profit-sharing and development funds, to taxation, the regulations of foreign trade, etc.

Within the general framework of regulations, some *new and characteristic methods aimed at development* may be distinguished. According to general practice (apart from a few exceptions, e.g., transports), 40 per cent of the total amortization allowance is due to the state budget. This claim of the state budget is renounced in the case of industrial branches where the net value of fixed assets is relatively low and their annual wear and tear is significant (e.g., the sugar and meat industries, the production of some building material, etc.). Such branches may increase their development funds proportionately with their capital rather than proportionately with the increase in their profits; they become more credit-worthy and more able of replacing their fixed assets.

Enterprise development funds continue to be taxed generally at a rate of 60 per cent of their increment, but as a new tool of the regulatory system also the possibility of reducing this tax has been made available. Such tax reductions may be granted to enterprises which undertake to implement certain objectives of the national economic plan, under conditions determined in advance. In enterprises enjoying such tax reduction, development can be achieved more economically, and also their creditworthiness is bound to grow.

The conditions of such tax reductions are being published, in the form of a tender, by the Planning Office, the Ministry of Finance and the ministry supervising the branch in question. Sometimes also the range of enterprises permitted to participate is determined.

In such public tenders, the objective to be achieved, the minimum of economic gain expected, the nature and extent of complementary investments, etc. are exactly established and published. Participants must submit, according to the published conditions of tender competition, their estimates on the foreseeable costs of development (separately for the increase in fixed and working assets), the full expected effect of the projected development on imports paid in dollar or rouble, the extent of the enterprise's own financial sources available for the purpose, the amount of credit needed, the terms of repayment that could be undertaken, etc. For the winner of the competition, the implementation of the investment in question is obligatory. The amount and the annual rates of tax reduction are determined by the competent tax authority; if the enterprise fails to fulfil the conditions, the preferential tax rate is cancelled and the difference must be paid.

Repayable state loans for development purposes were practised since 1969[2] but in 1971 their scope was extended to cover not only the major investment projects but a wider sphere of investments.

State loans serving development are intended to promote the implementation of development concepts included in the national economic plan, they may enable even enterprises lacking sufficient own financial sources to make the necessary investments. The rate of interest on the state loan is lower and the time of expiry is usually longer than with bank credits. The adjudgement takes place after a process essentially similar to the one applied in the case of a tax reduction: a competition is advertised and a public tender is organized.

Non-repayable state subsidies are applied only in exceptional cases, mainly when the sources of an enterprise are insufficient for implementing an investment made obligatory by the national economic plan; or when the low profitability of an enterprise is due to such a price situation which the state does not want to alter, and, therefore, the enterprise is not interested economically in the investment it is obliged to implement. State subsidies can be granted only for promoting objectives included in the national economic plan; the conditions of adjudgement must be exactly and unequivocally stated in advance.

Tax reductions, state loans and—even more—the non-repayable state subsidies can be used only for the purpose stated in the conditions, or else the enterprise must pay back to the state budget the sums received, plus interests.

One form of state subsidy consists in that the state undertakes to pay the interests of a bank credit granted to the enterprise. This form is used when there are two different development alternatives equally favourable from the enterprise's

[2] The essence of the system introduced in 1969 was that the state promises to grant a loan in the case the enterprise undertakes to implement the development concept preferred by the state; the enterprise is free to accept or refuse this offer. This loan differs from another type of state loan, which is applied when the state itself decides to implement some major individual investment project, in the costs of which also the enterprise going to operate the new plant must share. In such cases, the enterprise cannot refuse participation; its share in the costs is financed in the form of a state loan, to be paid back by the enterprise. Both forms of state loans differ from the investment credit granted by the bank: it is not the bank that decides on granting a state loan, and there is no previous competition among various development objectives as in the case of bank credits.

point of view, but the state has a preference for one of them.

Finally, also the credit policy is an important element in the regulation of development; with this we shall deal later.

4. REGULATION OF THE INVESTMENT VOLUME

The total volume of investment may be regulated from two sides: by the size of investments directly decided on by the government, and by regulating the incomes and development activities of enterprises (of course, the development fund of the enterprise must suffice, in addition to investments, also for increasing the working capital, which amounts, indirectly, to the regulation of demand for investment goods). The volume of direct state investment activities may be calculated with sufficient exactness, since the share of the enterprise sources in the major individual investments in 1971 - 1975 will amount only to about 9 per cent, and even this share will be decided on by the state administration.

The starting of each major individual investment project is decided on by the government usually on the ground of detailed proposals submitted. In order to prevent speculative underestimation of investment costs, the new regulation rules that any costs in excess of the projected sum must be covered from enterprise sources (or credits advancing such sources). It is particularly important that also the value of all complementary investment must be included in the estimate; lack of foresight in this field would cause grave difficulties at the time of implementation. Therefore, the government approves the projects of major individual investments only when they include all complementary investments. The government decision approving such a project prescribes in particular the scheduling and financial sources of productive and non-productive investments (among them also those to be implemented by the local councils), as well as the application of regulators ensuring the completeness of implementation.

The annual volume of major individual investment projects is only an estimate; our present regulation does not obligatorily prescribe a scheduling by years, and even in the future this will not be necessary since it would be but a formal, bureaucratic constraint. It is sufficient to determine the dates of starting and completing each major inverstment project; the chronic pressure on the market of investment goods makes it anyhow impossible regularly to exceed the estimated annual rates of implementation.

State investments made in the framework of "target-wise aggregate limits" (or lump-sum investments)[3] *and other state investments* serve mostly certain general development objectives to be achieved by a number of similar individual investments, only the total value of which is determined by the national economic plan. Thus, the annual value of these investments can be estimated with a relatively small margin of error.

The total amount of *new* major investment projects that can be started in a given year is obtained by deducting from the planned annual total of state investments the following estimated annual value: (a) the amount to be used for continuing the major individual investment project already under implementation; (b) the amount to be used for continuing investments already under implementation in the framework of "target-wise aggregate limits" (considering that in this case the amount scheduled for, but not spent in the previous year may be spent in the next); (c) the amount to be used for other state investments already under implementation.

In the first half of the Fourth Five-Year Plan the volume of major individual investments will grow slower than investments on average. This is due mainly to the high requirements of the housing program (under which 400,000 flats will be built), which reduce the means available for major individual investments. In the sphere of production, 90 major individual projects were under implementation in 1970; this number will be reduced to 45 by 1975, since for the years 1971—1975 only 5—7 new major projects will be started annually. Although the number of major individual projects is not a perfect characteristic (since the value of a single project varies between 300 and 6 000 million Forints), anyhow they show a substantial reduction in the share of this category.

Seen from another aspect, the volume of new state investments possible in the plan period and in each year is determined by the difference between the expected total supply of investment goods, on the one hand, and, on the other, by the total of demand raised by the continuation of state investments under implementation, the total of enterprise sources available for

[3] For definition see Appendix.

investment (as it is known, this demand is regulated indirectly), the planned amount of new investment credits, the estimated amount of state loans and subsidies promoting enterpise investments.

The regulation of enterprise investment activity as a part of total investment requires an intricate system of regulators. We continue to assert the principle that the part of profits left with the enterprise is being divided between the profit-sharing and the development funds. Since it is known that the part of enterprise profits designed for development purposes is taxed, as a rule, at a rate of 60 per cent, and that 40 per cent of the depreciation allowances are due to the state budget, we may approximately determine the effective demand of enterprises for investment goods (of course, also the expected price changes of these goods have to be considered).

A transitory constraint of enterprise investments continues to assert itself in the first years of the Fourth Five-Year Plan. When introducing the new economic mechanism it was ruled that enterprises whose fixed assets had grown between 1963 – 1968 at a rate exceeding average must not transfer any part of the depreciation allowance to their development funds; instead, they had to handle it as a special reserve. According to the original concept, these reserves were intended to be transferred to the development fund in 1972. In view of the prolonged tension in the market of investment goods, however, the regulation had to be changed. The enterprises in question must continue building special reserves even in 1971. This obligation will cease in 1972, so that from 1972 on 60 per cent of the depreciation allowance will go to the development fund, whereas the special reserves built up in the years 1968 – 1971 will be transferred to the development fund in annual instalments during 1973 – 1975.

As yet (for lack of adequate planning experience) *the regulation of enterprise investment activities* is but tentative. It has turned out that, as regards 1968 and 1969, the plans underestimated enterprise profits and, even more, the sources of the development fund other than profits or amortization (e.g., sale of used or scrapped equipment), so that the possibilities of the enterprises to invest were greater than planned. The problem became even more complicated because enterprise investments not only exceeded the planned volume but also their fragmentation became greater. The surplus of profits permitted many enterprises to start new investments, but they could not finish these in reasonable time, and thus the stock of investments under implementation became much larger.

Regulation of enterprise investment activity extends also to the volume of investment credits, state loans and subsidies. The last two are planned centrally and with adequate exactness, only the "automatic" system of state subsidies prevailing in agriculture (see Chapter XI) has caused in 1968 and 1969 an unexpected rise in investments. Therefore, in 1970, the automatic system of subsidies was transitorily confined to projects aimed at developing cattle and pig breeding. The new regulation entering into force in 1971 will reconciliate automatism with the budget-like planning of subsidies.

The planning of the credit volume is but a tool of secondary importance, since the proportion of credit-financed investments is relatively small, and particularly because about 80 per cent of the credit volume serves each year the continuation of investments under implementation, i.e. it is pre-determined.

5. ALLOCATION OF INVESTMENTS

Another important task of development regulation is to ensure a favourable allocation of investments from the national point of view.

The aggregate demand of enterprises for investments does not necessarily show the structure and the growth rates that would be required by a proportioned and balanced national economic growth. Deviations are due to the fact our present prices do not (and cannot) stimulate development exactly in the directions and to the extent desirable from the national-economic point of view, and that the social preferences provided by the national plan and its assumptions or estimates are not always backed adequately by enterprise interests and by a sufficient increase of enterprise-owned investment sources.

In the typically capital-intensive branches, that is, in those where the organic composition of capital is very high, most of the product prices are officially fixed, and frequently they do not permit to enterprises to accumulate even the financial sources needed to replace their equipment regularly by a more contemporary one. On the other hand, there are branches where the rate of growth made possible by the present price and value conditions and the present level of profitability should be accelerated in the interest of society as a whole. Therefore, we need partly a certain extent of direct regulation (that is, participation of the state budget in investments) and partly such indirect regulators as will influence enterprise decisions in the desired direction.

In our national economy, high capital-intensity of production is typically accompained by profits low in proportion compared to the capital engaged. Thus, in 1971 – 1975 the relative share of state investments and investment subsidies will be greatest in branches where capital-intensity is high and the proportion of profits to engaged capital is low. For example, capital-intensity in mining and in the production of electric energy is three to four times higher than in engineering or in the light and food industries, whereas the accumulation of enterprise-owned development sources is three to four times slower. It is thus understandable that, in 1971—1975, the relative share of state investments will amount to 64 per cent in mining and to 60 per cent in the production of electric energy.

Some economic regulators affecting investment structure are aimed at income regulation (e.g., the charge on assets and the wage multiplier); others affect the rate and directions of development, (e.g. the share of depreciation allowances left back with the enterprise, tax rates restricting the extent of development and preferential tax rates aimed at promoting it, state loans and non-repayable subsidies, etc.). All these means influence the allocation of investments among enterprises and branches. When their effect is not sufficient, even direct actions of the state may be necessary, in order to ensure an adequate level of investment in fields where the accumulation of enterprise-owned sources is unsatisfactory, or when it does not occur in time or in the concentration wanted.

The system of regulators influencing the allocation of investments affects not only the structure by branches but also the geographical location of investments, in order to ensure the proportioned development of each economic region (e. g., the state subsidies to industrial location, see Chapter XII).

The complicated system of regulators acting on development is *applied in different ways to the various branches of the national economy*. Evidently a very wide range of regulators cannot be applied in branches engaged in the exploitation of raw materials or in the production of basic materials and energy. It is easy to see that, e.g. the principles of a uniform credit policy regarding rates of interests or terms of expiry cannot be applied to the production of electric energy. In the extracting industries, the regulating influence of interest rates or even of preferential tax rates would be relatively small, whereas in the industrial branches more exposed to market and competition effects it would be wrong to give a substantial role to direct budget-financed investments or to non-repayable budget subsidies. The quality and the extent of regulators to be applied depends on the particular situation of the branch in question.

6. THE FLOW OF DEVELOPMENT SOURCES

Even a substantially improved system of income regulation could not ensure in all details that the development sources of enterprises should materialize exactly on the spot and in the concentration needed for implementing the deveopment objectives the national economic plan had determined for each branch. One of the most important functions of the banking system is to influence the development possibilities of individual enterprises by redistributing their accumulated financial sources and to ensure their concentration on the spot selected. But, in addition, also other forms of capital flows must take place in order to improve the general efficiency of the utilization of society's capital, the adequate management of fixed and working assets.

Our economic reform, by decentralizing part of the accumulation of development resources, has ensured development funds for each economic unit and accorded them an independent right of decision in this field. Already at the time of discussing the principles of the reform, experts were unanimous in believing that it was necessary to promote *the flow of accumulated development funds between enterprises*, in the first line between those having regular economic connections with one another, since the uniting of funds seemed advantageous both for the participants and the national economy. The meeting of justified social needs requires sometimes such an extent of development as cannot be economically achieved by the sources available to an individual economic unit. Therefore, enterprises are interested in regrouping their funds in order to *achieve their development objectives more economically*. Moreover, such regrouping may *promote and improve* inter-enterprise co-operation, modernization of production and the division of labour, and sharing in the profits commonly achieved will strengthen their economic interdependence. Direct regrouping of funds between enterprises is advantageous also to the national economy as it tends to increase the productivity of social labour by expanding production, improving its structure, developing competition, technological progress, concentrating the use of material and human resources.

Our new economic mechanism has, from the beginning, made possible certain flows of funds between economic units, e.g., the founding of joint enterprises, the common implementation of investments, the cession of the development fund owned by a foreign-trading enterprise to the producers of export goods. There were, however, *no generally valid legal rules permitting economically interrelated economic units to transfer their development funds to one another*. The forms permitted were rather narrow, they frequently remained unutilized for lack of either initiative or funds; also insufficient regulations of the related legal and financial problems have contributed to this state of affairs.

The direct distribution of funds between enterprises may take place,

— either by an association of two or more economic units for a defined purpose.

— or without such association, by their transferring funds transitorily or permanently to one another.

The question of association was newly regulated legally early in 1970. The outdated legal forms, not conforming to the requirements of socialist economy and lacking in a uniform basis of principle, were replaced by *uniform types of association*, equally accessible to every socialist economic unit.

Under the new regulation, the forms of association vary not according to the forms of ownership (enterprise or co-operative) of the units wanting to form an association, but according to how far and how closely their funds are going to be united in the framework of the association and whether or not the latter will be considered a legal entity in relation to third parties. Thus, there are but two basic forms:

— the simple association, and

— the joint enterprise.

In addition, also the forms of association created by the law on farming co-operatives, as simple economic co-operation, joint venture and joint co-operative enterprise (all these forms are accessible to farming co-operatives only) continue to exist, in view of the important national economic interests related to their successful operation, and also of the particularities of farming co-operatives. But also the participants of these associations can—if they deem it advantageous—change the form of organization in conformity with the new regulation. *Associations where at least one of the participants is a state-owned enterprise, must be transformed according to the new regulation.*

The new types of association allow for a great variety of economic relations to be created but the common characteristic of all these is that association is created by a *contract*; that in its framework a *common management* is taking place, *the gains or losses of which have to be shared between members*, generally in proportion to their contributions.

Only *socialist economic units* (state-owned enterprises or co-operatives) may participate. State organs or institutions alimented from the budget as well as social organizations operating on a non-profit basis are excluded, since the profit motive and risk-taking are incompatible with their tasks and they do not own funds to cover eventual losses. It is, however, possible for local councils to promote, by allocating part of their funds serving development purposes, the forming of associations between economic units supervised by them or by ministries, if this seems useful for achieving their local objectives.

Foreign legal entities may participate in Hungarian associations under special conditions stated by the minister of finance.

The new regulation did not affect the existing unions, joint-stock or limited liability companies. It is, however, possible to transform a union into a simple association, and a joint-stock or limited liability company into a common enterprise.

In general, a *simple association* is not aimed at producing jointly, only the co-ordination of certain activities of the members (e. g., purchases, sales, publicity, etc.) is intended. Nevertheless, this form allows for a great variety of economic activities. Funds needed for its operation are ensured from the surplus of the development and circulating funds or from the existing equipment of the participants; all these remain the property of the members even during the operation of the association.

The simple association is not a legal entity; in general, its foundation and operation is governed by the legal rules valid for associations under civil law. One of the participants is trusted with the affairs of the association so that, as a rule, no separate organization is needed; nevertheless, it is also possible to create for this purpose a special department within the organization of this participant.

The simple association is not a separate subject of taxation, it does not draw up a balance-sheet, its gain is divided up and added to the profits of the members, who must pay taxes on it according to the legal rules prevailing for them. Members are directly responsible for losses.

In order to facilitate participation in business life, the simple association is permitted to pursue its activities under a common firm name. In this case it may acquire rights and undertake obligations, but invariably with the direct, unlimited and universal responsibility of all its members.

The *joint enterprise* means a closer economic interdependence (mainly in the fields of production) based on intensive and permanent co-operation. Its foundation depends on permission by the supervising minister, with the previous consent of the minister of finance (if the joint enterprise is but of local importance, the permission is given by the local council). If the joint enterprise is going to pursue activities for which, under the prevailing legal rules, a special permission (e.g. on the part of the mining, health, etc. authorities) is required, also this permission has to be obtained before they can be entered into the trade register.

The joint enterprise is a legal entity, entitled to acquire rights and enter into obligations in its own name. The responsibility of its members against third parties is limited to their apports. As regards the affairs of the joint enterprise, the rights of control and instruction otherwise due to the state authority acting in the capacity of proprietor are exercised by a council of directors consisting of the representatives or the participating units.

The assets necessary for the economic activities have to be ensured from the unengaged development and circulating funds, as well as from the existing fixed assets, of the members. (The consent of the minister of finance to be obtained before the foundation serves also for making sure that this condition is observed.)

The assets contributed by the members become the property of the joint enterprise. Members may, in addition to contributing property, undertake obligations regarding the transfer of rights or the performing of services. In this case, they may rule in the association contract that the profits of the joint enterprise and its assets (if the association is going to be liquidated or some of the members would resign) shall be divided up in proportions other than what would follow from their physical contributions.

An important feature, in which the new regulation differs from the former one, is that the joint enterprise has its own responsibility for its obligations against the state budget, and that it is entitled to build up development and sharing funds of its own.

(Under the former regulation, all gains of the joint enterprise were divided up between the participants, so that it had no separate economic motivation.)

For a joint enterprise, the prescriptions in income regulation and economic incentives are identical with those prevailing for other state-owned enterprises pursuing similar economic activities. There is, however, a notable exception that, if its basic activity is of agricultural character and at least one of the participants is a farming co-operative—or if the basic activity is not agriculture but all participants are co-operatives—the regulation of incomes and incentives takes place according to the legal rules valid for co-operatives.

All preferences and allotments which are due to state-owned enterprises without special request, depending only on the nature of their status, are due also to the joint enterprises of the same character. In all other cases, they must submit a special request, to be judged according to the prevailing regulation.

In order that the founders of the joint enterprise become economically interested in its operations, it is necessary to let divide part of the profits between them. The proportion of profits to be divided and the relative shares of the participants must be stated in the association contract. At the same time, the economic incentives must act also on the joint enterprise as such; therefore the regulaton states the maximum of the divisible portion of profits. Thus the common enterprise is taxed according to the amount of profits left after deducting the shares of the members (and, of course, according to the rates and prescriptions valid for the branch in question), whereas the shares transferred to the members are accounted and taxed as part of their own profits.

Members may assign a portion of their own sharing and development funds to the joint enterprise. But, as long as the joint enterprise is functioning, no part of its own sharing and reserve funds may be withdrawn. This does not apply to the *development* fund of the joint enterprise; part of this may be withdrawn if a regrouping between members takes place.

If a loss occurs, this must be covered in the first line from the reserve fund of the joint enterprise itself. If this fund does not cover the loss, the members may share the burden, according to the proportions fixed in the association contract. In this case, it may be ruled that members shall be recompensated from future profits of the joint enterprise. If neither the reserve fund of the joint enterprise is able to cover the loss nor the members are inclined to do so, they must decide the liquidation of the joint enterprise. Third parties must not be damaged by such liquidation since the members must settle all their obligations.

The transfer of development sources outside the framework of an association may take various forms.

Fixed assets may be allotted by an enterprise to another even *free of charge*. Namely, if the regrouping of fixed assets were permitted only in the form of sale and purchase, in some cases the transaction would not take place at all, and the utilization of equipment more or less outdated but still able in some less exigent fields would be impeded. A free-of-charge allotment involves also the allotment of the enterprise-owned source that has served for financing it.

The economic units may also *sell or rent* part of their equipment to others. The unlimited possibility of renting equipment may also contribute to an improved utilization. We may even expect that institutional forms of renting equipment will develop, e.g., enterprises dealing exclusively with such renting.

It is also possible to regroup decentralized sources of development in such a way that the enterprise passes over to another enterprise (*transitorily or finally*) the unengaged part of its development fund (or of the fund of technical improvement) for investment purposes, and also by granting a commercial credit from the same source (see Chapter VIII).

All these transactions must serve development purposes. The enterprise receiving such funds must use them for technological improvement or for increasing of productive capacities, that is, for financing research and experimentation, for the purchase of equipment or—eventually—for expanding its stock of working assets.

The transaction is economically justified when the donor enterprise acquires by it such economic advantage as would not be accessible to it otherwise (e.g. scheduled supply, supply in excess of the contracted quantity, special quality requirements, etc.) If the funds are transferred only transitorily, a payment of interest may be stipulated.

From 1971 on, it has also become possible for the economic units to *regroup parts of their fixed* or working capital. They must, however, guarantee that such regrouping will not involve an additional credit demand, neither for investment nor for increasing the permanent stock of working assets.

7. CREDIT POLICY

Experience regarding the operation of the system of investment credits during the first years of the new economic mechanism has shown that *it has quite well performed the functions allotted to it within the system aimed at regulating accumulation.* The annual limits of investment credits were established circumspectly in the plans. These limits prevented the purchasing power of investors from exceeding the desirable extent, and the high requirements in respect of profitability set as a condition of credit helped to select the best enterprise initiatives, thereby improving the average efficiency of investments. Circumstances, however, were such that this role of the credit system taken in itself was relatively modest. Namely, the share of credits in financing new investments were raised by such investments as had been centrally decided upon in former years and were still under implementation. The role of credits in financing new investment was even slightly reduced (in 1969 and 1970 as against 1968) by the increasing share in investment of enterprise-owned funds built up from the profits gained during the first year of economic reform.

Since the greater part of investment credits had to be used for purposes determined in advance, the benefits of a selective credit policy could not materialize in a sufficiently wide sphere. In the first years, when enterprise development funds increased rapidly and most of them were still unengaged, we had to prescribe rather short terms for investment credits repayable from such funds. This, however, resulted in an advantage of enterprises better provided with own funds—and they were not necessarily the ones that had submitted to the most promising development conceptions.

Apart from the limits set by the supply with materials and equipment, the expansion of the credit volume was restricted also by the fact that part of the available credit sources had to be withdrawn—transitorily—for the purposes of the state budget.

As a matter of fact, in view of the tension in the market of investment goods, even the modest credit volume that was actually available for enterprise investments was too great. But had it been further reduced, not even the most promising investment projects could be supplied with bank credit. Investment credits form an integral part of our economic system, necessary to stimulate enterprises to adapt themselves to real market demand and to exploit possibilities offered by the market.

8. INVESTMENT CREDIT LIMITS

For each of the years 1968 to 1970 the government approved, in the framework of the annual economic plans, annual estimates of the available investment credit volume. There was a *global estimate* for the national economy as a whole, and within this, *limits were set for each branch of the national economy* that could be handled with a certain degree of tolerance.

It should be remarked that the established global limits were not exhausted either in 1968 or in 1969, because the implementation of many investments was retarded by the general disequilibrium of the investment market. As regards the relative shares of national economic branches in the total credit volume, some of them deviated substantially from those provided for in the original conceptions.

The growing indebtedness of enterprises and an increased role of preferences for longer terms of expiry, resulted in a greater share of long-term credits in the total volume.

Also for the period of the Fourth Five-Year Plan it is necessary to delimit the volume of investments implemented on a credit basis, in order to utilize the credit system as a tool of achieving the objectives of economic policy. The limiting of the credit volume must comply with the following tasks:

By establishing global limits for the annual credit volume available for investment purposes we must contribute to *regulating the purchasing power*, and thereby to achieving and maintaining equilibrium in the investment market. Although investment credits supply a relatively small part of the purchasing power flowing into the market of investment goods, the great elasticity of the credit policy makes it particularly suited for regulating supply and demand.

Within the global estimate, limits must be established for each branch of national economy and eventually for their subdivisions, or for certain special purposes (e.g. production of export goods). These branch limits should be handled with some elasticity but they most be established in a way that investment credits be available in a structure conforming to the objectives set by the national economic plan.

We must invariably keep in eye the requirement of ensuring and maintaining equilibrium in the balance between credits and credit sources; in other words the proportion between credits granted for short and longer terms must comply with the availability of credit sources.

The claim of enterprises that the credits they are asking for should be made available at the time when they need them is justified. It should be, however, also considered that a substantial part of the credit volume that may be available in any given year is earmarked by previous decisions. Here, two opposed requirements have to be reconciled. On the one hand, time is needed for preparing the projects and for implementing them, so that the investor must know whether or not a credit will be granted to him a rather long time before he will really need it; on the other, the credit system should be able to act with sufficient elasticity if it is to be used as a tool of market regulation. When weighing both points of views, it seems advisable that the *obligations undertaken by the banks regarding credits to be made available in the future should be held between reasonable limits.* It seems that an adequate freedom of central decisions and sufficient elasticity in regulating the purchasing power issued by credits may be ensured when, for instance, around the 1st of October (that is, at the time when operative plans regarding the next year are being elaborated) no more than the half of the next year's credit volume is being earmarked by obligatory promises made by the banks.

We must also consider that *the closer the granting of credits is connected with objectives, preferences, etc. previously determined by the plan, the less will be the elasticity of the credit system as a tool of regulating the investment market.* On the other hand, a substantial reduction of credit limits would endanger the achieving of plan objectives. In the period of the Fourth Five-Year Plan, interdependence between the national economic plan and the credit system is likely to become closer, so that no substantial fluctuation in the annual credit limits may be expected. Therefore, also the volume of credits that can be earmarked by obligatory promises on the part of the banks may remain fairly stable.

It is advisable to handle the credit limits established for branches of the national economy (or their subdivisions) with a certain elasticity. It may become also necessary to make special provisions for certain development purposes serving to achieve some plan objectives or for a determined (possibly narrow) sphere of production, the development of which is necessary but would have poor chances in the general competition for credits. In such cases, it is justified to narrow down the sphere of competition, by setting aside a credit volume accessible *only to enterprises implementing a certain plan objective*, rather than to all enterprises belonging to a given branch.

In order to help the banks in handling such partical credit limits, it is necessary to establish them for some years in advance (in the present case for 1971–1975). Thus, the banks will be able to estimate to what extent they may undertake obligations regarding future credits. In this way, the commitments, the specified portion of the future credit volume can be determined more circumspectly, conforming to the objectives of the five-year plan.

9. THE TYPES OF INVESTMENT CREDITS

In the Fourth Five-Year Plan period, a tension between ambitious development conceptions of enterprises and the limited resources of the national economy as a whole is likely to continue. Thus, credit policy must be sufficiently elastic and selective, if our credit sources are to be used with the highest possible rate of efficiency.

With the aid of the sources available, primarily those investments must be implemented that help to achieve the objectives of economic policy, to improve the economic structure. Therefore, in the first line it is necessary to *differentiate* the types of credits according to their purposes.

In the case of investment *causing but a small increase in the fixed assets of an enterprise,* estimates on the gain expected from them can be made and checked but in a most uncertain manner. Therefore, it would not be reasonable to make the granting of credits for such investments dependent on how far they seem profitable. And since from the development funds built up by the enterprises only the repayment—within 2–3 years—of such smaller investment credits may be undertaken, in the practice a separate category of "medium-term credits" was developed, and there the process of granting credits and making them available was greatly simplified. In such cases, generally the bank has only to make sure that repayment is guaranteed; in some cases, however, it uses its influence in favour of a concentrated use of the enterprise's own development sources, or for asserting certain points of view of economic policy.

In the case of *more important development projects decided on by the enterprise*, it is easier to make and check exact estimates of the economic gain expected from them, so that the allotting of credits may be more realistically based on the expected profitability of the various projects. In this case the bank, when selecting the credit applications, has to consider two factors: the expectable profitability of each project and the repayment terms of the credits asked for.

The selecting and "ranking" of credit claims takes place by calculating for each of them the so-called "rank indicator". This is obtained as the geometric mean of two factors:

— the time (expressed in years) within which the costs of investment will be returned from the additional gain produced by it;

— the term of expiry of the credit (also expressed in years) starting from the day when the first instalment of credit is made available to the day of full repayment.

Thus, selection of enterprise credit applications takes place at three levels:

At the *first level* the enterprise selects from among the possible development alternatives the one seeming most favourable from its own point of view. For this selection, the most generally applied criterion is maximizing the per capita personal incomes (wages plus profit-shares) of all workers and employees engaged. But also other important points of view (e. g. easing the hard working conditions, preparing further technological improvement, offsetting difficulties of manpower supply, etc.) may be occasionally weighed.

At the *second level*, development concepts of the enterprises are being filtered according to the "minimum requirements" of credit granting, stated in the Guiding Principles of Credit Policy approved by the government (by 1971, these requirements were set higher). Enterprises may apply for bank credit only for investments promising a certain minimum ratio between annual profits and the value of the funds fixed and working assets engaged: the minimum is 15 per cent for industry (except for food industry and the production of building materials) and construction, 10 per cent for the food industry and the trade, 7 per cent for the production of building materials, agriculture, transport and communication.

At the *third level*, the bank ranks the submitted credit demands by calculating their "rank indicators" as described above, and makes the credits available for those showing the most favourable (that is, the smallest) indicators.

The handling of credit types may be substantially modified by changes in the *credit-term policy*. For instance, in order to promote investments with relatively short repayment periods —particularly if the share of special limits reserved for preferred investments is too high—it would seem advisable to set longer terms of expiry (say five instead of three years) for medium-term credits. In this case, however, this credit type would become suitable also for financing more substantial development projects, where it is possible and necessary to investigate the purpose and economic efficiency.

According to what has been said above, three main types of development (investment) have to be applied in the Fourth Five-Year Plan period:

Short term credits of a technical nature, to be repaid within the same calendar year, i.e., with terms of expiry not exceeding twelve months. Virtually, they are but advances on the depreciation allowances of the enterprise or branch serving to finish within the same calendar year, an investment under implementation or—particularly in agriculture—the replacement of outdated machines. The condition of granting such credits is the possibility of their repayment from the source mentioned, and within at most twelve months.

Medium-term credits granted generally for twenty-four months or—in the case of investments serving to achieve an objective set by the national economic plan—for sixty months at most. Credits with a term of expiry of 24 months or less may be granted simply on the condition that their repayment is guaranteed. Credit demands with longer terms of expiry are, however, subject also to further investigation as regards the development objective they would serve and the meeting of the minimum requirement of profitability. Final selection takes place, in such cases, according to the "rank indicators".

Long-term credits, with terms of expiry of 10 – 12 years at most, may be granted for the preferred development objectives enumerated taxatively in the Guiding Principles of Credit Policy. Preferences include long terms of expiry and low rates of interest. Within the special limits established for each preferred development objective, competitive credit demands are met selectively, according to their "rank indicators".

In the first years of the economic reform —in particular in 1968 and 1969, when most enterprise funds were yet unengaged—it occurred frequenly that enterprises "richer in capital" obtained better rank indicators than "poorer" competitors, even if the latter submitted more profitable development projects, exactly because poorer enterprises were not able to undertake short terms of repayment.

This danger is always present when credit policy is too eager to shorten the terms of repayment. As, however, the credit liabilities of enterprises grow and the average term of expiry increases —mostly as a result of the increasing share of preferential long-term credits—the "*inherent*" *efficiency of individual development projects will influence the value of the "rank indicator" with an increasing weight*. This process is economically advantageous, since the growing weight of the efficiency factor influences the decisions of the bank in favour of the more efficient, more profitable development projects.

The regulation ruling that enterprise development projects must be financed to a certain minimum extent (from 1971 on, 30 per cent) out of the development fund freely available for the enterprise has proved to be very advantageous. Namely, it involved that the utilization of the enterprise development funds was, in a substantial part, concentrated on the implementation of development objectives approved by the credit system as economic regulator—in other words, on objectives fully complying with those set by the national economic plan. Moreover, particularly in the case of long-term credits, the social preference materializing in longer terms of expiry is fortunately combined with a risk—taking by the enterprise itself.

10. PREFERENTIAL CREDITS

In the past practice of long-term crediting, the Guiding Principles of Credit Policy established preferential conditions for credits serving some development objectives, consisting in longer terms of expiry and in lower requirements regarding profitability. Accordingly, also the "rank indicators" of the credit demands belonging here were corrected. As a result of such preferences, most of the long-term credits raised by enterprises have served such preferential purposes.

It seems fully justified to apply such credit preferences even in the future, in order to promote investments which are mainly important for the national economy. The effect of preferences depends, however, on the extent of their application. *They should stimulate only the most important investments*. If preferences are applied in a too wide sphere, their stimulating effect is bound to weakened; at the same time, they add to the pressure on the market of investment goods. It seems that the present sphere of preferences should be narrowed down.

The sphere of preferences should be stated (in conformity with former practice) in the Guiding Principles of Credit Policy, in due consideration of, and in harmony with, the principles and decisions governing the allotment of state loans and subsidies promoting investment, as well as with the conceptions of structural changes in the direction of the dynamic branches, set down by the national economic plan.

Credit preferences (e.g. regarding the term of expiry, the rate of interest, the minimum requirement of profitability or, in some exceptional cases, setting aside a certain credit volume for the purposes of a determined development objective) must be applied to a varying extent, depending on the importance of the economic objective concerned. Preferences may be made more effective by determining their limits both in respect of their functions and over time, as well as the total sum available.

Chapter VIII

MANAGEMENT AND CREDITING OF WORKING ASSETS

by

MIKLÓS PULAI

1. RECENT EXPERIENCES

The economic reform has introduced an essential change in the management and crediting of enterprise working assets. The change mainly means that enterprises have now to finance any permanent increase in their working assets from their own development funds. This requirement follows from the general principle ruling that *operating enterprises must finance any increase in their fixed and working assets with their own means*, that is, from their development funds. This principle holds even if the state—in order to achieve certain objectives of economic policy—grants budget subsidies to some enterprises for development purposes. Such state subsidies are a supplement to, rather than the basis of, the financing system.

One of the time-honoured rules of enterprise management was that any increase in *fixed* assets could be financed only from funds deriving from "accumulation". In general, the enterprises have really observed this rule, and it amounted to a severe violation of "financial discipline" if an enterprise purchased fixed assets from funds serving other purposes than investment.

Practice was different regarding the financing of working assets. Up to 1957, any increase in enterprise working assets was financed by the state budget to the extent "justified" according to the prevailing normatives. Even this practice was in accordance with the general principle ruling that an increase of assets (including working assets) has to be financed out of funds created by accumulation. At that time funds deriving from accumulation were available only to the state budget, since the enterprises were obliged to pay almost all their net income to the budget, so that they had no source left for financing an increase in working assets.

Some substantial progress has been achieved in 1957. Beginning with that year, enterprises were permitted to retain part of the increment in their net income, in order to create funds of profit-sharing and of development. The latter fund, however, was too small to cover all what they needed for developing their stock of fixed and working assets. Thus, essentially the system of financing such needs from the state budget continued to prevail. In the field of fixed assets not even a formal change was introduced: enterprises invariably received the whole sum necessary for development directly from the state budget. In contrast, the method of financing working assets underwent a substantial change. As a result, an increase in the "permanent stock of working assets" (according to the terminology of the time "the normative volume of working assets") was financed with a special type of bank credit called "operational" or "working-asset" credit. At the same time, the banks received from the state budget funds of about the same size, in order not to violate the principle that any increase in the permanent stock of working assets had to be financed out of funds deriving from accumulation. Thus, in fact the state budget remained the final source of financing working assets and it was but a formality to call this a bank credit; however, enterprise managers had the feeling that working assets were financed with bank credit.

Against this situation, the 1968 reform introduced a substantial change by adopting the basic principle that enterprises must finance all their development outlays from their own development funds, and that "development" includes the increase of the working as well as of the fixed assets.

Evidently, the methods of *crediting* on working assets had to conform to this principle. Just as bank credits serving the development of fixed assets must be paid back from the development fund since they serve development, those granted for financing increment of the *permanent* stock of working assets must be paid back also exclusively from the development fund of the enterprise.

In other words, there are now two types of working-asset credits, according to their purpose and to the source of their repayment:

(a) Credits serving to increase the permanent stock of working assets must be repaid from the development fund. When the enterprise repays such a credit, its *working capital* increases by about the same amount as the permanent stock of working assets does; between the two events there is but the time lag caused by crediting.

(b) Credits serving a transitory increase in working assets (made necessary by seasonal or other causes) can be paid back directly from the sales proceeds. It may occur that such a credit must be raised because there is a transitory lack of own funds; characteristic of all credits repayable from sales returns is that they cover but temporary needs that will cease to exist in a foreseeable time.

This new system of crediting strongly influences the business policies of enterprises. It is now a matter of enterprise decision (influenced, of course, by many circumstances, like duration of the production process, the period of time needed for replacing commodity stocks, terms of credit, etc.) what amount of stocks is deemed necessary to implement the enterprise's plan of production and sales. Thus, apart from a few quite exceptional cases, the necessary amount of working stocks is determined solely by the enterprise itself. Evidently, such a decision can be carried out only if the enterprise has sufficient own funds, since any increase in the permanent stock of working assets must be financed from the development fund, regardless of whether, at the given place and time, such increase seems justified or not from the viewpoint of the national economy as a whole. This is not a "penalty", it is simply the way of financing. Similarly to how the purchase of a machine must be financed from the development fund, regardless of whether it will be immediately put into operation or not, also any increase in the permanent stock of working assets must be financed in the same way, even if stocks increase only because some of the goods produced by the enterprise are unsaleable. Namely, even this case is but another form of engaging part of the national income in accumulation. Thus, the range of enterprise decicions in this context is limited by the size of the development fund, more exactly, of its part the enterprise wants to use for developing its working assets.

This system of crediting affects not only the enterprises but also the banks. In their crediting practice, they must try to distinguish between "permanent" and "transitory" increases in working assets, and accordingly to stipulate repayment from the development fund or directly from the sales proceeds. Moreover, the crediting practice must evidently observe the principle that credits can be granted only to credit-worthy enterprises and be secured by an adequate amount of saleable goods.

This new system of financing stocks acted favourably on the working-assets policy of the enterprises. Experience of more than three years has shown that they pay increasing attention to the economical utilization of their working assets and that, as a result, the growth of stocks generally slowed down.

When introducing the reform, government decision allocated substantial working capital to each enterprise; in other words, most of the working funds actually used by them was declared to be their own, and in some cases the former working fund was supplemented by non-repayable grants. As a result, at the start of the new economic system, about 60—80 per cent of the working assets were financed by own funds. In 1968, the system of financing was intended to ensure that any farther increase in working assets be financed at least in the same proportion (70—80 per cent) out of the own funds of enterprises; then, from 1969 on the general principle ruled that enterprises had to finance *all* increase of the permanent stock of working assets out in their development funds. Even if this objective could not be perfectly achieved, it is a fact that the role of enterprise-owned resources of financing the working assets became significantly greater during the past three years.

Evidently, the necessary expansion of working assets incumbent on the development fund differs by enterprises, depending on the actual growth of their commodity stocks and orther working assets.[1] Accordingly, it has represented a burden of different weight for enterprise development funds.

This system of financing unmistakeably induced the enterprises *to accelerate the circulation of working assets*, in order to prevent an increase of their permanent stock, or at least to achieve a slower rate of growth of the latter than that of production. This tendency, however, has its obvious limits, so that it could not uniformly assert itself everywhere. Indeed, in some enterprises the forced reduction of commodity stocks has led to disturbances in production and sales. A typical example for the acceleration, of the circulation of working assett was afforded by the building industry. In 1968 and 1969 the output of Hungary's state-owned building industry increased by 23 per cent. At the same time, the total stock of its working assets did not grow at all; only a few enterprises resorted to their development funds in order to increase such stock. In the branch as a whole, only 3 per cent of the aggregate development funds was used for replenishing stocks. As a contrast, the engineering industry in-

[1] The term "working assets" covers a wider sphere than the "stocks (of commodities)" since it includes, in addition to stocks, also the enterprise's claims (outstanding debts) on buyers and other business partners, as well as its active balance of bank accounts. The part of enterprise capital invested into working assets is called "circulating fund."

creased their output by 22 per cent, by using as much as 22 per cent of their development funds for this purpose.

Since the development fund may be charged only with outlays serving to increase the *permanent* stock of working assets, the question of defining the "permanent stock" and of measuring its increase has become vary important. Different methods were developed, of which two were mostly applied in practice. The first of these was called the "method of averages". This consisted in calculating annual averages from the quarterly stocks of working assets. The increase between these annual averages was considered as the increment of permanent stock which the enterprise was obliged to finance out of its development fund. Although this average truly reflected the actual size of enterprise working assets, it seemed objectionable since it also included some seasonal, transitory increments. It is, however, a well-known fact that in many industries seasonal fluctuations in stocks depend on physical circumstances, so that seasonal peaks should not enter into the calculation of the annual average of stocks.

The second method measured the change in commodity stocks and working assets at a defined date in each year; the growth observed in this way was considered the annual increment which the enterprise had to finance from the development fund. This method was applied at first in the food industry, where the seasonal changes in commodity stocks were conspicuous. In view of the favourable experience gained with this method, its application to all branches of the national economy was suggested.

In 1970, however, banks and enterprises introduced a *new method of calculation*. This consists, for each enterprise, essentially in that the date at which the annual change in working assets is going to be assessed is determined in advance, and this is the date when, according to previous experience, the stock of working assets is likely to be *lowest*. In certain cases, more than one date of observation per year may be fixed. (Of course, the annual minimum of working assets does not necessarily coincide with the minimum of the commodity stocks). Thus, in general, the annual increment in the minimum stock of working assets is what the enterprise must finance from its development fund. This method solves the problem caused by transitory peaks; in so far as they are smoothened out between the dates of observation, they do not raise requirements against the development fund.

This methodical change significantly affects also the short-term credit policy of the banks. By establishing a more secure basis for assessing the permanent stock of working assets, it enables them to follow a more elastic short-term credit policy.

As any pre-determined system of calculation, also the one presented here is far from being perfect and requires circumspect application. Since the stock of permanent working assets is being measured at the same specified date (or dates) in each year, it is likely that enterprises should try to minimize their stocks exactly at such dates. Such endeavour is not condemnable as long as it does not exceed the limits set by sound economic reason, that is, as far as it does not impair the continuity of production and sales. To the same extent as it is desirable to reduce the working assets of the enterprises to the possible minimum, it would be harmful to reduce them excessively, so as to disturb the natural circulation of enterprise funds. Moreover, since the rhythm of this circulation is likely to change over time, it is not advisable too rigidly to adhere to the same dates of observation in successive years. Nevertheless, experience gained so far with the application of this method was favourable, and we hope to have established a system suitable to measure the permanent stock of working assets adequately, during a reasonably long period.

Under the economic reform, significant differentiation has begun among enterprises also from the point of view whether they had some transitorily free means in their development funds or not. Many enterprises got into situations when they dispose, for a shorter or longer period of time, over free funds which could have been more advantageously used by another enterprise. It became necessary to find a solution enabling such enterprises to lend their transitorily unused money to others.

Inter-enterprises crediting seems necessary for two reasons.

First, such credits may serve *development purposes* (cf. Chapter VII). The analysis of the situation and of enterprise intentions has shown that such crediting was thought most advisable among co-operating enterprises. It occurs frequently that enterprise *A* cannot increase its output to the desired extent because co-operating enterprise *B* cannot increase its supplies for lack of funds that would be necessary to eliminate some bottleneck phase. In some of such cases, *A* may have a sufficient development fund and it may find more advantageous, in its own interest, to lend some money to *B* for eliminating the bottleneck in question, rather than investing it in its own plant. In the course of developing our credit system, this requirement has deserved attention.

Second, the idea of inter-enterprise crediting emerged also in the context of *commodity credits*. Not rarely, the introduction of new products is hindered by lack of funds on the part of the trading enterprises, or by their mistrust regarding saleability. The commission system which was expected to bridge over such difficulties and to forward the product to the consumer has failed, due to various administrative constraints. Now several producing enterprises were inclined to sell their new products to the trade on credit, with an expiry longer than the usual thirty days.[2] Such credits would be granted out of the transitorily free funds of the selling enterprise. In the course of further developing the credit system it seemed necessary to consider also this circumstance, and to create a possibility for granting commodity credits under defined conditions.

Measures serving further development of the credit system rest mainly on experience gained in the first three years of the new mechanism. Experience shows that the credit system introduced at the start was adequate and fulfilled the requirements that have been set against it. Further improvements should serve mainly for asserting even more consequently the basic principle approved by practice; the one ruling that any increase in the permanent stock of working assets must be financed from the development fund of the enterprise, and that banks should grant short-term credits only at the emergence of a really transitory (seasonal, etc.) demand for working funds. A significant new element to be introduced in the system is inter-enterprise crediting.

2. FINANCING AND CREDITING OF WORKING ASSETS

Improvements of the system of working-asset financing and crediting have been decided on in conformity with the Fourth Five-Year Plan and with the changes affecting other parts of the regulating system. Chapter VII deals with investment credits; here, it seems necessary shortly to deal with some problems affecting the credit system as a whole.

The primary aim of improvement is to make the credit system capable of better promoting the achievement of the central objectives, including consolidation of equilibrium on the do-

[2] According to present regulations, enterprises are not permitted to conclude with one another sales contracts providing for a settlement of accounts exceeding the term of thirty days.

mestic markets of investment goods and consumer articles, as well as of the planned equilibrium of the balance of international payments. It is invariably important that the methods and rules of crediting should help maintain the equilibrium between money supply and commodity fund and secure the value of the national currency.

The credit system cannot be isolated from the tasks of credit policy, but in the context of improving the system of regulators it is mainly the credit system that has to be considered. Credit policy, which is an element of economic policy, evidently affects the credit system. In the framework of a five-year plan, however, the principles of credit policy have to be formulated in rather general terms. In order to maintain elasticity in the crediting practice, it is necessary for the government annually to check the objectives of credit policy (in connection with the approval of the annual economic plan) and to change them according to actual necessities.

It is easy to see that conditions and volume of crediting may be changed more elastically than e.g., those of taxation. From this, it does not follow that the credit system must undergo radical changes every year; only that it is possible and necessary to modify it from time to time in so far as this seems justified by the central objectives and the economic situation.

When dealing with improvements affecting the credit system as a whole, it is necessary to remind ourselves that credit, as an instrument of regulating the purchasing power and of supplementing the own funds available to the economic units, unfolds its effects in a defined sphere; and that it must be adapted to other elements of the system of regulators but it also re-acts on these. It must not offset any effect intended and achieved by the application of any other regulator, since this would be contrary to the central objectives. Although the influence of credit on the purchasing power is relatively limited under our conditions, still it is a regulator that may be used elastically in order to change a given market situation.

In the practice of crediting, the financing of fixed and working assets are closely intertwined. All credits serving the expansion of fixed assets, as well as the credits serving an increase in the permanent stock of working assets must be repaid from the development fund. The development fund of an enterprise is considered creditworthy if it is able to ensure, within the terms of expiry, the repayment of both types of credits which, in their turn, are sufficient to finance a development of fixed and working assets required by the growth of the enterprise's production and sales. This correlation requires that the granting of credits on investment and working-assets be co-ordinated in practice.

The future tendency of working-assets financing consists in that the share of enterprise-owned funds are growing against the share of bank credit. This tendency has made it necessary to elaborate some rules permitting the enterprises to re-group their funds serving the development of fixed and working assets (as against the regulation valid up to 1970 and rigidly isolating these two categories), as well as to grant credits to one another. In conformity with these requirements, *the following concrete measures and regulations have been introduced.*

a. For different reasons, certain categories of state-owned enterprises (those operating in construction industry, in trade in means of production, in state purchase of agricultural products and in foreign trade) did not receive complementary state allocations of working assets by 1 of January 1968. Instead, bank credits (called "working-asset credits Type I") were granted to them. By 1 January 1971, *supplementary working capital was allocated also to these enterprises* (most of these allocations were granted during 1970, the rest in the first half of 1971, with effect from 1 January 1971). This measure has greatly increased the share of enterprise-owned funds in these categories. The allocation of working assets, however, was not a simple conversion of the former bank credits into enterprise-owned funds. The Ministry of Finance, co-operating with the competent supervisory authority and the banks, analysed the situation of each enterprise concerned, and the extent of working-assess to be allocated was determined individually.

This measure represented the completion of working-capital allocations that have been decided on at the time of introducing the new mechanism.

In this context, the official statement is worth mentioning that, in the future, working capital will be allocated to enterprises only in some exceptional cases, on the ground of individual considerations. Such cases may occur mainly when a development project to be implemented by an enterprise is called upon to achieve some important central objective, and the development fund of this enterprise is insufficient to finance the necessary growth in fixed and working assets.

Such exceptional cases do not affect the general principle of self-financing: as a rule, enterprises must finance the necessary development of their fixed and working assets from their own resources.

b. It occurred that the stock of working assets permanently engaged in some enterprises exceeded the sum of their permanent financial sources, consisting of their working funds owned before 1968, of the working funds allocated to them at the start of the new system, of the "working-asset credits Type I" serving to supplement the working funds, and of the other financial sources available to the enterprise. When there was a lack in such sources, the National Bank granted medium-term "working-asset credits Type II" to such enterprises.

This type of credit served also to finance some part of the increment in working assets that have become necessary in the meantime. (In the first half of 1968, enterprises were obliged to increase their working funds only in so far as this was necessary to maintain the proportion that has formerly existed between their working capital and the total stock of their working assets.)

Estimates have shown that, in the Fourth Five-Year Plan period, enterprises will be able to repay their "working-asset credits Type II" out of the expectable increment in their permanent financial sources. Such increment will materialize, e.g., in the portion of profits due to and retained by the enterprise (although the exact amount of these can be known only after the approval of the annual balance sheet, even in the course of the year the enterprises may retain some part of their expectable profits on the ground of provisory estimates), as well as the permanent surpluses included in the debts (wages until payday, taxes and suppliers invoicing before becoming due). In some branches it seems even possible that the enterprises may repay these credits before the end of the five-year plan period. Thus, it may be expected that enterprises which, aided by the rapid growth in the volume of the regular circulation of working assets, can repay the credit in a relatively short time, will be able to finance the whole stock of working assets from their own sources. But, since repayment depends on the growth of the permanent financial sources, some other enterprises will be late in repaying this credit.

c. *The state authorities must see to it* that enterprises finance any increment in the permanent stock of working assets from their development funds. When checking the annual balance sheets, the agencies of the Ministry of Finance investigate not only how the enterprises have met their tax obligations but also whether the increment in the stock of working assets was covered by an adequate increment of the working funds, based either on the enterprise's own sources or on credits raised for this purpose, repayable out of the development fund.

Since the banks are not permitted to grant short-term credits for the purpose of increasing the permanent stock of working assets, it follows that, before granting a credit, they must check the proportion of the permanently engaged working assets to the financial sources of the enterprise. The granting of the credit may be made dependent on an adequate supplementing of the working funds. But, evidently, with enterprises not needing credit, the bank is not able to influence the size of the working funds in this way.

The bank is expected, by the granting or denial of credits, *to induce enterprises to adopt correct pattern of behaviour*. By consequently refusing to grant short-term credits for the purpose of financing permanent stocks of working assets, it forces them to accept one of two alternatives: either to build up adequate own sources for this purpose (that is, by increasing its working funds out of its development fund or by asking for a medium-term credit to be repaid from the development fund), or to reduce the permanent stock of working assets.

The last-mentioned type of credit, an advance on the future sources of working funds, as it were, is considered a development credit, since its purpose is a permanent investment in working assets. Thus, such a credit must be repaid from the development fund. A basic condition of its granting is that the enterprise's development fund must increase at a rate warranting repayment within the term of expiry.

d. Thus, in the next few years, *a shift in proportions is likely to come about between the sources financing the permanent stock of working assets*, in favour of the own sources. This change may be illustrated by the following example:

Let the permanent stock of the working assets of an enterprise be 100 units, and its financing, in 1970, be shared among the various sources as follows:

working fund	60 units,
other own sources	20 units,
bank credit (working-asset credit Type II)	20 units.

Thus, 80 per cent of the permanent stock is financed from own sources.

Let us now assume that after some time the following changes will occur in this enterprise:

— the permanent stock of working assets increases by 10 units,

— the "other own sources" of the enterprise increase also by 10 units.

Since, according to the rules set by the state, any increase in the permanent stock must be financed in such a way that the working fund is accordingly supplemented out of the development fund, an increment of 10 units in the stock of working assets necessitates an equal increment in the working fund. Thus, the relative share of the working fund among the sources of financing will grow.

The increment of 10 units in the "other own sources" (destined similarly to finance the permanent stock of working assets) makes it possible to repay 10 units of the bank credit serving to finance the working assets. Thus the following situation will come about:

— permanent stock of working assets	110
— working fund	70
— other "own sources"	30
— bank credit	10

As a result, the share of own sources in financing the working assets will increase to 91 per cent. This will be true even if the working fund is increased partly by raising a bank credit repayable from the development fund, since—from this point of view—this is but an advance on the own sources of financing.

It should be added that enterprises may increase their working funds—by a transfer from the development fund—even to a greater extent than what would be required by the increment in the permanent stock of working assets. In this case, the share of own sources may increase even more quickly.

e. In order partly to ensure the equilibrium between supply and demand in the market of the means of production and partly to induce enterprises to invest their own funds in a profitable way, also the granting of investment credits as well as of the medium-term credits financing the increase in working assets connected with investment is subject to the condition that 30 per cent of the funds necessary for the development in question be raised by the enterprise itself, out of its already existing sources.

f. In the stock of working assets, *changes of a transitory character* may occur, involving an additional demand due to some seasonal or other transitory phenomena frequently occurring in economic life, such as fluctuations in production, purchases and sales, etc. It would not be advisable to build up enterprise working funds sufficient to finance even such a transitory increment of working assets. The credit system is called upon to collect, in the form of short-term deposits, the liquid means which are transitorily free in some enterprises and to redistribute them among those where there is a transitory demand for them.

Enterprises may meet such transitory needs primarily by resorting to their own (permanent or transitory) sources of financing; when these are insufficient, they may raise short-term bank credits. When deciding on such credits, the bank must know and weight both the liquidity of the sources available to the enterprise, and the economic cause that has involved the application for credit. It depends primarily on the nature of this cause whether the bank grants or denies the credit. If the bank decides to grant such credit (serving to supplement the own sources of the enterprise), the term of expiry will depend on the bank's expectations regarding the liquidity situation of the enterprise in question; but it cannot be longer than 12 months.

Enterprises must keep in eye that the short-term credit policy of the bank is aimed at preventing the graver or more frequent, or permanently repeated mistakes of economic management from being blurred. Banks must consequently assert the principle that credits may be granted only to credit-worthy enterprises, that is, to those which are able to sell their products with profit and to meet all their payments obligations. Although among the types of short-term credits there also exists one called "liquidity credit",[3] this is a special form which cannot be applied repeatedly or regularly; it serves only to solve some exceptional short-term liquidity problems of otherwise well-managed enterprises.

g. An essential question connected with the management of working assets concerns the size of the working funds. Up to the present time, this question emerged mainly as to how, and from what sources, the working fund has to be increased to match the increment in the stock of working assets. But the growing share of own sources (even now, quite a number of enterprises finance their working assets without needing a bank

[3] This is a credit that may be granted, for a very short term, to enterprises whose economic management is otherwise sound, in order to meet some transitory need of financing. In such cases—exactly in view of the otherwise correct operation of the enterprise, as well as of the short term involved, the question of coverage is not investigated in advance.

credit) makes it necessary to regulate also the ways in which, in the case of a decrease in the permanent stock of working assets, the *superfluous part of the working fund may be channelled back to the development fund* and thus become disposable for other development purposes.

In this context, the question emerged how to define this superfluous and "disposable" portion of the working fund.

From what has been explained above it follows that in the majority of enterprises even the permanent stock of working assets is being financed to a substantial extent by bank credit. Accordingly, some of the experts held the opinion that part of the working fund should be transferred into the development fund only in the case of enterprises which finance the whole stock of working assets from their own sources. This is a rather strict conception, although in principle it may seem justifiable.

According to another opinion, when assessing the "disposable" portion of working funds, the part of credits financing the permanent stock of working assets that is not due at the time of assessment should be added to the "own resources". This concept is more permissive, and more likely to induce enterprises to reduce their permanent stocks of working assets. At the same time, it would slow down the growth of enterprise-owned sources.

Another point of discussion has been whether it is advisable, and under what conditions, to permit also the regrouping of working capital allocated to the enterprise by the state? An alternative solution consists in that, as a first step, only the transfer (from the working fund to the development fund) of such means should be permitted which originated from the own sources of the enterprise; later on, according to experience, the regulation could be made more permissive.

According to the regulation eventually adopted, transfer from the working fund to the development fund (that is, essentially a regrouping of funds in favour of fixed investment) can take place only in enterprises where the total of the permanent financial sources of the enterprise has exceeded, over at least a year, the stock of permanent working assets; during this time, the means destined for regrouping must be deposited with the bank. A further condition is that, as far as can be foreseen, the enterprise would not be in need of a medium-term working-asset credit for some longer time.

Thus, the adopted regulation asserted the stricter concept: a regrouping of funds can take place only when there is no outstanding credit serving to finance the permanent stock of working assets (with the exception of the medium-term working asset credit repayable from the development fund), and where the existence of a "surplus" in the working fund has been proved over some longer time.

h. It has been said earlier that it is advisable to develop the economic regulating functions of credit in a way permitting also the granting of credits between enterprises. One of the forms of such crediting is the *commercial credit*. Its general application depends, however, on several conditions. Evidently, it can have a substantial role in economic life only when, in view of the abundance of commodities, it will be in the interest of the producers to promote the sale of their products by means of crediting. It is only then that the commercial credits may act favourably. It would be of no help if its role were confined only to promoting the sale of commodities which are not in demand or which, for some reason or other, are difficult to sell. In this case, the commercial credit would only help to perpetuate undesirable patterns of production.

Enterprises may grant commercial credits to one another in connection with the delivery of goods or performance of services; they have to finance such credits on account of the "free" means available in their development funds. From this point of view, also such existing means of the development fund may be considered "free" which are earmarked for some future liabilities (e.g., if a sum of money destined to pay for a certain machine is available in the development fund from May 1st, but the machine will be delivered and paid only in November, this part of the development fund is considered transitorily free and may serve as basis of commercial credit). Evidently, great circumspection is needed when granting such a credit, since sooner or later the enterprise will need this money. Banks are not permitted to grant commercial credits, neither to finance such venture ulteriorly.

On commercial credits, a rate of interest not exceeding 5 per cent p.a. may be charged.

The regulation of such credits must be aimed at the best utilization of their favourable effects and at preventing adverse tendencies from emerging. As in the case with every new system, opinions on the expectable effects are rather different. Therefore, it seemed advisable to apply more restraints at the start than later on. One of the most discussed points was how to account the assets and liabilities resulting from such crediting (that is, the claim of the creditor, on the one hand, and the commodity purchased on credit which is in the hands of the debtor on the other) if they happen to exist at the date when the stock of the working assets are being registered. The answers may differ. There was even an opinion that neither the creditor nor the debtor must expand their working funds, since the creditor's claim is financed by the development fund, whereas the commodity in the hands of the debtor is financed by another enterprise.

According to the adopted regulation, the creditor enterprise need not expand its working fund on account of an increase of its working assets resulting from a commercial credit; it suffices to engage the transitorily free portion of the development fund. As regards the deptor enterprise, however, the commodity purchased on credit must be counted to the permanent stock of working assets if they still exist at the time of registration.

The question was also discussed whether it was advisable or not to permit the granting of commercial credits on investment goods? The opinion, asserted also in the regulation, was that, for the time being—in view of the size of effective demand for investment goods—it does not seem advisable to extend commercial credits to this category.

Commercial credit does not affect the validity of regulations regarding the circulation of money and the order of payments. It was not introduced with the intention to develop it into some general form of payments. Thus, if enterprises did not conclude a credit contract, the obligation of the purchaser to pay within thirty days continues invariably. However, if the purchaser fails to pay within thirty days, the transaction must be considered—at least from the point of view of financing—as a commercial credit.

i. *The interest rates on each type of credit* are being determined uniformly for the national economy as a whole, in conformity with the costs of the various credit sources. They are intended to stimulate the raising of credits for *efficient* investment in fixed and working assets. The interest rates on deposits must correctly orientate the decisions of economic units in the field of development and its financing.

According to the present regulations the general rate of interest on medium-term and long-term development credits varies between 8 and 9 per cent p.a. (it may be reduced to 6 per cent for the most preferred development projects). The interest rate on short-term credits is 8 per cent (or higher if the term of expiry is longer than 90 days). Interest rates on deposits vary between 3 and 8 per cent p.a., depending on the time of engagement (from a minimum of half a year up to those of 2 years and longer).

The prinicples, conditions, practice and extent of crediting in connection with the improvement of the credit system described here and in Chapter VII are laid down in a document called "Directives of Credit Policy" which has been approved by the government in connection with the national economic plan of the year 1971. However, the validity of these principles is not confined to 1971; it will extend over a longer period, depending on how the anticipated possibilities and conditions will materialize.

The role of credit as an elastic tool of regulation is going to become increasingly important during the period of the Fourth Five-Year Plan. In order that it may perform its functions, it is necessary that credit sources should also become available according to plan calculations, i.e. not only in their global amount but also as regards their tenacity and their economic character. Moreover, it is necessary to reduce, within the total credit volume, the relative share of credits, the granting of which is predetermined by previous processes and decisions. This requirement is also in conformity with the efforts of economic control aimed at reducing the gestation period of investment projects.

Chapter IX

REGULATION OF PRODUCT TURNOVER

by

PÁL VALLUS

1. REGULATION SINCE 1968

The new system of economic management has brought about substantial changes in product turnover. The present system relies on the principle of free turnover. This has been achieved by abandoning the former forced paths in turnover of materials or products and the calendar periodicity of supply, by introducing a market mechanism of multi-channel turnover, by ensuring the right of choosing partner for both buyer and seller, and so on. The possibility of free buying and selling is warranted by law, and its material-technical conditions are established by our national economic plans. Our system of regulators promotes the assertion of the principle of free turnover by material incentives and by monetary-financing funds. The provisions regulating product turnover organically include prescriptions on the prohibition of agreements restricting free turnover, that is, agreements on dividing the market, on excluding certain consumers or on limiting possibilities of choice.

Under the new system of regulators it has become possible to discontinue such central economic control as would restrict purchases and sales by statutory provisions, except for meat. Instead of the almost exclusive form of central instructions in the economy, looser forms of rules on turnover have been introduced since 1968 (for instance quotas, compulsory delivery contracts, etc.) for a part of materials and products, mainly where the market equilibrium seemed to be unstable.

The lifting of former restrictions, the granting of rights to choose partners and contractual forms have had a beneficial effect on the efficiency of enterprises, promoting enterprise responsibilities and activity. The new conditions have enhanced the interest of co-operating partners in solving their tasks jointly, have cut short the ways of turnover in various areas, confirmed the positions of buyers, etc. The change has involved many positive consequences; the earlier shortage psychosis has been replaced by an almost complete normalization of supply on such vast markets as those of ferrous metals, of timber products, of non-ferrous metals and so on, and the structure of material supply has taken a turn for the better.

Most quotas preserved in 1968 as a remnant of the earlier economic management by plan instructions regulated *turnover between producing enterprises.* The maximum amounts the major users were allowed to purchase within one year were prescribed for 28 groups of products, such as all types of fuel, basic materials for plastics, some basic materials in chemistry (sulphur, caustic soda, ammonia soda, methylated alcohol), basic materials for heavy metals, newsprint and writing paper, some metallurgical products and of the processing industries (steel wire, tyres, cables, diesel engines).

The quotas in turnover between producers were later abandoned for almost all groups of products, except for five in 1970: iron ore, copper blocks and semifinished goods, the above-mentioned kinds of paper and buses sold at home. The other quotas between domestic produces have been abandoned either because they failed to promote the correction of equilibrium troubles or because the equilibrium situation itself was found to have improved. In the case of some products the quotas did not regulate turnover because they were raised parallel to increasing demand.

The fuel situation in 1969—70, for instance, clearly showed that other methods than physical quotas could be used more efficiently even under worse conditions. (For instance, the modification of material incentives for enhancing interest in higher production, payment of overtime work from other than wages funds, preferences in making vehicles available for transport, in some cases import, and so on.) Capacity contracts with the coal industry are to be concluded in time by those users who need more than a definite quantity. Another looser prescription in fuel turnover has also become necessary: to prescribe a minimum stock of black coal, of foundry coke and fuel oil for the largest consumers to be attained by the beginning of the heating season.

Another group of quotas is also destined to preserve equilibrium in the sphere of production *by limiting exports above a certain quantity.* Most of these quotas have been made necessary by the differences between domestic and foreign prices (as, for instance, in the case of aluminium products, coke, soft-sawn wood, fine steel bars, cables and conduits, steel tubes, etc.). These quotas may also be reduced probably by a better co-ordination of domestic and foreign prices, by expanding foreign-trade price risk reserve funds. (This, essentially, applies to commodities that can meet domestic demand if foreign market prices are balanced and export interests are adequately regulated.)

The third group of quotas serves *the protection of the balance of payments*. The number of such quotas was reduced to two products by 1970, but even the *import quotas* for protein fodder have since been also abolished, because their price has been regulated on the basis of the real import costs. Today the import quotas mean much rather an obligation of importing enterprises to ensure a minimum amount of the commodity in question from foreign trade (electric energy, passenger cars, coke).

The fourth group of quotas is meant to secure the *supply of the home market* (some of them putting a limit to the demands on domestic trade). The former has been found necessary only for basic building materials and for foreign briquette. The quotas restricting trade demands are set for passenger cars, industrial and household coke and soft-sawn wood goods. The home trade quotas seem to be sufficiently stable and, coupled with consumer price policy, they are indispensable for meeting the demands of the population.

The number of products to be handled exclusively by appointed buying, respectively selling enterprises was 50 in 1968, 20 in 1969 and 11 in 1970. The wide-scale application of "forced paths" was partly due to the old mechanism of distribution. These paths are being maintained at present rather by financial and price constructions, as well as by the rational solution of tasks concomitant to the manipulation of import (to reclassification etc.).

Accordingly, the turnover of producing and trade enterprises was restricted by the following prescriptions during the first three years of the new system of management:

	1968	1969	1970
Central allocation	2	2	1
Import quotas	18	18	5
Purchase quotas for producers	28	13	4
Purchase quotas for home trade	13	8	10
Export quotas	22	10	10
Appointment of exclusive buyers or sellers	50	20	11
Prescription of a minimum level of stocks	—	—	3

Beside the above-listed forms in certain cases the *suppliers are bound to conclude contracts*. The obligation of concluding contracts is annually approved by the government partly by definition of the cases and partly by concrete enumeration of products. Such cases are the large individual investment projects, orderances, services and technological developments of military character, health services (i.e., pharmaceutical products, nutriment and dressing materials of domestic origin), the state reserves.

The rules of product turnover are prepared in the course of annual planning. During this work the balances of some 140 groups of products are drawn up in the National Planning Office and in the National Office for Prices and Materials on the basis of co-ordinating the expected production and demand to clarify the fields where the above cogent means are to be applied. Synthetic input-output tables play an increasing role in this planning work by which the product links between industries and branches are comprehensively planned. In addition, a wide-scale information system on the actual turnover and reserves is available for drawing up the balances of products:

(a) Balances of materials used; these contain the opening stock, the purchases, the use (losses and sellings) and the closing stock of the appointed enterprises, concerning the above-mentioned 140 products.

(b) Realization-balances: opening stock, production, purchase, realization, other reduction of stock and closing stock data for 202 products are given by the appointed big industrial enterprises and enterprises trading in means of production, or by trusts and by ministries.

(c) Statistics on the order-book of more important products shows the production of about 150 products in the previous year and their order-book for the current year with the appointed major producers.

(d) Regular quota statistics on the turnover of allotted products supplied by the authorities benefiting from the quotas.

The general information on planning work, including the plan conceptions of the big enterprises, the information of the bank system, the normatives and norms of planning, materials for investment and foreign-trade computations, etc. are, naturally, used in planning both production and imports, as well as demands.

In the first three years of the reform, in the transition period of switch-over to freer turnover it was possible essentially to ensure unhampered material supply with the help of the enumerated regulators and of other methods. Permanent supply essentially without a hitch was ensured even in such critical situations as were produced by the exceptional winter weather, import lags and other causes in the field of fuels. In addition, we have made significant steps toward bringing about an up-to-date structure in the utilization of materials in more than one field. Different complex measures have been taken amidst the possibilities of the national-economic plan and the system of regulators in order to normalize the market situation and to achieve favourable structural changes.

A new method of official market supervision started to take shape in practice in the years of 1969 to 1970. Its essence is to try to cope with sporadically occurring troubles on the basis of adequate operative information by measures affecting turnover, investment, by prices, taxation, incentives and other measures without, whenever it was possible, squeezing the development of production and turnover into rigid official prescriptions again. By using these methods — stimulated rather by management routine in the past — more consciously and consistently in the future, the management of turnover can be made more effective, as shown by experience.

Such a management, naturally, requires an appropriate executive organization capable of concentrating the work of the management authorities on warding off possible troubles.

However successful we have been in our transition to a freer turnover system, studies show that we have not yet found the optimal means for influencing and directing turnover. The principle of multi-channel turnover does not yet prevail in some fields. Enterprises do not avail themselves of their legal possibilities since these do not yet automatically ensure either interests or means. Enterprises sometimes do not possess the means (storage capacities, reserves etc.) or funds enabling them efficiently to initiate the shortening of turnover routes, the reduction of turnover restrictions. In many cases, lacking motivation, they do not take steps to develop multi-channel turnover. With increasing experiences in the functioning of the turnover system, we have realized that free product turnover — in addition to maintaining financial equilibrium — is largely dependent on a co-ordinated further development of the system of regulators, particularly on the income-regulating and incentive system, on financing stocks and also on the trade regulators.

2. CHANGES IN THE METHODS OF CONTROLLING TRADE

The application of stricter or looser forms of turnover prescriptions may be influenced by the expected demand-and-supply trends on the market, by the intensity of problems arising in various fields. *The projected demand-and-supply proportions earmarked in the Fourth Five-Year Plan essentially satisfy the main criteria of equilibrium.* Yet even a small failure in executing the estimates in certain fields may lead to disturbances and may require stricter turnover prescriptions to be imposed in the course of implementation. Examples can be quoted from 1969 and 1970.

Presuming the general equilibrium to be secured, the problem in shaping the product turnover instruments of the Fourth Five-Year Plan is, in fact, not whether major or minor tensions are likely to arise in certain fields but rather what methods will be applied to eliminate the difficulties possibly arising and what means will be used for their mitigation or elimination. According to the results of the analysis, this question can unequivocally be answered by saying that even without a significant improvement in the market situation the improvement of our management methods would justify the reduction of physical restrictions still in force in 1970, and by a change for the better in the market ralations we can obtain further possibilities, impulses for expanding the system of free turnover.

Considering also the above, the improvement of the product turnover system consists of two tasks:

— *legal regulation of instruments* which may have to be applied during the Fourth Five-Year Plan;

— raising to higher standards the policy of *applying the instruments.*

The legal regulation of the instruments is to cover a relatively wide field. To be maintained are even such product turnover provisions as would better be relegated into the background in economic-political practices, yet cannot be eliminated entirely from the arsenal available in case of need (for instance, the prescription of a minimal stock level).

On the basis of the analyses performed, the regulators of turnover have been modified in compliance with the following main guidelines:

a. *The number of quotas is to be reduced* during the Fourth Five-Year Plan. The experiences of the first two years of the economic reform have shown that turnover restrictions are not suited either for adequately increasing supply or for a necessary and rational reduction of demand. Quotas often create demands not really existing or maintain demands that would otherwise not arise (this is due to the fact that quotas give preference to certain groups of consumers over others putting them into a comfortable situation while unduly preserving strained situations elsewhere). The system of quotas is unable to influence the structural processes of production to an extent it would otherwise be possible by a rational application of market categories (price, credit and other monetary means). Consequently, the system of quotas often renders the production and consumption patterns unduly rigid and is less suitable for following the elastic changes in production and trade processes.

With due regard to these considerations it seems most expedient to carry on the practice started in 1969 and 1970. This essentially consists, — as has been exposed — in trying to liquidate the real causes responsible for equilibrium difficulties by adopting complex measures, in the collective corporation of the ministries concerned, in the Interdepartmental Price and Product Turnover Commission (to be referred to as IPPTC). Its president is the chairman of the National Office for Prices and Materials. According to the experiences gained in revising the system of regulators, the IPPTC will have to extend its activities and supervision, as a collective authority, over all important fields of the market (comprehensively influencing production and consumption). Measures restricting the flow of commodities (production, import, export, consumption) will, naturally, be applied only in fields where imbalances require central measures, according to the collective judgement of the ministries.

The activity of the IPPTC in supervising the market does not mean that the Commission assumes the responsibilities of the ministries or that the old system of management is to be reintroduced in the economy. The ministries participate in the work of the IPPTC as authorities responsible for management; the task of the Commission is, in fact, to prevent imbalances heavily affecting several economic fields, by operative methods, co-ordinating the various interests of the ministries and deciding on the main lines along which tensions can be resolved. The ministries, in the case of disagreement, may lodge a protest with the government against the resolutions of the IPPTC.

Similarly, the responsibility of the IPPTC does not mean the application of the old methods of management, since its measures can only be taken within the legal framework of the existing mechanism.

Accordingly, the regulators of product turnover shall further be developed in a manner to *maintain quotas only* in fields where serious imbalances are expected or where a stricter observance of equilibrium is required by interests which cannot be ensured with other means, such as trade incentives, monetary, price, etc. means. The scope of such products continues to be determined annually as a function of the market equilibrium.

b. Further steps are to be taken to develop the system of multi-channel turnover. This requires the further reduction of the number of the forced paths, a regular revision of the existing paths of turnover[1] and the securing of the material and financial conditions for multi-channel turnover.

As far as the administrative (legal) restrictions on product turnover are concerned, progress has already been made towards evolving product turnover determined by market conditions. But there are certain restrictions, forced paths in product turnover which are not embodied in legal provisions but derive from price relations, financial bridges and problems of accounting methods (pools, price mixing), as well as from organizational situations (monopoly positions). After a revision of the entire system of regulators, the factors contributing to the gradual liquidation of the restrictions on product turnover are gaining ground.

c. Prescriptions for *keeping a minimum stock*, first applied in 1970, cannot be dispensed with as an instrument influencing product turnover. These and other, more rigid methods of product turnover may be applied within a very limited scope only. The use of this instrument gave rise to debates during the revision of the system of regulators but was eventually adopted as one of the legal means of product turnover control. It has been made clear that this is not a prescription that would create additional demand with the enterprises, but it meant to induce the enterprise to ensure the lowest stock level necessary for reproduction processes in the national economy. And this, too, is prescribed only in cases when the problems cannot be satisfactorily solved by applying more flexible means.

d. Another objective to be attained during the Fourth Five-Year Plan is to reduce the scope of compulsory delivery contracts,

[1] The revision of enterprises engaged in the trade in means of production will be discussed in a later part of this chapter.

although, this too, depends on the stabilization of market conditions. This form of restriction is likely to be maintained for a longer time in order to fill up state reserve and for defence and health reasons.

e. As has been shown by investigations, the efficiency of product turnover management can be improved also by a very conscious organization of what is referred to as *state intervention activity*. The analytical studies seem to indicate that this may, for the time being, acquire importance in agriculture and in the field of foreign trade. (The problem of intervention in agriculture is discussed in Chapter XI.) In the field of foreign trade, the main goal of intervention is a better utilization of favourable marketing possibilities deriving from external market boom and other causes, a most advantageous scheduling of purchases in time, a reduction of losses due to the seasonal character of foreign production and the utilization of related favourable possibilities.

f. The *information system* of product turnover is to be placed on *wider foundations*, utilizing therein also the possibilities provided by the system of foreign-trade licences. Beside the planned commodity and material balances anyway available, other analyses and prognoses, specific information for the controlling of product turnover can be gained also from the procedure of granting foreign-trade licences, such information as can help to better judge the expected trends in domestic supply, and market.

3. CHANGES IN TRADE IN MEANS OF PRODUCTION (TMP)

The controlling bodies concerned have examined the activities, market position, turnover contacts, economic efficiency of operation of the thirty enterprises engaged in TMP.

The revision was based on the principle of carrying out all changes in TMP that may become necessary for the unhampered material and commodity turnover. The idea was to promote competition planned to be introduced when establishing multichannel turnover, and to make it possible to pursue more rational stock-building policies with less assets engaged. Thus the attention of the participants in revision covered the examination of the spheres and functions of turnover; commercial, monetary and motivation questions associated with the strengthening of competition; questions of financing and stock policies (including storage policies).

The most important statement resulting from the investigations was that turnover contacts reasonable for the national economy could not yet evolve merely through decisions based on the profit motive of enterprises. In the present state of development of the management system the micro-economic sphere has not yet acquired the capacity of self-regulation to direct trade in the desired direction with the required intensity. Yet, in many fields official measures can be taken to promote the turning of enterprise contacts into an adequate direction.

The highest authorities concerned have adopted the following guidelines for the improvement of the system of trade in means of production:

a. Some enterprises participate superfluously in turnover, and direct contacts could more reasonably be moulded by *withdrawing their trading licences or by modifying its scope.* The resolutions contain actual decisions in some concrete cases. The path to be travelled by commodities should be simplified especially in the case of imported mass goods where the enterprise manufacturing the product, or foreign trade and some major users can establish direct contacts with one another. The inclusion of the TMP enterprises is in general redundant in cases when the commodities regularly travel a path from producer or foreign-trade enterprise directly to customers.

b. In order to make product turnover more rational, beside a possible—probably later—extension of import rights, efforts should be made enhance the common interests of foreign trade and TMP enterprises; these enterprises are to be merged, i.e. the two activities should be carried on in a common organization if later concrete enterprise investigations justify such steps.

c. As an exception, foreign-trade enterprises may also be granted import and export rights if this contributes to the improvement of product turnover.

d. It seems expedient for enterprises operating in the TMP form to prepare for the *service of small consumers.* If they so desire, the means and funds necessary for such steps are to be granted to them.

e. Whenever turnover, organization or means are rearranged in order to make the turnover paths smoother, steps should be taken to regroup credits complementing liquid funds and other financial funds if necessary. These steps should also promote transaction of the necessary turnover with less assets engaged and smaller cost, as well as the development of economic competition, as planned in establishing multi-channel turnover.

The implementation of the resolution may involve a withdrawal of credits complementing liquid funds, of the liquid funds or of the enterprise's own funds, or their transfer on the enterprise undertaking the function. In the case of measures having the character of reorganization, the financial funds becoming superfluous may be withdrawn or the necessary funds granted. *Such regroupings, however, must not involve the increase of state burdens.*

f. The transformation of credits complementing working assets of TMP enterprises should be determined with due regard to their role to be played in product turnover. The credit needs of enterprises shall be revised by the banks in the same manner, within the scope of the crediting rules in force.

According to a comprehensive statement of the studies, the development funds necessary for keeping stocks and for turnover are at the disposal of the national economy in the various enterprises. Yet, a body able to transact turnover will not initiate new devices if it has to use its own funds. This is because the enterprises in question does not dispose of the financial reserves for the regrouped stock but has to earn it through future profits, and this is a heavy transitional burden on its development fund. Considering thus that this is no "distribution of cash" the regrouping of stocks should be accompanied by adequate financing measures where the regrouping of redundant or unreasonably handled stocks to other fields is considered as an obvious necessity by the authorities and corresponding measures are taken.

Where the turnover paths are to be modified or turnover profiles, stocks, stores, etc. are to be regrouped, care should be taken that the enterprise receiving the stock (store, etc.) *should not find itself in a situation worse than in what it was before.* The methods of this procedure are determined by the ministers concerned with due regard to the new regulators of motivation, in connection with the actual reorganizational measures.

g. It is necessary to remove all obstacles stemming from official price prescriptions and *unduly directing turnover towards TMP enterprises.* This problem assumes a particularly serious character in connection with *price mixing.* Price and monetary measures are to be taken to eliminate—in this respect—obstacles to the development of turnover paths. These measures may include price changes, the establishment of a definite financial bridge (skimming of support), or its modification, possibilities of adequate domestic sales (on own account) for foreign-trade enterprises, etc.

h. In some cases measures should be taken to withdraw or regroup credits complementing circulating funds, to prevent turnover from being superfluously directed towards TMB enterprises in the form of commission or agency construction and make it possible for services that can be performed by intermediate trade to be realized for the production sphere without a compulsory shifting of stocks.

i. In the future, TMP enterprises should make use of their stores in the form of letting them against compensation, if the buyer turns to a TMP enterprise with the aim of using its stores and not with the intention of making use of its commercial services. Consequently, the problem of the commodity's path being protracted on account of storing obligation can be dismissed in the future.

j. A specific problem is the setting up of *consignment storing* for foreign enterprises. The setting up of such warehouses, etc., can be economical only under certain conditions, and thus no general measures can be taken to promote it. This possibility, as a mode of making trade cheaper must not be excluded, particularly in the case of products for which there is adequate demand on the world market.

k. It is necessary that the TMP enterprises create and develop a network of shops for *directly servicing the customers.*

These resolutions are implemented gradually. The control authorities contribute thereby to the shortening of turnover paths and contacts.

It is clear, however, that the primary means for achieving this aim should be the economic considerations of enterprises—as has been laid down in the basic principles adopted in 1968—and these considerations should be elicited by a balanced material supply and by the proper operation of the system of regulators.

Chapter X

TECHNICAL DEVELOPMENT AND ECONOMIC REGULATORS

by

JÁNOS SEBESTYÉN and ERVIN FARKASFALVY

1. MODIFIED ECONOMIC REGULATORS INFLUENCING TECHNICAL DEVELOPMENT

The close connection existing between economic growth and technical progress makes it necessary to deal separately with the question how far our modified economic regulators promote technical development.[1]

The importance of technical development has been duly considered ever since the first year of the new economic mechanism. Everybody has recognized that up-to-date quality of products and competitive power in the world market—which latter depends also on the costs of the products, that is, on their being produced with advanced technologies—are necessary conditions of a rapid economic growth, and that, for achieving this, home and foreign scientific and technological results have to be equally applied. Therefore, economic regulators have been expected, among others, to facilitate such activities, to make enterprises and cooperatives economically interested in technical progress and also to create such economic and market relations where continuous and efficient technical development becomes an indispensable factor for the successful operation of any economic unit.

Though the economic regulators introduced early in 1968 were intended to meet these requirements and have led to measures altogether correct in principle, a review of results achieved in this field shows that the rate of technical progress —apart from certain conspicuous achievements—was not generally favourable. It is not necessary to look after special causes and seek for explanations. Evidently, all the deficiencies well

[1] In order to distinguish two separate categories, we use the term "technical development" when dealing with a special group of measures aimed directly at developing and introducing new equipment and technologies, turning out new types of articles, etc.—as distinguished from the more general term of "development" (see Chapter VII). Accordingly, enterprises build up two separate funds: "technical development fund" for the first purpose and "development fund" for the second.

known from various analyses to high level executives — in market relations, investments, price development, etc. — must have also affected, and perhaps even more strongly, the field of technical development. Thus, the problem is not to find out exactly what hinders or retards technical development, or whether or not it is possible to modify our economic regulators in order to offset adverse effects. The real problem is how to regroup and concentrate the often insufficient material and human resources of the national economy in order to achieve optimum efficiency in all fields and how to ensure, instead of excessive centralization, an adequate degree of freedom for the initiative of economic units and for the assertion of the requirements of the market.

Namely, if we tolerate an economic environment where excessive monopolization dominates instead of a healthy competition, enterprise and personal incomes can be raised more simply by means of price rises than by turning out more up-to-date products with higher use-values. In this case, very few possibilities and — what is more important — very few incentives, if any, would be left for technical development. On the other hand, it is also true that if we do not undertake substantial financial sacrifices for promoting technical development, we shall never be able to break the vicious circle resulting from restraints on investment, the equilibrium requirement of the balance of payments, low productivity of labour, etc.

The effects of the modified regulation system on technical development must be investigated under two main aspects:

— does it better redistribute the sources of the national economy between the two tasks of ensuring present economic equilibrium and the efficient achieving of our future development objectives, and

— does it promote the unfolding of technical improvement on a wider scale?

2. THE ROLE OF REGULATORS STIMULATING TECHNICAL DEVELOPMENT

Technical development activities — including mainly the introduction of more up-to-date products and progressive technologies, as well as the acquisition and application of up-to-date technological knowledge (research results, licences, know-how, etc.) accumulated at home or abroad — are to a decisive extent the task of enterprises. Therefore, economic regulators must be investigated in the first line from the aspect whether they are providing sufficient incentive to enterprises in this field.

Let us remark first of all that, in our opinion, the legal rules relating to the creation and use of the "technological development funds" of enterprises regulate adequately the economic and financial conditions of enterprise activities aimed at technical development, so that it does not seem necessary to modify them substantially in the Fourth Five-Year Plan period (apart from occasional changes in the extent to which some regulators should be applied). We must state, however, also that the enterprises do not yet avail themselves of the possibilities open to them; many of them avoid to initiate technical development measures involving substantial costs and risks. Causes may evidently differ by enterprises, but let us enumerate some of the more generally occurring ones.

a. In so far as "technical development" remains within the limits mentioned above, its financing is ensured by the enterprise-owned sources accumulated in the "fund of technological development". But as soon as an enterprise wants to apply the results achieved in this way, that is, to introduce them into its production and sales activities, several difficulties arise. First of all, up-to-date products and technologies require up-to-date equipment, and the known tensions in the market of investment goods may make its purchase very difficult. It must be admitted that central economic organs make serious efforts to ensure equilibrium in the market of investment goods, trying to increase supplies from domestic and (even more) from foreign sources, and thereby to bring about competition situations. At the same time, they endeavour to increase the economic efficiency of investments, to promote the better variants by crediting and — what is but a necessary counterpart of all this — to withdraw from the enterprises such sources as they would use for investments deemed less urgent (from the central point of view). If we abstract now from investment projects centrally prescribed or promoted by state preferences, it is evident that it is very difficult to reconcile enterprise development conceptions with the limited supply of investment goods, and with the system of regulators reckoning with those constraints. It will take several years to work out a satisfying solution.

b. Essentially the same problem arises if we investigate the interrelation between the income regulators affecting an enterprise and its activities aimed at technical development. The general principle that enterprise activities must add to enterprise profits is correct, since this is the way of increasing the incomes of the enterprise as a whole and those of its workers. Nevertheless, as long as the effects of the new economic mechanism have not fully unfolded, for many enterprises it is easier to increase enterprise and personal incomes by "negative" measures, like price rises, deterioration of quality, or by choosing the extensive way of development by increasing the volume of output, etc., rather than by genuinely progressive measures aimed at technical development.

c. Development of products and of the technologies applied in production, as well as of the general technical and organizational level of an enterprise requires it to build up a staff of well-educated, well-experienced and—as a consequence—better paid workers, technicians and engineers. Already when dealing with the regulations affecting the management of manpower and wages (Chapter III) it has been stated that the former regulation did not sufficiently enable the enterprises to achieve this aim. The modified system of regulators represent, in this field, but a very careful step ahead. Circumspection is much justified in view of the general requirements of economic equilibrium; it is true, however, that the modifications opened but modest possibilities to the enterprises of achieving a qualitative change in the field of technical development.

d. Finally, we must refer to the risks connected with technical development. Our enterprises are still rather reluctant to undertake such risks; and there is nothing to force or simulate them. As a result of the general market situation, there are very few enterprises that would be faced with sales difficulties resulting from the obsoleteness or high prices of their products, that is, from their outdated production technology. The market, or the authority fixing the prices, acknowledges even the high costs of production and the state helps to solve their difficulties by granting subsidies: why should then an enterprise undertake risks over a conventional minimum? Very much will have to be done—including the improvement of economic regulators in this sense—before the enterprises replace their present short-term concepts with longer pespectives in their policies regarding production, sales and—as a necessary precondition—technical development.

No doubt, the modified economic regulators valid for the Fourth Five-Year Plan period represent a further step on the way determined at the time the new economic mechanism was introduced. This step was taken in consideration of the results and deficiencies observed during the first three years. Some results may be expected in the wake of these modifications; but the objectives in the field of technical development will be achieved only if the economic regulators advance higher claims against enterprise management, and if they succeed in coordinating the conceptions of economic efficiency, financing, personal incomes, etc., connected with short-term and long-term development.

3. NEW MEASURES

As regards the Fourth Five-Year Plan period, the regulations affecting technical development modified in the following respects:

a. Official price measures, by bringing the Hungarian price level and price proportions nearer to those prevailing in the world market, supply more reliable information to an enterprise as to the fields where economic results of technical development may be ensured more permanently and with smaller risk.

b. The expanding market competition of goods with prices determined by bargaining, as well as the increasing import possibilities, tend to transform the former seller's markets into competitive ones but, at the same time, it also helps the sellers of genuinely up-to-date goods in attaining favourable prices.

c. Combined measures regulating prices and incomes prevent prices from growing excessively, that is to the extent where enterprises would become uninterested in increasing profitability and incomes by technical development. In other words, they must find it rather difficult to approach or attain maximum profits; but if they attain it—not with state subsidies but as a result of proper management—they may expect several kinds of preferences (in taxes, credits, etc.) promoting their future development. At the same time, inefficiently operating or badly managed enterprises must feel very severe constraints, instead of the state's trying to hold them above water by subsidies.

d. If the new regulations regarding manpower and wages ensure slightly greater freedom and independence for enterprises, this means only that certain of the effects that in recent years retarded development are now offset. Still, it continues to be the task of the enterprises to take active measures for improving the discipline, conditions and productivity of labour. This has to be stressed here because effective measures regarding technical development are conceivable only in enterprises where work is well disciplined and organized, where live labour is not being squandered, and where competence and skill are adequately valued, both in general and in financial terms. The modified economic regulators open the path for all this, but it depends on the enterprises whether or not they avail themselves of this possibility deliberately and with precaution, i.e. in a planned way. Above all this, however, the economic regulators acting in this field should also solve the problem of making enterprises executives—and particularly those dealing with technical development—more interested in the long-range development of the enterprise. Thus, for example, leaders who managed to ensure a continuous and balanced development of their enterprises during five years or more should be substantially preferred against others who attained dramatic increase in a single year, to be followed by an unjustified (or even intended) recession.

e. To sum up: *the modified economic regulators may be expected to increase the profitability of measures* aimed at technical development, but they will do this only if enterprise management as a whole is able to meet the new requirements in general. In the Fourth Five-Year Plan period, *enterprises must be increasingly coerced* to channel their activities serving technical improvement in conformity to market demands and cost-saving. They must understand that this requires patience and continuous efforts on their part, and that in these efforts enterprise initiatives and the centrally set plan objectives—as well as the sources made available by the national economic plan—must be brought into harmony.

4. THE CENTRAL CONTROL OF TECHNICAL DEVELOPMENT

Beside the initiatives emanating from enterprises—limited by several factors and therefore not fully unfolded as yet—in the present stage of our economic growth a certain central control of technical development still seems necessary. This system of central control has begun to develop but a few years ago; apart from initial difficulties, its results were favourable, indicating that we should maintain and improve it during the Fourth Five-Year Plan period. In the spirit of the new economic system, we should avoid direct interference by the state authorities as far as possible, and to replace it by economic and financial measures affecting enterprise decisions indirectly. For this, it is necessary, first, that state authorities entrusted with the control and co-ordination of technical development should — instead of, or besides, their right of giving direct instructions to enterprises — dispose of own financial sources and, second, that our economic regulators promote the really efficient use of these sources. In order to meet the first requirement, central funds (available partly to the National Office for Technical Development) are being built up from contributions from enterprise-owned technical development funds. The contribution amounted roughly to :/3 of the funds of the enterprises. At present, these central funds receive about 3·5 per cent more from enterprise funds[2]. The centralized fund is available for investment purposes, too.

The centrally financed reasearch and development targets (programs) have, generally, the following common features:

— they require the co-ordinated operation of two or more industries or national-economic branches;

— they need a substantial amount of funds, eventually the combined use of enterprise and central funds;

— they would involve an excessive risk-taking for any individual enterprise or research institution;

— they cannot be expected immediately to improve the economic situation of the enterprises or institutions concerned;

— they affect a field where it is difficult to determine in advance the joint economic interest of the producers and users;

— the results of technical development do not materialize directly for the producer (in some cases, they are measurable only for the national economy as a whole), so that the granting of state preferences is necessary;

— central decisions are needed for determining the directions of technical development (e.g. in the production of colour

[2] Enterprise funds for technical development are being alimented by an officially determined portion of *sales returns*, but transfers into the fund may be complemented also at the charge of the production costs. This fund is available for research, experimentation, etc. aimed at introducing new products and new technologies; generally it cannot be used for investment purposes. (The reader will remember that the so-called "development fund" of enterprises is alimented from a defined part of *profits*—rather than of sales returns or production costs—and that it is being used generally for investments or the increase in the permanent stock of working assets.)

television sets) or its most advisable methods (e.g. international co-operation).

It is generally admitted, however, that technical development should be promoted in these cases by indirect economic measures (credits, state loans, subsidies and other preferences, too) rather than by direct instructions. Economic regulators should offer all these possibilities and, in addition, they should ensure state preferences exceeding those generally granted, since in most cases of technical development also the efforts of deviating from traditional lines and shortening the time of introduction deserve premia.

Speaking generally, the modified economic regulators established for the Fourth Five-Year Plan period were intended to meet also these requirements. From this point of view we have to stress that, from 1971 on, no "import deposits" (see Appendix) are being required from purchasers of imported machines and other equipment serving technical development, and that import duties on such goods were differentiated according to their usefulness in this respect.

Substantial help in technical development is being afforded by the purchase of foreign licences, knowhow, and documentation. But the efficiency of such help depends on selecting the best technical solution, on the economic and financial conditions of purchasing licences and that they should be purchased and applied quickly, etc. In this field, our enterprises need a quick and elastic aid on the part of the authorities, and the new regulations offer better possibilities for this.

Greater possibilities were opened also for the economic and financial promotion of international co-operation. Although the importance of international co-operation for technical development was well known in the past the creation of such relations was made rather difficult. Let us mention the following difficulties.

a. In the course of intensifying international co-operation, frequently the purchase of some machine in a capitalist country becomes necessary in order to apply up-to-date technology. The easiest form of such a purchase would be to ask for a credit in foreign currency, to be repaid from increased exports. But the general condition of applying for this type of credit is that the applicant must renounce to all state refunds on exports whereas the co-operation in question might ensure but a partial improvement in the enterprise's situation, so that continuation of the refunding would be needed.

b. There may arise difficulties in developing the liquid funds. The starting of an international co-operation imposes, as a rule, a substantial burden on the development fund, so that the enterprise may not be in a position to complement its circulation funds before the third or fourth year of co-operation. Until then the enterprise would have to raise a credit for this purpose, and this is rather difficult under the present crediting practice.

Therefore, subsidies granted from centralized funds of technical development should ensure, first, that enterprises and research institutes performing their tasks in technical improvement should not face a more disadvantageous financial situation and, second, they should offset the constraints set by other regulators concerning customs duties, import deposits, allotment of foreign currency, etc., third, they should distribute risks in a way that only development concepts advantageous both to the enterprise and to national economy as a whole shall be subsidized by the state or preferred by the credit system. (We apply here the term "advantageous" in a complex sense meaning an optimum compromise between development concepts covering shorter or longer periods.)

5. RESEARCH

A very important field of technological development is the one of research, and economic regulators tend to act on this field in a particular way. Reseasch takes place, as a rule, either in enterprise laboratories or in research institutes operated on a profit basis, or else in non-profit institutes financed by the state budget. Activities in *laboratories owned by enterprises or trusts* are closely linked with the needs and requirements of the economic unit operating them, and it is in the interest of these economic units to ensure conditions of successful operation for the research units within the system of regulators generally affecting the enterprise or trust in question.

It is conceivable, however, that enterprise-owned laboratories are commissioned tasks affecting a whole branch, or the national economy as a whole. In this case, exceptions from the general rules may be justified.

As regards *research institutions operated on a profits basis*, experience gained in the years of transition has made it clear that such institutions cannot be subjected to rules identical with those governing the profitability and taxability of the state-owned productive enterprise. It is necessary to apply the profit principle to the operation of such institutions in order to make them dependable on market demands and on how they perform researches meeting such demands; but when establishing economic regulators affecting them, we must consider some of their particular features.

For instance, the fact that research institutes operate mainly with human resources and they perform particular functions excludes the possibility of a wide-scale competition, of doing away with "monopoly situations". In other words, a mechanical application of general economic regulators to research institutes would result either in an unjustifiable rise in research costs, or in a limitation of research activities, that is, in a less reasonable and less efficient use of sources.

Although the activity of *designing bureaus*, *institutes dealing with organization*, etc. differs from that of the institutions mentioned above, their great indirect influence on technical development requires that their particular features be considered by the regulation.

Most of these *research institutes alimented from the state budget* pursue a scientific activity to which the economic regulators cannot be applied, or can be applied but formally. Even here, our aim should be that all institutions actually contributing, by scientific work, to the growth of productive forces receive all incentives—in the form of state subsidies—necessary for the continuation of their activities. In 1970, a decisive step was taken in this direction, so that our research institutions serving as a basis for technical development may start work in the Fourth Five-Year Plan period under favourable auspices.

6. FURTHER QUESTIONS TO BE INVESTIGATED

When investigating the relationships between economic regulators and technical development, several ideas and propositions emerged which could have helped technical development but were not yet ripe for practical application at the start of the Fourth Five-Year Plan period. Let us mention some of these:

a. The present proportion between the costs of live and embodied labour does not favour mechanization, automation, and generally any technical development depending on an increase of fixed assets.

b. From 1971 on, an experiment of evaluating work of enterprise executives (in the main those of large industrial enterprises) was introduced, including also considerations regarding how certain long-term objectives of technical development (extending over three to five years) have been implemented by them. Since the implementation of objectives of technical development and—in particular—their economic results will appear only after the lapse of some years, it would be desirable to extend the present experiment to a larger scale. Namely, the system of economic interests depending on the results of several years would force enterprise leaders to apply the extent of foresight so necessary for setting and accomplishing the tasks of technical development.

The present system under which 40 per cent of the depreciation allowances are withdrawn for central purposes might seem justified from the aspect of making enterprises more interested in their profits, or in view of the development tasks that have to be financed centrally. Nevertheless, this regulation tends to restrain the independence of enterprises, and also their responsibility for maintaining the level of performance of their fixed assets. Therefore, it seems advisable in the future to reduce gradually the portion of depreciation allowance withdrawn for central purposes.

Moreover, it seems necessary to ensure (in a way more effective than at present) the complementing of the enterprise-owned liquid-funds from the state budget in cases where production of an enterprise increases rapidly, without a corresponding increase in investments. Namely, the modified system of economic regulators affects—in the framework of the Five-Year Plan—primarily the investments and the increase in working assets related to them, and it is desirable to create a closer connection between the concepts of technical development and the financial resources available for their purpose.

Thus, the promotion of technical development involves modifications both in the system of economic regulators and in the extent of their application. In order to maintain the right proportions and mutual effects, it is also necessary to revise, from time to time, the relationships between economic regulators and technical development.

Chapter XI

SPECIAL REGULATORS IN FOOD ECONOMY[1]

by

KÁLMÁN KAZARECZKI

1. EXPERIENCES AND REQUIREMENTS

When introducing the new methods of economic control and management, the special features of agriculture have made it necessary to shape its system of economic regulators differently from those acting on other branches of the national economy, whereas the regulators of food processing were mostly identical with those applied to other industries.

Recent development has required, however, that the process of food production should be regarded as a consistent whole, from the output of the raw materials to their final processing and sale. Namely, an integration process leading towards the unity of food economy has begun, requiring a co-ordinated development of agriculture, industrial processing and turnover. This urges us also to shape vertical relationships between the various stages, in order to utilize the inherent possibilities for improving efficiency.

The conception of food economy as a unity has made it necessary to consider also the above objectives when improving the system of economic regulators. In the future, economic regulators must give more help to coordinating the processes in agricultural production and industrial processing, to reconcile their economic interests and, as a result, to improve the efficiency of food production in all its phases and as a whole.

Starting from these requirements, in the following we shall deal in the first line with the regulators acting under the special conditions of agriculture and, subsequently, with those regulators of industrial food processing which differ from the general

[1] In Hungary the term food economy covers the whole of agriculture, food processing, as well as domestic and foreign trade in food stuffs. When dealing with the economic regulators acting in this field, for practical reasons we do not dwell on trade sector, since here mostly the regulators generally applied to trade are involved. And, for each of space, we do not deal with the special questions of forestry either (forestry being otherwise included in agriculture according to Hungarian classifications).

system of industrial regulators, being meaningful in the first line for linking agricultural production and food processing, for developing vertical relationships and for gradually bringing into existence the united network of food economy.

When comparing averages of 1966–1970 (i.e. of the period of the third five-year plan) to the averages of 1961–1965, agricultural production increased by about 15 per cent. The output of the food industry in 1970 was 26 per cent higher than in 1965. The average annual growth of agricultural production accelerated in comparison with the preceding five-year period and slightly exceeded the planned rate.

Among the conditions of this accelerated growth, we should mention improved mechanization, a wider use of up-to-date agrotechnology, an increasing application of fertilizers and plant protectives. Another important factor was the application of new scientific achievements including creation or introduction of new breeds, of up-to-date methods of cultivation, breeding and farm organization. As a result, the growth in some branches particularly accelerated.

Although the growth of the food economy was on the whole rather quick and satisfactory, an internal disproportionality evolved. Plant growing, and the processing industries based on it, developed at an above average rate, whereas animal husbandry (most of all, meat production) lagged behind. Cattle and pig breeding were not able to satisfy demand.

Apart from improved scientific and technological equipment, an important factor to accelerate agricultural development was the circumstance that a great part of the young large-scale farms, the co-operatives,[2] were strengthened economically and organizationally after the introduction of the new system of economic control and management. In addition, the gradual rise in the prices paid by the state's procurement organizations (adding up to 18 per cent between 1966 and 1970), and an expedient system of subsidies have made it possible for these large farms to bring about the conditions of independent economic management. In most large farms, financial funds serving enlarged reproduction were created.

[2] Most farming co-operatives now operating were founded in the years 1959–1961. At present, 83 per cent of the country's agricultural population is working in farming co-operatives. They cultivate 77 per cent of all agricultural area (including household plots) and supply 70 per cent of agricultural production.

The quick growth of production, the possibilities created by giving co-operatives the same rights as to enterprises and the new "economic environment" created by government measures contributed to an increase in peasant incomes exceeding even the planned rate, so that, by 1970, the average per capita income of peasant families attained that of industrial workers' families. Growing economic incentives acting on the members and employees of farming cooperatives contributed to an improved labour discipline, better organization and higher productivity of labour.

The system of economic regulators introduced in 1968 has, however, carried an important internal contradiction, leading to structural disproportionalities in production. The regulators made the farms fairly well interested in developing plant growing but did not ensure adequate profitability for cattle breeding. At the same time, the state subsidies covering 70 per cent of all investments in cattle and pig breeding tended to lessen interest in weighting their investment objectives. As regards household plots,[3] cattle breeding involved losses, and thus livestock diminished to an extent that could not be compensated by the increase in the stocks of large farms. In addition, cattle breeding was not profitable in the greater part of large-scale farms, either.

Clearly, this conflicting situation called for substantial modifications of certain elements in the regulating system. Accordingly, the following changes were introduced by 1 January 1970.

— The prices paid by state procurement organizations were raised by 28·5 per cent for cattle, by 5·6 per cent for milk, and by 2 ft/kg for pigs.

— The state's contribution (subsidy) to investments serving for cattle and pig breeding was reduced from 70 per cent to 50 per cent.

— The sale and purchase of fodder were liberalized, restrictions on the imports of protein fodder ceased. As a result of this and of withdrawing the state subsidy on fodder prices, a price rise of about 50 per cent came about in this field.

— The price of fodder grains was reduced by 13 per cent, and the tax benefit on its sale to the state's procurement organiza-

[3] A household plot is an area of arable land (0·29 to 0·58 hectare) assigned to each co-operative member, where he or she is entitled freely to cultivate plants and breed animals (horses excepted), and freely dispose of the products gained. However, the sale of animals and animal products by the intermediary of the co-operative is connected with a certain economic advantage.

tions ceased (formerly, such benefit was due to all kinds of grains).

— Smaller upward or downward corrections of prices were introduced.

— An income tax of 8 per cent on the earnings of people employed by farming co-operatives[4] was introduced.

Experience gained so far permits us to state that the regulator system applied in recent years to agriculture functioned more or less adequately; together with its modifications introduced in the meantime, it was able to help implementing the objectives set by the Third Five-Year Plan. Thus, substantial changes do not seem to be necessary in the future. Incidentally, it would not even be practicable to start a regulating system widely different from the present one, in view of the particular character of the value relations prevailing in agriculture, as compared with those of other economic branches. Later on I shall deal with this difference. (Thus, it seems necessary to apply, even in the future, a regulating system in which state subsidy is an important element.)

Owing to circumstances calling for improvements, the part of the regulating system acting on food economy has been recently modified in view of the main objectives set for this part of the national economy by the Fourth Five-Year Plan. The main requirements against the regulating system were the following:

— It should provide added incentives to enterprises and farms to adapt their production structure to the requirements of domestic and foreign markets, that is, it should transmit better the effect emanating from the market.

It should help to improve profitability and labour productivity, as well as to reduce unit costs in all vertical stages of production,

— It should stimulate production in the household plots in such a way that the stock of pigs and poultry should increase and those of cattle should at least diminish at a slower rate.

— It should promote the assertion of economic reason on the spheres of both production and turnover, the strengthening of

[4] Only the earnings of employees and hired workers (and not the members of co-operatives) were affected by this. By this measure, the level of taxes and contributions charged on the wages and salaries became uniform throughout the national economy. (The contribution to social insurance, amounting to 17 per cent of wages and salaries, has been charged on the farming co-operatives even formerly; the new income tax corresponds to the 8 per cent wages tax charged elsewhere.)

common interests inducing agricultural, industrial and trade organizations to build up horizontal and vertical relationships and enter into co-operation agreements; finally, it should help unfolding of a multi-channel purchase and sale of products.

— It should help the personal incomes of peasants to keep on at the rate provided by the fourth national economic plan (that is, at a rate identical with the growth of income of workers and employees) and contribute to reducing the excessive dispersion of individual incomes.

— It should ensure, for each economic unit, the financial conditions of expanded reproduction, i.e., a level of current incomes and development funds that is necessary for this and, at the same time, compatible with the provisions of the national economic plan. Further, a closer relation between the incomes of economic units and their payments into the state budget should be developed.

— It should make possible the creation of stocks sufficient to eliminate the adverse effects of fluctuations in agricultural output both on the supply of population and the utilization of export possibilities; in general, to avoid excessive market fluctuation.

The main problems of modifying the system of economic regulators will be dealt with in the following, with a view to past experience and to the requirements and constraints set by the Fourth Five-Year Plan.

2. THE SYSTEM AND LEVEL OF PRICES, THE TURNOVER OF PRODUCTS

According to the estimates of the Fourth Five-Year Plan, the general level of agricultural prices will not change substantially (of course, on the assumed condition that neither the industrial prices influencing the agricultural price level will suffer substantial changes).

Differences in opinion concerning this field are not a novelty but, understandably, they have become more acute since the introduction of our new system of economic control. The particular situation of agriculture has called for a regulating system substantially different from what is applied to other branches of the national economy, and one of the most important differences consists exactly in the methods and extent of state subsidies. This circumstance, however, may give birth to misunderstandings—regarding the role of agriculture in the economy—on both sides.

In agriculture, it is mainly the prevailing price and value relations that make it necessary to apply a regulating system substantially different from the general model. (Further, in agriculture also the preponderance of collective or group property against state property involves differences in the regulators applied.) The price and value relations prevailing in agriculture do not permit income withdrawals of a proportion practised in the industry. (In agriculture, there is no charge on assets, and no wage tax.) At the same time, it is necessary to maintain a wide system of state subsidies, even if their extent has been somewhat reduced by the recent revisions of agricultural prices.

An additional motivation of this state of things rests from the point of view of the living standard policy on the desirability of relatively low food prices (involving also price subsidies to staple foodstuffs), as well as on considerations of export competitions; yet, the decisive factor remains the disparity existing between agricultural and industrial prices.

According to the price models calculated on the basis of the (preliminary) 1968 input-output tables, the proportion between producer price level and "ideal" price level (expressing the amount of social inputs plus a uniformly proportionate part of net social income, according to the principle of the production-type price) differs by economic branches.

The difference between actual and "ideal" prices (the latter being proportionate to inputs) indicates that, in spite of repeated price rises affecting agricultural products, there still exists a substantial gap between agricultural and industrial price levels. In order to attain the "ideal" level, present agricultural prices should be increased by 20 per cent; and in order to attain parity with industrial prices, a 25 per cent rise would be necessary.

This means, in other words, that in reality *the withdrawal of agricultural incomes* (ensuring agriculture's contribution to the burden of society as a whole) *still takes place mostly through prices.* At the same time, the *disparity between agricultural and industrial prices makes it necessary to grant price reductions on the industrially produced machines and materials bought and used by agriculture.*

Thus, it would be a mistake to judge agriculture unfavourably on the grounds of prevailing price and value relations. As a matter of fact, a parity in prices would also involve a parity in taxation.

When comparing price levels, we have to consider also the differences in the proportion of net incomes included in the prices. It is a fact that a much smaller portion of net income is included in agricultural prices (in comparison to industrial ones) and, evidently, also a much smaller portion of net income is withdrawn—for central purposes—from agriculture. Thus, it has been already mentioned that agricultural enterprises and co-operatives do not pay a charge on their fixed assets or a wage tax. They also pay a smaller portion of their net income (profits) into the state budget than the industrial enterprises.

In the given situation *it is thus a parity of incomes rather than a parity of prices that may be reasonably striven after*. Moreover, the approximation of agricultural and industrial price levels should be achieved (in perspective) not so much by raising agricultural prices than by reducing industrial ones (by reducing costs and/or net income content). As a matter of fact, the present proportions of agricultural and industrial prices do not seem to justify any further price rises in favour of agriculture.

The price system and the turnover of products marketed, about 80 per cent is affected by various forms of official price limitations; and for about 60 per cent of the marketed volume officially *fixed* prices are prevailing. In the Fourth Five-Year Plan period, we must satisfy two opposed requirements: an extent of *price stability* necessary for a reasonable security of production, and an extent of *price elasticity* necessary for an increased assertion or marked effects. Further, any improvement of the price system has to be conceived of as an objective to be realized gradually.

It seems that in the first half of the coming five-year period the requirement of price stability will dominate. Accordingly, for the time being no essential changes will be introduced in the present price types.

In the second half of the period, a greater elasticity of the price system seems to be wanted. This must be achieved by relieving official price limitations and in harmony with improvements in the regulating system as a whole, as well as with the gradual elimination of turnover restrictions.

A main requirement consists in narrowing down the sphere of officially *fixed* prices, and in ensuring the stability by more or less close upper or lower limits, thus leaving some freedom for the market effects to assert themselves and for seasonal price movements—rather than by rigidly fixed official prices.

Stimulating high-quality production will remain a standing task of our agricultural price policy. Prices must better reflect the value judgements prevailing in domestic and export markets, and the relative yields of the various qualities of a raw product in the course of processing.

In the system regulating the sale and purchase of agricultural and food products, in 1968 the former strongly centralized methods were succeeded by a system of multi-channel purchases and sales; administrative restrictions continued to prevail only for a few products, and even for these with a transistory character. As regards a further improvement of this system, it seems much likely that in the Fourth Five-Year Plan period the increase in the output of agriculture and the food industry will tend to strengthen the positions of purchasers against those of suppliers, so that the conditions for eliminating administrative restrictions on turnover are likely to come about. In such a situation, the demand of purchasers and of final consumers will get increasingly differentiated by qualities, and such demand cannot be met by authoritatively prescribed flows of sales and purchases. Thus, relieving the still existing constraints on turnover will sooner or later become an economic necessity (with the possible exception of a few commodities, the sale of which is closely connected with fiscal revenue, as tabacco, alcoholic beverages, etc.).

Further development of the system regulating turnover must vary according to the production and marketing background of the different products. The most important task, imparalleled as regards the methods it requires, is the *modernization of the marketing of fruits and vegetables*: improving the present multichannel methods in a sense that the producing enterprises may become more immediately interested in a better supply of the population.

Here, reconciliation of production and market requirements calls for a solution uniting various economic organizations, formerly led by different profit interests, into associations or joint enterprises based on common interest. The founders of these associations or joint enterprises should be interested in a *secure* marketing of the products in question; in other words, they should prefer marketing at low price to no marketing. Thus, expectably, they will contribute to a cheaper supply of the population.

Of course, it would be a mistake to grant monopoly rights to these new-type organizations in the marketing of fruits and vegetables. The interests of both consumers and national economy call for a broadening of market competition; in other words, not only the associations or joint enterprises mentioned above but also the state-owned enterprises, the consumers' cooperatives and even the private producers must be present in the market of these goods.

At present, all-embracing central administration prevails only for a single article: carcasse meat. Even here, we may expect that the administrative restrictions on turnover will be eliminated in the course of the Fourth Five-Year Plan. The condition of this is an equilibrium of the supply and demand of meat and meatwares (where demand includes both domestic and export requirements). In order to attain such a situation, a substantial increase in the supply of animals for slaughter — especially of pigs — is needed.

It follows from a typical feature of Hungarian agricultural production (the still important role of producing for own consumption) that prices have a rather great influence on the extent and ways of marketing. In addition, as a result of post-war historical development, the level of consumer food prices is much lower that what it should be with the present level of agricultural producer prices, and — among other things — this circumstance calls for certain constraints acting on the distribution of products and the choice of its channels.

There are some exceptional cases, too. For instance, export interests require us to maintain the state monopoly of purchasing and slaughtering cattle. Or, in order to maintain the security of producers, the state enterprises purchasing bread grain must remain obliged to buy up, at a fixed price, any quantity offered for sale.

In order to implement the objectives of the national economic plan it is also necessary to prevent periodical oversupplies from causing an excessive price fall or an impossibility of selling certain agricultural products, that is, from undermining the stability of production. Therefore, in cases of emergency it is now possible for the central authorities of the food economy (in the main, the Ministry of Agriculture and Food) to undertake market-supporting purchases. Such intervention is justified mostly in the market of young animals and breeding stock, in order to avoid a reduction in stocks as a result of unprofitable prices. This is mostly important for avoiding fluctuations in the meat supply. The risks, losses or additional costs of intervention are borne by the state, under special budget allocation. Of course, such intervention must take place only in exceptional cases, and does not relieve the purchasing and processing enterprises from making efforts to re-establish and maintain market equilibrium. For this purpose, the role of enterprise price-risk funds must be increased in the coming plan period.

3. THE SYSTEM OF ECONOMIC INCENTIVES AND INCOME WITHDRAWAL

By improving the system of economic incentives we must continue to strengthen the independent economic management of state-owned agricultural enterprises and farming co-operatives. The aim of regulation is to improve productivity and profitability in order to develop production and productive capacities, to increase personal incomes to the extent provided for by the national economic plan, and, at the same time, to reduce unjustified differences in their levels.

We should note that, in the case of the farming co-operatives, the system of economic incentives differs from what is applied in state-owned enterprises. Since the products of a co-operative are group property, it cannot be prescribed centrally how the gross income (sales returns less material costs) has to be divided between personal incomes and collective accumulation. Though co-operative members receive periodical payments in proportion with work performed by them, this is only an advance on their share in the total income. (The farming co-operatives are free to use their depreciation allowances, but only for investment purposes.)

As in the past, the state will further promote the achievement of national economic objectives by indirect means. First of all, the following circumstances are to be borne in mind.

(a) State farm enterprises are entitled to decide, within the limits set by legal rules and central income regulations, on the use of their income, as well as on the size and utilization of their various funds built up from their income.

(b) Farming co-operatives and their associations are entitled to decide on the extent and level of rewarding the work performed by their members, depending on the size of the sharing fund they are able to create from their income, and in due consideration of the proportion between personal incomes and accumulation conforming to general economic reason and locally developed practice.

The system of financial regulators will further enable farming co-operatives to pay their members advances in proportion with work up to the level previously guaranteed. The annual total of such guaranteed fees, however, must not exceed 80 per cent of the average sharing fund of the two preceding years.

(c) In farming co-operatives, the management of the funds must take place according to plans. Therefore, when planning the alimentation and use of their funds, the cooperatives must, in the interest of financial equilibrium, lay emphasis on the increase of the so-called income security fund. As soon as possible, they have to ensure that their reserves should attain about 30 to 35 per cent of the annually distributed income, since natural adversities cannot be wholly eliminated as factors influencing production.

A. *Income withdrawal*

When developing the system of regulators aimed at diverting part of agricultural incomes for central purposes (this is what we mean by "income withdrawal") it was considered as an important objective that the major means of withdrawal (in the first line taxes) should serve also the reduction of any excessive dispersion in the incomes of individual co-operatives, in conformity with the plan objectives relating to living standards. In other words, we must reduce differences in income stemming from varying natural and other endowments of the farms, and the resulting excessive differentiation of personal incomes that might lead to social tensions. At the same time, taxes must not act against improvement in economic efficiency. A potential differentiation of incomes is certainly an important motive for improving efficiency, only it must not be permitted to become excessive.

(a) *The land tax*

An important change in this field consisted in a wider differentiation of tax rates according to the quality and location of individual land parcels, and in the criteria of tax exemption for poor land were changed, so that more land is now exempt from tax. This is how the land tax contributes to reducing excessive income differences.

(b) *Income tax*

Here the main change consisted in introducing a progressive rate. Formerly, all farming co-operatives had to pay in uniformly 6 per cent on their annual sharing fund. The new rate varies between 2 and 10 per cent, depending on the average income of the co-operative members and their dependants for a day (10 hours) of work performed. If this average is less than 50 forints per day, no income tax is charged.

Incomes of employees and hired workers of farming co-operatives are taxed at the rate of 8 per cent (see above) if the daily (ten-hour) average is less than 120 forints; above this, rates of 9 or 10 per cent are applied.

The incomes of those receiving pensions or rent are exempted from the tax.

Control calculations made with sample data have shown that —other conditions being equal—the changes introduced in the system of the land and income taxes will not result in an increase of the budget income stemming from the two taxes taken together. By differentiating tax rates, only a reduction of the dispersion of income was intended.

(c) *Tax on incremental income*

As regards farming co-operatives, central influence on the level of personal incomes, as well as on the proportion between personal incomes and accumulation, is exerted—in addition to the land and income taxes—mainly by the tax on incremental income. Its political objectives is to regulate personal incomes in conformity with the Fourth Five-Year Plan, and to reduce their excessive dispersion. This tax charges a defined part of the annual increment in personal incomes at varying rates, if it exceeds the income of the base-year beyond a certain extent. The rate depends on the average level of the personal incomes, as well as on its annual rate of growth.[5] Budget incomes from this tax must be used for increasing state subsidies assigned to co-operatives working under adverse natural conditions. Thereby, the tax in incremental income has a further role to play in reducing income differences.

[5] The number of the "working population" of a farming co-operative is calculated from the annual total of working days performed and from a uniformly estimated average of working days annually performed by a person. Thus, differences of income stemming from the varying types of work are automatically considered, and the incremental income to be charged varies according to the natural and other endowments of each farming co-operative.

(d) *Turnover tax and production tax*

Another improvement of the tax system relates to the turnover tax to be paid on the ***non-agricultural*** activities of agricultural farms. Formerly, the sales returns stemming from such activities were charged at rates less differentiated than in the general practice of turnover tax. From 1971 on, the generally applied (enterprise) tax rates are applied also on the non-agricultural activities pursued by large agricultural farms. A special problem in this field continues to consist in that agricultural farms are wholly (that is, not only as regards their agricultural activities) exempt from the charge on assets and from the wage tax, and also their income tax is lower that that of state-owned enterprises belonging to other branches of national economy. It is, however, a basic principle that *similar activities should be taxed at about similar rates,* in order to ensure equal terms in competition. Thus, the cost advantage of agricultural farms pursuing non-agricultural activities has to be balanced by some form of income withdrawal. This so-called "sectoral cost difference" is being withdrawn in the form of a "production tax", differentiated according to the main categories of activities.[6]

The rate of this production tax may be reduced when the activity consists in the processing of agricultural products, whereas certain activities foreign to agriculture may be charged at higher rates.

(e) *Contribution to the communal development fund*

Also this type of income withdrawal may be considered as a tax. From 1971 on, it is paid also by agricultural farms; its rate is 1 per cent of the gross income in the farming co-operatives and 6 per cent of the net profit in the state-owned farms. (When related to net gain, the two rates are about equal.)

B. *Co-ordination of income regulators affecting agriculture and the food-processing industries*

The increasing requirements set against the extent, quality and economic efficiency of food processing involve a closer and closed intertwining between the processes of agriculture, trade

[6] Up to now, this difference has been withdrawn in the form of the so-called "turnover tax Number One".

and the food industry and, accordingly, also a closer co-ordination of the economic regulators influencing all these branches.

Such a co-ordination is called for even within agriculture itself, where, on the side of farming co-operatives, also the state-owned farms have an important role to play.[7] Although much has been done in recent years to approach the two systems of regulators acting on state farms and co-operatives (introduction of a uniform land tax and a uniform system of assigning state subsidies, divergences are still substantial, hindering the creation of associations between units belonging to the two categories, as well as their economic co-operation). In order to diminish differences, by 1971 some modifications were introduced regarding the taxation of profits in state farms (the part going to the development fund is exempted from taxation), and their contributions to social insurance was raised to 17 per cent, with the result that in the latter field their charges became comparable to those of industrial enterprises and of the farming co-operatives in respect of their employees. Another important difference, however, continues to exist in two fields: the net gain of the state farms must be divided up according to centrally prescribed proportions, and also the total annual amount of wages is regulated centrally. (See Chapter III, workers and employees of state farms receive wages and salaries; they share in the profits of the enterprise according to the general rules applied to state-owned enterprises.)

In the next stage of development, another actual task will consist in eliminating, or at least reducing, the differences in economic regulators which hinder closer co-operation between units of agricultural production and processing, the creation of joint enterprises, the utilizing of advantages which vertical relationships offer, as well as improved efficiency and better adaptation to market situations. All this can be possibly solved by modifying the budget relationships of food industry, that is by transforming the present "gross accounting" into a "net accounting". At present, food industry has to pay charges on assets, wage tax and profit tax, but at the same time it receives from the budget substantial price subsidies, since the consumer prices of its final products are lower then what would follow from the producer prices. The method of "net accounting", to be

[7] The state-owned farms supply 14 per cent of agricultural production and employ 13 per cent of the population gainfully occupied in agriculture.

introduced gradually for food industry, means that only the balance of taxes and subsidies are going to be transferred.

The transformation of regulators in the whole field of food industry needs much experience and preparation. Therefore, as a first step, only those relating to the canning and poultry industries have been changed so far. This choice was justified by the circumstance that agricultural production and industrial processing are most closely related in these two branches. In addition, it is here that increased supply and broadening markets make it urgent to develop vertical co-operation between producing and processing units. Even in these two branches, only part of the divergences in the regulating systems can be eliminated, namely the major hindrances of a closer cooperation. Accordingly, the two branches mentioned above

— will be exempted from the charge on assets and the wage tax, and

— they will be partly exempted from the profit tax (the part going to the development fund will be exempted);

— but they continue to be subjected to central regulations regarding division of profits, to taxation of sharing fund and to wage regulations.

As a result of these measures, budget incomes are going to diminish, but this will be compensated by smaller subsidies on consumer prices and smaller export-refunds.

The closed approach ("rapprochement") of the two regulating systems has been achieved in the wine industry; here, apart from the extent of retaining the amortization allowances, the regulation system of the state-owned wine estate is applied everywhere.

4. STATE SUBSIDIES

According to what has been said under Paragraph 2, the economic conditions of agriculture continue to call for state subsidies as an important element of regulation. Subsidies are important tools in the hands of the central control bodies, serving the promotion of determined objectives of production policy. When deciding on the future sphere and extent of state subsidies we had to consider, first, the rate of development achieved in the past, second, the improved efficiency of agricultural farms, third, the central measures (introduced mainly with 1 January 1970), aimed at increasing agricultural incomes, because they may make it possible to reduce the scope and rates of subsidies.

The necessary forms, extents and rates of state subsidies are subject to discussion even if, in principle, their necessity is recognized. Opinions differ mainly as regards the extent and methods (automatism) of state subsidies serving investment purposes.

In principle, there is a possibility of reducing subsidies when

— the efficiency of agricultural production is improving,

— the rate of income withdrawal for the purposes of society is reduced,

— the disparity between industry and agriculture diminishes either because agricultural producer prices rise or because industrial prices fall.

According to plan calculations but small improvements in total input efficiency can be expected in agriculture, because structural transformation is going to increase the share of the more cost-intensive branches like animal breeding, and this will reduce average improvement in profitability.

A reduction in the rate of income withdrawal (taxation) cannot be realistically expected. Agricultural farms must operate under widely different natural and economic endowments, strongly influencing the efficiency of production. It is important to reduce income differences stemming from such endowments, and the simplest method consists in the progressivity of tax rates. But in view of the particularities of agricultural production (including the high rate of the producers' own consumption) it is highly important to correctly establish the proportion between producer and consumer prices, and the same is a condition of liberalizing the turnover of agricultural products. Moreover, it is not possible to differentiate tax rates adequately if the average tax rate decreases.

According to what has been said, it would seem that the most practicable solution consists in reducing the disparity of agricultural and industrial prices. But, according to our present foresight, we cannot expect any reduction in the industrial prices influencing the agriculture price level; at the same time, considerations of living standard postulate a relatively low level of food prices, and the latter determines the level of agricultural producer prices.

Any substantial rise in the purchasing prices of agricultural products would endanger the exports of Hungarian food economy, in particular, if we consider that both in the capitalist and the socialist markets we must compete with subsidized prices based on agrarian protectionism.

Thus, consideration of economic policy are against levelling out the price disparity by raising agricultural prices. The most reasonable solution seems to consist in maintaining the present low levels of taxation and the state subsidies in favour of agriculture.

State subsidies as a complementing element income of regulation may be granted either uniformly (e.g., as a percentage of sales returns), or in a differentiated way, in order to serve the objectives of production policy. Under the conditions of a socialist planned economy, it is neither sufficient nor expedient to regulate the market solely from the side of the prices. The interests of producers and consumers related to price stability call for preferences other that those expressed in prices. Therefore at the time being we cannot do without the direct effects of differentiated state subsidies.

Agricultural development involves an above-average increase in the organic composition of capital. In our present world, the organic composition of agricultural capital is almost everywhere higher than average. The replacement (by embodied labour) of manpower being sucked away from agriculture requires increasing investment, in particular of fixed capital. In our country, the increasing burden of investment needed by a growing agricultural production may be borne only when the purchase prices of the necessary industrial products are being held on a tolerable level, and for this, again state subsidies are needed.

In its present stage of development, Hungarian agriculture is not sufficiently equipped with means of production. During the past decade, most of the machines purchased by agriculture served but as a compensation for lost manpower. The coming into existence of large farms has, apart from creating radically different production relations, also brought about better possibilities for international competition. But for exploiting these possibilities we need enormous new productive capacities, at a time when a great part of the old ones has to be discarded because of their inability of being used under the condition of large-scale farming (e.g. the buildings and tools formerly used by small-scale peasant farms).

It follows that investment subsidizing continues to be an important task. Substantial savings in this field would be incompatible with the interests of the national economy; they are conceivable only in fields where we intend to warn the producers that no greater increase in capacities is needed and only the most efficiently operating economic units should increase their capacities from their own sources.

Within their natural and other endowments, the various branches of cultivation are competing with one another in the farms, and the level of profitability gives orientation to individual economic units as regards their economic decisions and the structural changes they should strive after.

It is, for instance, decisively important to prefer investments serving cattle and pig breeding. In the absence of special incentives it may occur that agricultural farms adopt an investment policy not conforming to the desired general line of development, and even less as regards animal breeding. Therefore, the bulk of state subsidies involved by the disparity of agricultural and industrial prices has to be used for promoting the production objectives of the national economic plan.

A. *Investment subsidies*

In the implementation of development objectives, the state subsidies assigned to investments will continue to play an important role. At the same time, they are the decisive elements in the system of state subsidies, since it is by subsidizing investments that the state may best promote its long-term development objectives.

a. *Price subsidies promoting agricultural construction and plantations*[8]

Agricultural farms (state-owned or co-operative) undertaking large-scale construction and plantation works may be granted by the state a so-called "price subsidy" of 50 or 30 per cent from the price sum of the industrial product purchased by them for the purpose.

A 50 per cent subsidy may be granted to farms investing in:

— constructions and facilities serving for specialized cattle or pig breeding, inclusive of the necessary infrastructure;

— other constructions for cattle breeding,

— other constructions for pig breeding,

— cold-storage plants with a capacity of and over 1000 tons,

— water reservoirs,

— building of paved internal transport-roads

[8] In the following, only the regulations that may interest a foreign reader are dealt with, without any attempt at a full enumeration.

— plantation of cherries, sour-cherries, appricots, gooseberries, raspberries, currants, strawberries and hop-yards,

— plantation of vineyards (only in the framework of the reconstruction project of the Tokaj-Hegyalja region).

A 30 per cent subsidy may be granted for the following investments:

— constructions related to fruit growing (storage houses, spray mixers, mash basins, manipulating houses),

— constructions serving for the production, storage and processing of grapes (exclusive of bottle-filling plants),

— constructions for goose and turkey breeding,

— constructions for sheep breeding,

— constructions for the storage of grain, etc., with a minimum capacity of 300 tons,

— constructions for drying or dehydrating agricultural and horticultural products, for pulverizing vegetables and fruits,

— wells, dug or drilled, water towers, hydrophors, conduits and water supply systems,

— constructions for the local collecting, marketing and processing of milk,

— official quarters (residential buildings for employees and workers) within the farm (when equipped with public utilities),

— plantation of high-quality vineyards (only within the wine regions of Badacsony, Eger, Somló, Mátra, Szekszárd, and Villány-Siklós, and only when vinestalks of varieties determined by legal rule are planted).

— asparagus plantations.

From among constructions serving cattle and pig breeding, a 50 per cent subsidy may be granted to those

— ensuring additional productive capacities (i.e., location for additional livestock);

— destined for replacing such buildings which, according to the normatives of amortization, will be completely written down within the next three years;

— and to investments in mechanical equipment of existing buildings.

If the old building to be replaced is going to be written down within more than three years, a subsidy of 25 per cent may be granted.

Constructions serving animal husbandry may be granted a state subsidy only when they include technological equipment, water supply and electricity. (Sheds for sheep are excepted from this rule.)

Requests for this type of subsidy have to be submitted by state-owned enterprises to the Hungarian Investment Bank, by farming cooperatives to the county tax office, on the condition that they are in possession of all blueprints and official permits necessary to implement the investment in question; further, that they are able to cover (either from own funds or from bank credit) the difference between total investment costs and the subsidy requested for, as well as what will be needed for increasing the permanent stocks of working assets necessary for the operation of the new investment. Requests for subsidy will be accepted only up to the limit determined by the state budget for each calendar year.

Implementation of subsidized construction investments must start within six months from the date of the granting certificate; otherwise the certificate becomes invalid. The investment must be fully implemented within 36 months from the date of the certificate in the case of an independent complexity of investments, and within 24 months in all other cases. For every month over this deadline, the subsidized farm must pay back 0·5 per cent of the granted subsidy.

The capacity of subsidized constructions serving cattle or pig breeding must be continuously utilized up to at least 80 per cent from the second year following their full implementation; otherwise the subsidized farm must pay back 0·5 per cent of the granted subsidy for every month of the delay, until an 80 per cent level of utilization is attained.

When calculating depreciation allowances, the initial purchase, value of agricultural investments implemented with this type of subsidy must be accounted by deducing the subsidy from the total costs. This means that even the *operational* costs are reduced by the subsidy. At the same time it also means that, within the lifetime of the investment, only the difference between its total costs and the state subsidy will accumulate for replacement purposes. (Let us note that some Hungarian economists doubt the advisability of this practice.)

The state subsidy must be revoked if the fixed assets created after 1 January 1968 are used unjustifiably against their original purpose, or not used at all, or they are scrapped before their planned life-time is over.

In the field of constructions and plantations, the so-called "*automatism of subsidies*" will continue to prevail, in the sense that large-scale agricultural farms will be granted subsidies practically (that is, under the conditions pre-set by legal rules and within the annual limits determined by the state budget), to an extent depending on their *own* autonomous investment decisions. Of course, the possibilities of subsidizing are limited by the national economic plan and, accordingly, by the state budget, so that if in a given year the total of requests submitted to the Investment Bank and to the county tax offices has exhausted the annual limit, any further requests must be carried over to the next year. This practice, introduced in 1971, is called upon to maintain an equilibrium between investment demands and the capacity of the building industry.

Apart from this "automatic" system of investment subsidies, the state continues to subsidize *some other investments* aimed at incorporating large agricultural farms into the network of roads, electrical energy supply, telecommunication and the underground supply of irrigation water. These investments serve mainly the development of the infrastructure securing, as it were, the background of agricultural production, and thus belong to the development tasks of the national economy as a whole.

b. *Subsidizing of other agricultural investments and the purchase of some industrial products*

Regulation of the purchase price level of some industrial products used by agriculture includes, first of all, the state subsidies granted *for the purchase of machines and spare parts.*

The *average* rates of this subsidy (in per cent of industrial producer price, or of the import price) are the following:

— for tractors	10 per cent
— for other machines, equipment and tools	47 per cent
— for spare parts of machines qualified by the Ministry of Agriculture and Food as "up-to-date"	23 per cent.

This subsidy is paid by the state budget to the organizations selling the products mentioned.

The same aim is served by the *subsidy on the purchase of fertilizers, plant protecting agents and weedkiller*. It is paid by the state budget to the selling organizations, according to the following average rates:

— home-produced nitrogeneous fertilizers	24 per cent
— home-produced phosphorous fertilizers	43 per cent
— imported fertilizers: to an extent necessary for ensuring a proportionate purchase price for users	
— plant-protecting agents and weedkillers	51 per cent.

Also for *ameliorations* performed in agricultural plants state subsidies continue to be granted, but their method differs from the automatism described above. The amounts assigned in the national economic plan and in the state budget for this purpose are divided up by regions, according to the expected needs of each.

For each of the various types of amelioration, average rates of subsidy (as a percentage of total costs) are established. The authorities granting individual subsidies may apply—without exceeding the total limits set for them—higher or lower rates, considering the own sources of the farm in question, the varying quantities of materials needed and the distances at which they will have to be hauled. Subsidies serving the amelioration of meadows and pastures must be granted preferably in regions where larger centres of cattle breeding exist, or are planned to be created.

B. *State subsidies connected with productive activities*

a. *Subsidizing cattle breeding*

Both the Fourth Five-Year Plan and the long-term (fifteen-year) plan conceptions emphasize cattle breeding as one of the most important development objectives.

The present situation of cattle breeding, the requirements of domestic supply and exports call for effective incentives influencing the breeding in large scale farms. Accordingly, the following premia are being paid to these:

- for each live-born calf of a cow owned by a state farm or by a farming co-operative — Ft 2000
- for the live-born first calves of heifers in state or collective property — Ft 4500
- for each cow exceeding the annual average stock of the preceding year (the annual average stocks of the preceding and the current year are calculated from the quarterly averages) — Ft 8000

It would not, however, suffice to subsidize only the cattle breeding in large farms. At present, 37 per cent of the country's cattle stock is held in household plots, auxiliary farms and individual peasant plots or in small, specialized co-operatives. In order to stimulate also this kind of breeding activity, the inclusion into the breeding stock of each first-gravid heifer (stemming either from own breed of from purchase) is rewarded a premium of Ft 8000.

b. *A special subsidy for pig breeding*

One of the basic objectives of the Fourth Five-Year Plan consists in a substantial increase and stabilization of meat production. For achieving this, the breeding and fattening of pigs is decisive. In spite of considerable reconstruction and development in recent years, a good part of these activities is even now going on in old constructions where costs are considerably higher than in the up-to-date centres recently created (mostly with important state subsidies). At present, however, in spite of high investments, we cannot afford to leave the older, outdated buildings unutilized. Therefore, the government decided to grant a state subsidy of 2 forints per kilogramme of live weight on pigs produced in farms compelled to operate under outdated conditions. This measure, evidently, is not a price regulation of a general and permanent character; it is but a transitory premium paid within determined limits, during a determined period of time, and to producers working under determined conditions.

c. *Stopping of the special subsidy on the production of breadgrain*

The former tax preference accorded to farms selling bread grain to state-owned purchasing organizations has ceased by 1 June 1971. This measure is justified by the circumstances that the general spread of high-yielding sorts of grain and of up-to-date production techniques resulted in much higher yields (the average yield per hectare was 2·51 tons in 1966 – 1969) and accordingly, in a substantial reduction of production costs.

C. *Special state subsidies granted for farms operating under adverse natural conditions*

The system of income regulation generally applied in agriculture ensures the returning of costs and the possibility of expanding production for farms operating with average or better efficiency. However, *about a third of our large-scale farms operate under conditions worse than average*; their costs are higher and their hectare yields are lower than national averages. Such farms must be granted *special state subsidies*, in order to enable them to maintain their production and the necessary minimum of personal incomes.

The *basic form* of such special aids consists in subsidizing the prices of farm products, aimed at refunding costs. This subsidy can be granted to farms whose lands are at least 25 per cent poorer than national average. (We have developed an adequate system for evaluating the quality of each parcel of land.) This "automatic" form of state subsidies is complemented by a system of compensating *for harvest damage caused by natural factors*, insofar as they cannot be compensated by the insurance system.

In some farming co-operatives and state-owned farms, the general income regulators and the generally prevailing state subsidies are not able to ensure adequate living conditions for their working population. In such cases a *subsidy on personal incomes* may be granted. Only such farming co-operatives are eligible for this subsidy where the average of annual personal income per working member is less than Ft 15,000.

To state farms operating under adverse conditions where — according to conceptions elaborated and approved — agricultural or other activities might be rationally developed, a *development subsidy* may be assigned (over and above the general subsidies on investment), with or without an obligation of subsequent repayment.

D. *Subsidies promoting the employment of qualified experts*

The number of qualified experts now working in farms, especially in the cooperatives, is insufficient. This hinders in many cases the development of production, being an efficient utilization of existing productive capacities.

In view of this, the state promotes the employment of experts in various ways, first of all in farming cooperatives operating under adverse conditions where competence is mostly needed. The state subsidies granted for this purpose serve mostly for complementing salaries and for covering the costs of removal settlement.

Farms employing young experts (beginners) may receive a subsidy to complement the total earnings (salaries and income-sharing) of such people. In addition, special measures promote the employment of experts in farms operating under adverse conditions.

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In our opinion the economic regulators now applied in Hungarian economy will be able to ensure the implementation of the objectives set by the Fourth (1971 — 1975) Five-Year Plan. They will help us to increase production, improve its efficiency, ensure a more copious and qualitatively better food supply and let the food economy also to perform its important role in the country's foreign trade.

Chapter XII

ECONOMIC ACTIVITY OF LOCAL COUNCILS: ITS DEVELOPMENT AND REGULATION

by

LAJOS FALUVÉGI and LAJOS PAPP

1. ECONOMIC FUNCTIONS OF LOCAL COUNCILS

a. *Past experience and present situation*

The organs of our system of local government are the elected local councils, representing politically the population living in their area and performing the local tasks of state administration as well as those of self-government.

The *country councils* (or territorial councils) assert the directives of the central government and represent the interests of all local councils functioning in the country; they co-ordinate all social and economic activities in their territory. Each country has several districts. The town districts have their own elected councils; the rural districts have no elected bodies. Here, so-called "district offices" perform, under the control of county council, some specialized tasks of state administration.

The *council of the capital* has the same competence as the county councils. It is responsible for the elaboration and implementation of plans relating to urban development and the supply of goods and services for the population in the capital. The importance of these tasks may be illustrated by the fact that more than one-fifth of Hungary's population lives in Budapest.

In the *local* (municipal) *councils*, the tasks of self-government are predominating. These councils, beside performing tasks of state administration, are also responsible for the public utilities, social, health and cultural standards of their areas. At present, municipal councils are functioning in the 4 largest county towns, with residents 100—250 thousands in 71 other towns, in 215 larger and 1660 smaller communities.

Each *council* is a body elected according to legal rules, convening periodically in order to take decisions. Its organs are: the executive committee and the specialized administrative departments. Its executive organ is the *executive committee* responsible for implementing the council's decision. The executive committee is subordinated to the local council, to the higher (county) executive committee supervising it and, finally, to the central government. The *specialized administrative departments* comprise those controlling and supervising local industry, construction, agriculture, trade, transports, etc., and in some respect they have authority also over ministerial enterprises.

The central supervision and control of all council organizations (including the elected councils, their executive committees and their offices) is performed, in a general sense, by a central Office of Local Councils directly attached to the Council of Ministers. The supervision and control of their activities in the specialized departments (industry, agriculture, etc.) is performed by the competent ministries, with the intermediary of the councils and executive committees of the counties or of the capital, respectively.

The sphere of economic competence of the local councils has greatly changed during the past two decades. In the first years following their creation, their freedom of decision was rather restricted, in most cases they had but to implement the plans metriculously elaborated by the central authorities. It is only during the last ten years that a certain indepencence of local economic decisions unfolded, according to the requirements of national economy and the demands of the population.

During the recent few years the economic activities of the local councils tended to take the shape of a purposeful policy aimed at the development of the town and rural communities. As a result, the councils take an increasing share in the implementation of the state's housing program and in supporting private building activities; they control public utilities, educational, health and social supplies to the requirements of their population; they develop the local activities of production, services and trade. They control the whole network of primary education, about 70 per cent of budget expenditures on secondary education, as well as more than 60 per cent of the cultural institutions, 84 per cent of hospital beds, 97 per cent of ambulatory (outpatient) services, about 90 per cent of maternity welfare and childrens' institutions, 90 per cent of the institutions of social welfare. As a result of the economic reform of 1968, their economic power and their influence on the co-ordinated development of *all* economic activities taking place in their area increased; they became more autonomous.

The most substantial change brought about by the 1968 reform in the competence of the local councils consisted in reducing the operative intervention by central organs, in an increased autonomy of local councils. All this reacted favourably on the development of state consciousness, socialist democracy and brought about a more meaningful relationship between local councils, enterprises and the population.

The growing autonomy of local councils in recent years was characterized by the following:

— between the limits of their means available they are free to establish their development objectives and budget spendings;

— they are now more able to coordinate their own functions and development projects with those of centrally controlled enterprises and institutions functioning in their area;

— they become increasingly able to establish priorities according to local needs, of course, by weighing also the interests of the national economy as a whole;

— instead of the former rigid system of budgeting, they are now able to carry over their savings to subsequent years.

All this provided better chances for the unfolding of more efficient economic activities and, accordingly, also for increasing reliance on co-operation and initiative on the part of the population.

Analysis has shown, however, that in spite of all improvement in the activities of the local councils there have been some retarding factors. In particular, the following have been stated:

— Up to now, the economic competence on the local councils has been restricted to state-owned enterprises and institutions supervised by them. At the same time, however, the supply of the population living in the area of a local council depended partly on enterprises supervised by central organs (mostly ministries); and the councils have been unable to influence and co-ordinate the activities of the latter. Also the rational co-ordination of spatial and settlement development has called for a regulation of the relationships between local councils and the centrally supervised units functioning in their area.

— The system of regional planning called upon to ensure *planned development of the various areas* has been created under the old system of economic control. In lack of more up-to-date methods, co-ordinated implementation of development projects alimented from different sources and a rational concentration of means were difficult.

— The *financial autonomy* of the local councils was restricted by the low share of their "own" incomes in covering their total expenditure (in other words, by the high share of direct aids from the central budget), as well as by some unnecessary restrictions affecting their operative economic decisions.

In addition, the economic activities of the councils and the system of economic regulators influencing them had to be adapted in conformity with the changes in the general system of regulators.

b. *The trends of development*

The recent measures aimed at developing the economic activity of local councils have been based on the following considerations.

The economic tasks of the local councils are twofold:

— they organize and co-ordinate activities, according to centrally established principles, with a view to implementing in their area the objectives of *central economic* policy;

— under their responsibility for *local economic tasks,* they elaborate their own economic conceptions and organize their implementation.

The two tasks are closely inderdependent. Namely, by a correct implementation of the central objectives, also the level of local production and supply of goods and services is improved; and if local economic activities are properly managed, also the increase of central resources is ensured. Thus, the *economic activities* of the local councils must be pursued in comformity with these two sets of requirements.

The major tasks are the following:

— Settlement development (mainly by construction of residential and public buildings, and public utilities); economic management and operation of communal, health, social and educational institutions.

— The councils must ensure the satisfaction of the needs of the population to be covered by production, trade and services, partly through the activities of enterprises controlled by them and partly by co-ordinating, and helping to develop the activities of other state-owned economic units and of co-operatives functioning in their area.[1]

— As regards the tasks connected with the regional development[2] of the network of settlements, it is particularly important that the contribution of enterprises —in the form of co-operation —to infrastructural development should be ensured.

[1] Local councils also have among their tasks to supervise the activities of private artisans and shopkeepers.

[2] Regional development is used throughout this paper to denote complex areal development within a given administrative unit.

To further the economic activities of the local councils and to improve the economic regulators affecting them, a decisive requirement was *to strenghten the autonomy and self-government of the municipal councils and of those in rural communities.*

For creating adequate economic conditions for the local councils, it is invariably necessary that they should make efforts at higher incomes, they should be made interested in revealing and utilizing new sources of income, as well as in applying the principles of thrift and efficiency in their spending. They must be stimulated also to mobilize their population for contributing to works aimed at a better satisfaction of their needs and making more comfortable the community they belong to.

A greater autonomy of the local councils also involves a greater responsibility for regional development, and thus also a greater responsibility in respect of the population. All this is intrinsically associated with what we mean by unfolding socialist democracy, by participation of the population in the management of public affairs. Namely, under such circumstances it becomes inevitable to ask for the opinion of the population.

This direction of development requires *circumspect in planning* the economic activities of the local councils. This aim is served also by establishing by law, *for five years in advance*, the state revenue sources accessible to the local councils, their shares in such incomes and the amount of additional subsidies to be granted to them by the central budget if needed. This system enables them also to save some of their incomes for the future, since the financial means not utilized in a given year are not withdrawn, they may be carried forward to the next year.

The improvement of the economic activities of the local councils and, in particular, their increased independence and responsibility involve *a clear-cut delimitation of the tasks of the various councils*. This requirement follows also from the fact that each local council has some particular task of its own. Despite the common features, the economic tasks of the territorial and municipal (local) councils are different. A distinction must be made as regards the character of the economic activities and the grade of autonomy between the *municipal (local) councils* organized in a given settlement (rural community, town and capital) and the *territorial councils* responsible for the area of a county.

The main task of the municipal (local) councils consists in the development of the settlement in question, in maintaining economic units serving the utilities, health, social and educational supply of the population. Accordingly, they must be provided with a *development fund* and an independent *budget*, they must be granted central subsidies in conformity with the legal rules, and they must be able to contract bank credits.

The *councils of the greatest country towns* having greater responsibilities and outstanding scope also in other respects, fall under particular consideration. Namely, each of these towns has a large sphere of attraction where employment and supply of the population depend on the town. Since, however, this sphere of influence belongs to the county in which the town is located, the development plans of the town cannot be detached from those regarding the county, even if development in the town is faster and of a different character.

The *districts of a county*, as a rule, do not represent separate and homogeneous economic units; they cannot be considered as areas of independent economic competence. The role of the district offices consists mainly in helping and making more efficient the activities of the councils of rural communities and — in some exceptional cases — in operating certain institutions that can be run most successfully on the district level.

The *county council* continues to perform, in order to improve the supply of its population and to develop the towns and rural communities located in its area, certain autonomous functions. It may create and operate enterprises and institutions supplying several settlements. Thus, the economic activity of the county council is considerable:

— it establishes the extent of incomes of each town and rural council to be derived from the amounts ceded by the central budget;

— it may grant subsidies to the town and rural communities in order to subsidize development projects;

— it has to level out differences existing within the county in the social and educational supply;

— it has to take part in, and co-ordinate, the spatial and settlement development in its area.

The *council of the capital* performs functions, among them economic ones, the importance of which goes beyond the strictly municipal activities. Some of these economic functions have an importance for the country as a whole, e. g. the maintenance of many national institutions, the organized removal to the countryside of part of the industries formerly operating in the capital, etc. The council of the capital performs an outstanding role also because the importance of the various development measures affecting its sphere of attraction requires strictly co-ordinated planning and implementation.

The autonomy of local councils is increased mainly by decentralizing some spheres of competence that had formerly belonged to a central authority. Here, the leading principle is that the right of decision should be accorded to the level where information needed for a correct decision is most abundant, and the conditions of implementation are most favourable. With their growing autonomy, also the responsibility of the local councils increases. Greater tasks and wider competence require more of better-qualified manpower. Thus, the correct functioning of the councils depends on various conditions.

Spheres of competence can be decentralized only when all these conditions are present. Therefore, the indepencence of local councils can be increased and the sphere of their autonomous functions can be widened only *gradually*. Independence can be increased at the time when and to the extent this is made possible by improved operating conditions. In the case of economic independence it is particularly important to ensure the necessary qualification and competence of the leaders, the efficiency of supervision and, in general, of all work performed. It is also an important requirement that the supervision of enterprises controlled by the local councils, as well as the control and maintenance of institutions, should be entrusted exactly to the type of local council where they can be performed most efficiently.

c. *Territorial interrelationships*

One of the most important theoretical and practical problems arising in connection with the economic functions of the local councils is how to regulate their relationships with the economic organizations operating in their area but *not* belonging under their supervision. In recent years, the influence of local councils on the economic development of their area as a whole was much increased. In the course of such activities of the councils, relationships of varying form and contents have developed between them and the enterprises, co-operatives and institutions operating in their area. On the level of counties and towns such relationships came into existence spontaneously as a result of local initiative, and they were rather rudimentary. Still, they produced considerable results in many fields, including the joint implementation of development projects serving an improved supply of the population, and even the joint operation of certain units. They were two-way relationships: not only the "external" organizations had helped the local councils in performing their tasks but also the latter could afford assistance to the "external" organizations for solving their development and operational problems.

Based on experience and special investigations, our recent measures were aimed at strengthening the position of the local councils and to enable them to bring about more close economic and budgetal relationships with all organizations functioning in their area. The motive of these measures was twofold. First, if the economy of a region develops quicker than it has been planned, also the local council should be given a share in the additional gain, in order that it may improve the living conditions of its population. Second, the local councils themselves should look for possibilities of increasing the number, and improving the work, of economic and other organizations satisfying the needs of the population; and some of these possibilities consist in associations with external organizations, in the joint creation and operation of certain units.

This aim may be served by such a type of financial links as may make the local councils economically interested in their area's economic development as a whole, instead of being one-sidedly interested in the development of the enterprises directly controlled by them (practically this was the case before 1970). The council's interest in the development of the "external" organizations operating in their area must gradually increase and, after some time, they should become almost equally interested in the development of all three sectors of the economy, namely, the centrally-controlled, the council-controlled and the co-operative sectors. This, of course, will not alter the principle that the local councils have to perform, as regards the enterprises founded by them or entrusted to their supervision, the same functions stemming from state ownership as are being performed by the ministries in the case of centrally-controlled enterprises; nor the fact that both categories of state-owned enterprises are subject to the same rules.

Eeonomic relationships of the local councils—in particular, the council of the capital and the councils of the counties—with the external economic organizations operating in their area can be established most generally in the framework of the *regional development plans*. (Up to now, the lack of such plans hindered the co-ordinated implementation of a development project affecting a given area, a more concentrated and thus more efficient utilization of resources and, in some cases, it has also led to a reluctance to coordination.) The regional development plans of the capital and of the counties include, in addition to the development projects of the council, also those parts of the plans of 'external' organizations operating in the area which affect the council, either because the council will have to satisfy certain needs (e. g., in the field of public utilities), or because the projected development will substantially influence the living conditions of the population (e. g., by increased employment) or—in the case of infrastructural development—it will considerably affect the general way of life (e.g. maternity and childrens' institutions, educational facilities, etc.).

The necessity of taking into consideration, in the planning work and in the economic activities of the local councils, the central objectives regarding regional development and their implementation became one of the most actual questions, since the role of the local councils in regional development has greatly increased.

Before the end of World War II, economic development by regions was spontaneous and incidental. It has resulted in an excessive concentration of the country's industry in the capital. Since then, the transformation of production relations and the rapid increase of productive forces have corrected much of the former disproportionalities in the geographical location of productive forces.[3]

In spite of the results achieved, concentration of productive forces in the capital is still excessive. Economic efficiency is still handicapped by the circumstance that the geographical location of productive forces is not yet adapted to the natural and economic endowments of the various areas. This affects unfavourably also the living conditions of people in the less developed regions. In areas where natural resources are scarce, the full employment of the population and the ensuring of an acceptable income level are still problematic.

All this calls for a well-weighed regional development policy, particularly in our days, because we have now attained a stage of economic growth where the basic objectives of a regional

[3] This process may be characterized by the fact that between 1960 and 1970, the share of the capital in total industrial employment of the country fell from 51 per cent to 35 per cent. At the same time, the former great differences in the income levels of the various regions diminished to 10–12 per cent.

development policy cannot be achieved simply by putting a brake on extensive industrial development in the capital and by accelerating rural industrialization. At the actual stage of intensive economic development, in addition to increased efforts to fulfil social objectives, it is also necessary to reveal the possibilities of improving economic efficiency inherent in regional development.

The policy of regional development is aimed at a more proportioned and co-ordinated location of productive forces throughout the country's area. Conceptions regarding this assume concrete form in the long-term, medium-term and annual national economic plans, as well as in the plans of the local economic councils, co-ordinated with the former.

Objectives and requirements connected with a better location of productive forces (manufacturing and agricultural plants), as well as with infrastructural development involved, have made it necessary geographically to delimit certain regions of our country where economic underdevelopment and other problems causing permanent social tensions are characteristically concentrated. In this context the Fourth Five-Year Plan provides for measures aimed at solving gradually the problems of these underdeveloped agrarian regions, and at changing the industrial structure in others where formerly coal mining predominated,[4] and at the selective economic development of the capital and its sphere of attraction.

These objectives of regional economic development policy are served also by the plans of the local councils, by their co-ordinating activity and by certain special economic regulators.

The local councils elaborate both medium-term (five-year) plans and annual plans but the *basic form of planning is the five-year plan.* Thus, in relation to the past when annual plans represented the basic form, the plans of the local councils tend to become better founded and to embrace larger perspectives. The councils of the counties, the capital and other towns, as well as of the rural communities, elaborate development plans and budget

[4] Transformation of the structure of energy supply will be accelerated in the next five-year period; the combined share of mineral oil and natural gas will increase from 43 per cent in 1970 to 53–55 per cent in 1975. The output of coal mines supplying better qualities will increase whereas that of mines operating uneconomically and supplying poor coal will diminish. In the regions of such mines the industrial structure must change in favour of engineering, light industries, etc., that may ensure a long-term economic development of these regions.

plans, the latter including also expenditure for the operation and maintenance of already existing economic units.

The importance of annual plans will consist invariably in that they establish the time shedules contained in the Fourth Five-Year Plan more accurately, perform the necessary corrections and prescribe the tasks of the year according to what has been previously achieved.

It was for 1971—1975 that the local councils elaborated regional development plans for the first time. Such plans are linked mostly with the councils' own tasks. Namely, according to the general principles, the enterprises elaborate their plans themselves and these plans are approved only by the director of the enterprise. Still, it is very important that the production and development conceptions of the enterprises should be in harmony with the general situation of the geographical area where they operate. This can be achieved if the local council sums up, first, the requirements set by the external organizations against the infrastructure and public services and, second, the expectable influence of the development planned by "external organizations" on the supply and living conditions of the area's population. All this materializes in the area's development plan that sums up all conceptions relating to this area and serves as a basis for a more efficient co-ordination.

The councils may afford great help by stimulating and co-ordinating such development conceptions of enterprises that may become important for their area.

The elaboration of regional development plans may reveal substantial possibilities of a closer economic co-operation between the local councils and the external organizations operating in their area. They make it possible to sum up, in a uniform framework, all the development conceptions of various types and contents, and open new possibilities for unfolding initiatives coming from the enterprises and the population. All this is reflected in the intention of the government to strengthen *the activities of the local councils aimed at co-ordination.*

Up to now the co-ordinative activities of a local council were restricted to investments to be made in a given settlement. In order to open the possibilites mentioned above, it is necessary, however, to expand co-ordination in space and time, to make it more comprehensive in economic problems. The basic principle of such co-ordination rules that the joint development and operation of economic units or institutions must be useful and advantageous for each of the participants, it should create a community of interests and must not interfere with the autonomy and the right of decision of the participating organizations. Therefore, its methods may be only those of request, invitation, and, as a result, contracting on the basis of mutual advantages.

Further improvement in the regional planning performed by the local councils and in the co-ordination of conceptions stemming from the various branches will be served by the *planning committees* recently organized in the capital and the counties. The planning committee will be an important organ ensuring a complex survey of all economic activities performed in a given area and the co-ordination of all development conceptions relating to it. The committee consists of the leading functionaries of the local council and of the external economic organizations, as well as of other economic and technical experts. Its composition enables it to take the preliminary steps in elaborating the plan of the local council and of spatial development, as well as to follow up its implementation. The improvement of co-ordination requires also that it extends in addition to investments, also to the operation of the trading network, to the supply of services, to balancing the demand and supply of labour, the capacity of building organizations and the demand for it, as well as to such other economic activities performed in the area as are deemed possible and necessary to be planned and followed up.

The basic condition of co-ordination is that the councils should have the adequate legal power and financial means. Development projects and major reconstruction plans must be brought to the knowledge of the council of the area in due time. On the request of the council, also the banks have to supply information on these. According to the existing legal rules, the local council concerned has a right to demand (from the supervisory organ of the external organization in question) to renew negotiations regarding co-ordination if thus a more economical solution may be expected and if the organization in question refuses to negotiate.

In order to ensure the financial means wanted for efficient co-ordination in the case if any of the interested organizations were in lack of funds, it is possible to resort to intermediary solutions, e.g., bank credit or a subsidy from the funds of the local council.

The recently-made legal rules regulating the economic activites of the local councils and their development have set up an adequate framework for unfolding these activities to a greater extent than it was possible in the past. The ways and means of all this are ensured by the system of economic regulators.

2. THE FINANCIAL FUNDS OF THE LOCAL COUNCILS

The principle governing the 1968 reform of the budget system of local councils was that they were to be made more interested in the functioning of the economic sector controlled by them; in other words that, over and above their traditional sources of income (taxes paid by the population and co-operatives, levies and fees, etc., charged by council organs), another decisive part of their budget income should be supplied by the enterprises supervised by them. Accordingly, the whole amount of the wage tax, charge on assets and profit tax paid by these enterprises was ceded to the supervisory local council.

More recent conceptions regarding the autonomy of the local councils have made it possible to improve the system introduced in 1968. It has become clear that the system regulating their financial funds has to serve the following two objectives:

— to strengthen their economic independence,

— to shape their financial and economic interests in a way that their assertion should serve the objectives of society as a whole.

The economic activity of the local councils is served by two kinds of financial funds: *by their budget and by their development fund*. The size of these funds is regulated centrally, by defining the sources of income alimenting them and establishing their percentual shares in these incomes. The aim of this regulation is that the composition of incomes must

— conform to the equilibrium requirements concerning central and local financial funds;

— serve the objective of the national economic plan as regards regional development;

— support the maintenance, operation and improvement of communal, health, social and cultural institutions;

— ensure for the local councils a share in the results achieved on their territory;

— contribute to levelling out the differences existing in the level of economic advancement and supply among the various areas.

In establishing the above requirements, also the consideration of the interdependence between the tasks of the local councils and the economic development of the area as a whole has been weighed, since the latter influences the size of the population, the number of people industrially employed, the extent of urbanization, as well as the income and demand of the population.

In preparation of the regulation, investigations have been performed regarding the correlation between the extent of the tasks of local councils and the level of economic advancement. They showed that, whereas the level of the productive forces differs widely by regions, differences were substantially smaller in the demands of the population to be satisfied through the councils' work.

This may be explained by the fact that the tasks of the councils belong to two main groups. To the first belong such tasks of public service, health, social and educational character as are performed by a network of institutions providing for the most important, "basic" supply of the population. As regards such supply, the requirement is justified that demands must be satisfied to the same extent everywhere, regardless of the local structure and level of production.

The second group includes further tasks involved by the processes of industrialization and urbanization, that is, representing a *qualitatively higher level* of public services, health and cultural supply of the population (e.g. dust-free roads and streets, closed canals, cultural institutions of a higher degree, etc.).

The latter kind of demands and tasks is less related to the size of the area and the number of its population than to the development level of productive forces and to the character of the settlement in question. Since, however, the tasks of the first group are overwhelming, it is understandable that the combined tasks cannot substantially differ by the various areas of the country, and the differences existing in the level of economic development are but moderately reflected by the total amount of tasks to be covered by the budgets of the various local councils. On the other hand, it is also evident that we must not aim at a perfect equality, in the case of every local council, of the proportions between their various tasks. Demands are differentiated, depending on the level of economic development and on the conditions of settlement and employment.

These considerations have led to the idea that, to the incomes of the local councils stemming from "traditional" sources, other incomes should be added from sources representing the total income realized in the area in question, and the *shares* of the councils in such income sources should be *differentiated*, depending on the level of economic development. Namely, if shares were equal throughout the country, there would be wide gaps between incomes and tasks of individual councils. And if shares were rigidly established, say, for a five-year period, the gaps would even tend to increase, with growing income surpluses in the advanced areas and growing deficits in the less developed ones. By differentiating the shares it may be ensured that the effect of economic growth should be felt everywhere, in such a way that the relative rate of increase of the councils' income will be smaller in the advanced areas and greater in the less developed ones.

The new regulation according to which a local council shares in the tax revenues from all enterprises and other economic units operating in its area makes the council interested in all economic activities. It brings about a *de facto community of interest* between the local council and the economic units operating in its area, regarding the creation and maintenance of the various utilities and other infrastructural facilities (e.g., water supply, canalization, health and educational institutions, etc.). These institutions serve the interests of all enterprises, co-operatives and institutions operating in the area, regardless of the sector they belong to, either as conditions directly needed for their productive activity, or by supplying people employed by them. Mutuality in this community of interests has been accomplished by the regulation permitting that from 1971 on the local councils may contribute, from their own development funds, to the expansion of the fixed or working assets of *any* enterprise operating in their area.

It seemed invariably necessary to distinguish between the *current budget* of the local councils and their *development fund* serving for investments. These two categories are influenced by different sets of economic regulators and different income sources are assigned to them, in order to control the proportions of consumption and accumulation.

The widening of income sources available for local councils (by cession of a part of "central" incomes to them) has made it necessary more profoundly to investigate the nature of the various incomes. The greater part of net social income rests on centrally established legal rules, according to which the state-owned enterprises (controlled whether centrally or by the local councils), the co-operatives and the population perform their obligations towards the state.

The partial cession of some central incomes to the local councils *involves for the latter also certain constraints regarding the use of these incomes*. Such constraints are consistent with the general conception that the local councils, when using such incomes, perform tasks entrusted to them by society as a whole, that is, by the state. Namely, in the framework of our social and economic system it is not possible to make a sharp distinction between the tasks of the state (i.e. central) authorities and those of the autonomous local councils (see, e.g., the tasks of education and health). The tendency of the central authorities to cede an increasing number of tasks to the local councils is motivated by considerations of economic efficiency, but their performance must be controlled centrally in various ways.

Although we continue to distinguish between local and central incomes and tasks, in principle the basis of such distinction consists not so much in the character of the various income sources or tasks as in the practical fact that the state shares its tasks with the local councils in such a way as it seems expedient from the point of view of their more efficient performance.

Considering all this, the "autonomous" revenues and the "derived" incomes of the local councils (that is, those based on own resources and those ceded to them by the state budget) may be delimited as follows:

— Autonomous (local) revenues are those which fall into the exclusive competence of the local councils (e.g. fees for occupying a certain area, market fees, parking rates, etc.), further those which determine in the framework of centrally established rules (e.g. contribution of the population to the local development, certain taxes on the population etc.,) and finally, which are directly collected by the councils.

— Derived (divided) incomes are those which are centrally determined in the framework of the general system of income regulation. The councils are generally not authorized to establish their concrete extent, to reduec them or to allow exemptions from them.

The first group is due in full to the councils, but as regards the second, in the majority of cases, they are entitled to a definite share only.

3. REGULATIONS FOR THE FOURTH FIVE-YEAR PLAN PERIOD

Starting from the regional development objectives of the national economic plan, the local councils elaborate their *five-year financial plans* for the same period, in order to create a basis for their medium-term economic conceptions and to ensure an efficient use of their sources. The financial plan includes estimates regarding the budget and the development fund of the council for the period of five years.

For the purpose of elaborating plan proposals in this respect, the councils are provided with information by the Ministry of Finances and the National Planning Office. Also the branch ministries—in the first line the Ministry of Health and the Ministry of Education—take part in this work, asserting, as far as possible, their specific policies. In the course of calculations, consideration must be given to the amounts needed for implementing the investments whose "targetwise aggregate limits" figure in the national economic plan as a lump sum (in so far as they concern the tasks of councils), as well as to the equilibrium requirements of the state budget.

For elaborating their five-year financial plans, the following informations are available for the councils of the capital and the counties:

— the rules relating to and the economic regulators affecting the budget;

— indicators expressing the level of utilities, social, health and educational supply of the population at the time of planning, and the level of the same indicators proposed for the end of the five-year plan period;

— the proposed normative of expenditure (for the increase by one unit) for each of these indicators;

— special planning directives for each individual branch.

The *economic regulators affecting the budgets of the Budapest and county councils* establish the amount of incomes due to their current budget and to the development fund.

The *budget incomes* are the following:

Autonomous sources:

— operative incomes of institutions supervised by the council;

— taxes paid by the population; money fees and duties charged by the council.

Sources divided between the central and local budgets (according to varying proportions):

— the wage tax and the charge of fixed and working assets paid by state-owned enterprises operating in the area of the council, as well as their contribution to communal development;

— the wage tax paid by the industrial and trading co-operatives, and their contribution to the communal development fund;

— the land tax, income tax and the tax on motor vehicles paid by the farming co-operatives, and their contribution to the communal development fund.

Direct subsidies paid from the central (state) budget to local councils.

The *incomes of the communal development fund* are the following:

Own sources:

— contribution of the population to the communal development fund;

— the ground tax and a proportionate contribution to the development fund for public utilities;[5]

— the rent paid by the state-owned enterprises, industrial and trading co-operatives for the grounds used by them;

— other incomes.

Sources divided between the central budget and the local councils:

— a share (generally 40 per cent) of the depreciation allowances of the enterprises supervised by the local councils;

— the contribution to the development fund of public utilities paid by other state-owned enterprises and by the industrial, trading and farming co-operatives operating in the area, on the basis of differentiated rates.

Direct contributions of the central state budget to the local budgets.

Many of the revenues belonging to groups (a) and (b) serve, at the same time, also as important elements of the system of economic regulators affecting the enterprises and co-operatives, and thus they are adapted rather to the requirements of influencing enterprise and co-operative activities than to those stemming from the tasks of the given local council. Therefore, it is necessary to divide the incomes of group (b) between the central and local budgets according to varying proportions, in order to bring about an equilibrium of the tasks and incomes of each council.

It follows that it is not possible to regulate local budgets merely by letting them share in the central incomes uniformly. It is necessary to consider the desired increase of the tasks connected with public consumption, both for the totality of the local councils and for each one separately. Thus, if in principle the local budgets are regulated from the side of incomes, in practice the incomes themselves depend on the income sources

[5] These are paid by the population; the ground tax depends on the size of ground available for contribution, and varies between 1 – 10 forint per *öl* □ (equalling about 3·5 square metres). The contribution to the utilities development fund is paid when public utilities and roads are being constructed; it amounts to 1,500 to 6,000 forint for each building plot and for each separate project.

of the central budget and on the proportions in which they are shared with the various local budgets and on the extent of direct state grants as well; in other words, on calculations regarding the expected and justifiable needs of each council.

In order to ensure the equilibrium between revenues and expenditure, the five-year trends of incomes stemming from the various sources are investigated. These trends seem to differ, according to the economic structure and development level of the various areas.

Considering these differences, the 19 counties were grouped into three categories: industrially advanced, moderately advanced and least industrialized. The capital of the country is a category by itself, in view of its special situation.

The share of the county councils in the *wage tax* is equal in all three categories but it is much less in the case of the capital. As regards the share in the *charge on assets*, this is highest in the industrially less advanced counties where 100 per cent of this income (that is, 5 per cent of the value of the assets charged) is ceded to the local budget. In the moderately developed industrial or agricultural regions the shares vary between 60 and 100 per cent (3 to 5 per cent); in the industrially most advanced counties they are between 20 and 50 per cent (1 to 2·5 per cent), finally the council of the capital receives only 10 per cent (0·5 per cent of the value of the assets charged).

Regions	Income of the local councils, as a percentage of the basis of assessment	
	wage tax	charge on assets
I. Industrially developed counties	0·8	1·0 – 2·5
II. Moderately developed counties	8·0	3·0 – 5·0
III. Least industrialized counties	8·0	5·0
IV. Budapest	1·0	0·5

The contributions paid to the communal development fund (for public utilities which see later) are wholly due to the local council in all regions.

By differentiating income shares it was possible almost to level out, for all counties, the ratio of direct state subsidy to their total income. As a result, all counties (and the capital) will have, during the Fourth Five-Year Plan period, *an approximately similar proportion of "dynamic" income sources* (i.e., such as will grow parallel with economic development) to their total income. In this five-year period the relative importance of incomes derived from sharing the wage tax and the charge on assets with the state budget will increase. This tendency is favourable because, although these incomes are influenced by the feasibility and extent of local economic development, they do not depend directly on changes in enterprise profits, and thus they represent fairly safe sources or revenue for local budgets.

According to our estimates, the aggregate income of the councils from the sources listed will grow at a higher rate rate than their expected expenditure, so that the amount of *direct subsidies from the state budget* is likely to decrease continuously.

The former function of these subsidies of covering local deficits will cease or substantially diminish in the future. Instead, they will serve for gradually levelling out regional differences existing in the basic supply of the population. Thus, contributions from the state budget will become the tools of a purposeful central policy aimed at eliminating the observable disproportionalities in performing the councils' belonging to the first group.

Already an initial step was made to introduce this function of state contribution for the Fourth Five-Year Plan period. The five counties found relatively most backward as regards the basic supply of the population receive special subsidies from the state budget. Of these, 41 per cent will have to be used for improving educational and cultural supplies, 31 per cent serve the development of public utilities and 28 per cent will be used for improving basic health and social provision.

The income structure of local councils was decisively changed by the *communal contribution of enterprises and co-operatives* introduced by 1 January 1971. Every enterprise, industrial and trading co-operative has to pay a specific part (for the time being 6 per cent) of their gross profits (profits before tax) to the council in whose area they are operating; the farming co-operatives pay 1 per cent of their gross income.

Each county council has, in consideration of the regulators established for it by the budget law, *to provide adequate income sources for all towns and rural communities located in the county.* The council of the capital has the same duty against the district councils. The councils of the counties and the capital elaborate five-year budget plans of their own, and establish budget regulators for each town and rural community supervised by them.

In order to strengthen the economic independence of local councils, it is primarily necessary adequately to expand and stabilize the income sources available for the councils of the towns and rural communities. It is characteristic for most rural councils that, regardless of the principle followed when assigning their income resources, there will always appear substantial differences between the budget incomes and the necessary expenditure of the individual councils.

In general, however, there exist even now possibilities of making the income distribution between individual towns and rural communities belonging to a given county more proportionate and of ensuring for each of them an income increasing at about the same rate as its tasks and responsibilities are likely to grow. In the case of towns and developing rural communities it is expedient to establish their income sources (including the proportions in which they will share in the incomes of the state budget) in such a way that their incomes cover the bulk, 80 to 90 per cent, of their expenditures, and the expectable growth rate of aggregate income equals the rate at which the requirements connected with the development of the settlement in question are likely to increase. This latter aim is served by the principle ruling that the councils of towns and rural communities must be given a share in what the enterprises and co-operatives operating in their area are paying to the county council (even if the seat of the economic unit is elsewhere).

The territorial councils, i.e., the councils of the counties and the council of Budapest (the latter in relation to its district councils) bear an enormous responsibility for the correct regulation of income sources of all councils subordinated to them. Namely, this regulation extends over five-year plan period and the sphere of sources assigned to individual councils or the proportions of their sharing in central incomes can, as a rule, not be changed during this period.

Thus, the methods applied by the territorial councils for regulating the incomes of the councils subordinated to them deserve profound attention. Here, some alternative solutions are conceivable.

— In adequately developed areas the principle would be that the councils of the towns and rural communities should freely dispose of all their "own" income sources and, over and above these, they should share in the contributions paid to the county council by all "external" organizations operating in their area. The advantage of this conception consists in that a direct community of economic interest develops between the local council and all economic units operating in its area. As a matter of fact, this is an adaptation to a lower level, of the principle applied in the case of the county councils.

– Another solution – seeming most expedient in the case of less developed areas – consists in that only the "own" income sources (or even but a part of these) are being made available for the local (in most cases rural) councils, without any sharing in the central incomes. The advantage of this conception lies in its simplicity and in the possibility of applying uniform principles for regulating local budgets. Its drawback is that it prevents from developing any community of interests between the local council and the external organizations operating in its area.

– In the third conception the council of the county and the councils of the county towns and rural communities belonging to this county would share in the *aggregate* income of the county as a whole (including also the subsidies paid by the state budget), according to previously established percentages. In our opinion, this is the least expedient of the regulation methods mentioned. True, it has the advantage that each council belonging to a county would share in all income sources, regardless of what economic units operate in its area; subsidies paid by the county council to the subordinated councils would not become necessary, and the rate of income surpluses (or deficits) would be the same for each council. However, the drawbacks of the method would consist in that, first, the local councils would not become interested in an autonomous and expedient planning of incomes, second, the differences in the character and tasks of the various towns and rural communities could not be adequately considered. Instead, the income structure of all local councils belonging to a county would become almost uniform.

4. OPERATIVE ECONOMIC ACTIVITIES

Operative economic activities of the local councils are based on the annual estimates regarding the *current budget* and the *development fund*, as well as on informations supplied by central authorities.

For establishing the current budgets:

– the *parliament* determines – in the framework of the budget law – the amounts of state subsidies to be granted to the councils of the capital and the counties;

– the *government* determines a few obligatory provisions: the total payroll of the local councils and its part utilizable for paying the administrative staff, and the expenditure to be used for the renewal of roads, bridges and state-owned residential buildings. The local councils are free to decide on every other item of expenditure.

As regard the size of the *communal development funds*, the state's contribution to these is also determined by the budget law. The contribution of the state serves as a partial cover for the councils' expenditure on implementing some investments included in the form of "targetwise aggregated limits" (or: lump-sum investments, such as government housing, county hospitals, development of the network of secondary technological education).

The councils of towns and rural communities elaborate their own budgets and development projects aimed at implementing their medium-term conceptions. They proceed in the knowledge of the obligatory tasks prescribed to them by the county council, and of the amount of subsidy the county council is going to pay to them (in consideration of their other, formerly established incomes). Councils of rural communities have no separate development funds, their expenditure serving development is included in their current budget.

The medium-term (five-year) financial plan of the local councils provides basic orientation for elaborating their annual budgets. Its importance consists in that the sources of revenue are essentially determined in the five-year financial plan, so that it reveals the limits of expanding the council's economic activity.

Decisions relating to the annual budget usually do not change the income structure of the council. Elaboration of the annual budget is aimed at a more exact determination of the various incomes and tasks. In the course of this procedure, the national economic interests are more directly asserted by an exact determination both of the subsidies to be granted by the state or the supervisory council and of the obligatory tasks and expenditures. On the other hand, in a more exact knowledge of their annual tasks and sources, the local councils may make their estimates in greater detail.

In the interest of an elastic adaptation to actual requirements, the local councils have the right to change, in the course of the year, their annual budget and development estimates. This can be done either *within* the budget or the development fund, that is, by using additional incomes, saving in expediture or budget reserves, or by re-grouping sources and expenditures *between* the current budget and the development fund.

The executive committee of each local council must *report to its council every half-year and annually on the realization of the budget and development fund estimates*. The data of these reports serve partly to assert the right to information of the local council and partly a general review, on national level, of effecting the state budget.

a. *The system of money supply*

The incomes stemming from the own resources of the local councils (e.g., the taxes paid by the population) are collected by the councils' own financial organs.

As regards the *incomes shared between the central and the local budgets* (wage tax, charge on assets), the shares due to the local councils are transferred by the regional organizations of the Revenue Directorate of the Ministry of Finance according to a "plan of income regulation". This plan has to be elaborated on the basis of the medium-term (five-year) financial plan for each council separately: it includes all sources of income and the rate at which the council will share in them.

The participation of the Revenue Directorate in the money supply of the local councils is necessary in order to ensure uniformity in handling some of the most important revenues of the state and in the general control of taxation. The circumstance that this apparatus supplies continuous and up-to-date information both to the central and the local authorities is very important. The most important function of this apparatus consists in accounting the incomes collected to the state budget, the councils and the enterprises or co-operatives.

The *direct state subsidies* granted to the local budgets are made available to the councils by the Ministry of Finance each quarter. State contributions for the implementation of investments included in the national economic plan in the form of "targetwise aggregate limits" are made available to the competent county council proportionately with implementing such investments.

b. *The utilization of budget means*

The financial means provided by the current budget serve the maintenance of institutions and the performance of other tasks. The local councils may use these means only for the purposes determined by the budget and in proportion to the actual performance of the various tasks for which they have been provided. The legal rules regulating the proceedings of organizations alimented from the budget must be observed also by the local councils:

— The right of handling its payroll independently—within the annual wage fund determined by the budget—is generally due to every local council.

— Funds for renewals must be created also by the local councils in proportions to the gross value of fixed assets. Unused funds in a given calendar year might be transferred to the next year, to be used for purposes of renewal.

— For some major institutions (e.g., hospitals) supervised by a local council, the council may grant the right of managing their payrolls and creating funds for renewal independently.

c. *Utilization of the development fund*

The financial means of the local development fund may be used:

— for improving the level of communal supply (housing, public utilities, health service, education, etc.) and for developing the network of institutions alimented from the budget;

— for increasing the development funds (fixed and working assets) of enterprises and plants operating in the council's area, in particular those of the bakeries, the building industry and the industries employing people with reduced ability to work;

— for assigning a starting capital to enterprises and institutions founded by the executive committee of the council within its competence of supervision;

— for the development and renewal of sports facilities, for preparing residential buildings sites to be sold, for aiding investments of the budget and sports institutions, as well as the development projects of citizens' associations to construct public utilities.

Some of these expenditures (public housing, development of hospitals and of secondary education) are obligatory prescribed for each local council in the form of "targetwise aggregate limits". In all other matters of development they may take their decisions independently, in consideration of the local needs and of certain centrally-set principles.

By utilizing part of the communal development fund, the local council may co-operate with enterprises, co-operatives, external institutions and social organizations in order to create joint projects, and it may subsidize the creation of various associations.

The development fund of the local council may be annually supplemented by contributions coming from external organizations and intended to serve investment purposes. Such contributions must be handled separately, apart from the council's own development fund, and they can be used only for the purpose for which they have been assigned.

With the exception of the means provided for implementing the investments determined by "targetwise aggregate limits", an annual and transitory regrouping is possible between the financial means of the current budget and of the communal development fund. By this, local councils are enabled to co-ordinate their tasks of maintenance (current budget) and of growth (development fund) and to keep both in harmony with their income sources.

d. *The regulators of regional development*

This system of regulators serves partly the efficient geographical location of the productive forces and partly the interest of society calling for a balanced development of all economic regions.

The social objectives regarding regional development materialize in the decisions taken by the central state organs and by the local councils, as well as in the economic regulators influencing the decisions and activities of enterprises, co-operatives and local councils. These regulators express the preferences and dispreferences of society.

The long-term and five-year national economic plans include some central decisions regarding regionial development. For instance, they determine the geographical location of some major productive investments, they trace the lines of nationally important networks, and locate some major non-productive investments to be implemented from budgetary funds (e.g. hospitals, universities, etc.).

The objectives of regional development are served also by the regulators acting on the current budget and on the development fund of the local councils.

In addition, the adequate geographical location and development of the productive forces is served financially by the *regional development fund* as a part of the central state budget, the extent of which is determined by the national economic plan.

This fund is divided up between the councils, and is to be used for developing the production of enterprises and co-operatives.

The regional development fund consists of three parts (or three different funds). They are: first, the fund serving industrialization in the preferred regions; second, the fund serving changes in the industrial structure; and third, the fund serving the renewal of certain enterprises and plants from the capital.

The local councils entitled to dispose of an *industrialization fund* may assign subsidies serving either the creation of new plants in their area or the widening of productive capacities of enterprises and co-operatives already operating there. The subsidy may attain 20 to 40 per cent of the projected investment. The local council may *ex ante* establish the conditions of its grant, mainly by prescribing a minimum level of economic efficiency. The regions for which subsidies from the regional development fund are available are determined centrally, by the national economic plan. However, the councils are free to establish the actual extent of subsidy and its conditions.

The fund serving to stimulate changes in the industrial structure practically promotes the structural changes involved by the decline in the mining of poor-quality coal, that is, the structural transformation of the areas affected. Such changes, as well as the industrialization of the industrially less developed areas, are being promoted also by the removal of industry from the capital, obligatorily prescribed by special legal rules.

The fund serving the removal of industry from the capital stimulates the transfer from the capital of plants which can be operated elsewhere. It is to be remarked that an investment serving this purpose may be subsidized both from the fund of industrialization and from the removal fund itself. It is prohibited to build, in the area of the capital plants likely to withdraw some of the potential sources of manpower, with the exception of the producing and servicing enterprises meeting everyday needs of the local population.

As regards the regions to be developed, in addition to the industrialization fund, also certain *preferences* are being applied. For instances, investments in the preferred regions enjoy more favourable credit conditions; some of the costs of starting new plants (e.g. those connected with the training of manpower) are borne by the state or the local council; the settling down of technological and other experts is aided by returning removal expenses and by granting preferential credits on residential construction, etc.

As regards *agricultural development* in some regions determined by the national economic plan, the desirable changes in cultures are stimulated by state subsidies. In addition, the state subsidizes the incomes of people engaged in large-scale farms, to the extent justified by social policy. Within the system of subsidizing the farming co-operatives, the local councils play an important role in implementing central measures.

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The new system regulating the economic activity of the local councils contains also some elements of uncertainty, mainly as regards the assertion of the principles of regulation and of the technicalities in financial supply. Therefore, it seemed necessary to insert some guarantees to the financial regulation. Such guarantees are: the annual determination of the state subsidy; the continuous checking of the councils' incomes; the modification of their income sources (at the time of approving their budgets) if this is deemed necessary. In addition, the supervising authorities have the right to modify the provisions of the local budgets if economic circumstances change as a result of central decisions, or if the implementation of investments determined by targetwise aggregate limits differs from the plan, or if the system of taxation is changed, or if extraordinary natural hardships make it necessary to regroup the means. Still, the new system regulating the economic activities of the local councils is characterized by a tendency to create stable sources which enable the councils to plan for a longer perspective; and all this helps to meet the requirement of a better planned, more efficient use of means in the sphere of the local councils.

Appendix

TECHNICAL TERMS EXPLAINED

ALLOCATION OF GOODS (*Árueloszlás*): cf. Trade regulators concerning means of production.
AMORTIZATION (*Értékcsökkenés*): cf. Depreciation allowance.
ASSETS (*Eszközök*): State property is divided into separate bodies of assets. Each of these is entrusted to a relatively autonomous unit (a legal entity) entitled to enter into private-law relations. In Hungary, state-owned enterprises have from the beginning been provided with separate assets. The change brought about by the economic reform in this respect is that the supervisory authority has, as a rule, no longer the right to transfer assets from one enterprise to another unless an enterprise is to be liquidated or reorganized or belongs to a trust (cf. Trust). Enterprises have *fixed* and *circulating* (working) *assets.* The former include real estate, buildings and other constructions, as well as all durable (productive or non-productive) equipment except objects of a relatively small value (at present less than 5,000 forints a piece). The circulating assets include, beside these objects of small value, the materials, semifinished (intermediary) goods, products in the making and the stock (inventory) of finished goods, as well as the money balances and cash.
AUDITING (*Mérlegellenőrzés*): This is the right and duty of the supervisory authority; it comprises a complete checkup of business management. Functional authorities (q.v.) may also undertake revisions in matters falling directly within their competence. The tax authority checks the balance sheet, the observation of legal rules and the meeting of obligations towards the state budget. The banks (q.v.) are not entitled to a general auditing of enterprises but have auditing rights in matters associated with credits granted by them.

BANKS (*Bankok*): The National Bank of Hungary and the Hungarian Investment Bank are enterprises of a special type, since their economic interests are not so closely associated with profits as are those of other enterprises. The National Bank receives instructions directly from the government issuing the "Directives on credit policy". In general the National Bank keeps the current accounts of all economic and budget organizations, accepts interest-bearing deposits from enterprises (when they can temporarily spare some of their financial means), and grants credits for financing both investments and the circulating assets of enterprises, whereas the Development Bank deals with investment credits at the expense of the state budget. The National Bank is the central agency of foreign-exchange monopoly. Before 1 January 1972 the Investment Bank was the sole distributor of investment loans for state-owned enterprises.

BRANCH DIRECTORATES (*Iparigazgatóságok*): Formerly, most enterprises were subject to a two-level supervision exercised by the branch ministry (q.v.) and by one of the branch directorates subordinated to the latter. The branch directorates as "authorities of first instance" have been abolished in the new system.

BRANCH MINISTRIES (*Ágazati minisztériumok*): The ministries of metallurgy and engineering, of heavy industry, of light industry, of construction and urban development, of agriculture and food industry, of transport and communication, of home trade and of foreign trade bear economic and political responsibility for all activities within the sphere of their competence. They take part in drawing up national economic plans and in preparing central measures relating to their scope of work. In their capacity of supervisory authorities, they represent the state as the proprietor of state-owned enterprises and exercise the relevant rights of supervision and auditing. As opposed to the former situation, however, their right of directly instructing individual enterprises as regards the content of their plans and their everyday economic activities is now restricted to exceptional cases connected mostly with national defence and the meeting of foreign-trade obligations undertaken by the state. Another new feature of the present situation is that the branch ministries are responsible for the technological development of an entire branch, irrespective of whether or not some economic units of the given branch fall under the supervision of another ministry, and irrespective even of whether they belong to the state or a co-operative. The minister of engineering, for instance, is responsible for the complex development of this branch, although there exist engineering enterprises subordinated to other ministries and to local councils, and there are also engineering co-operatives.

CALCULATIVE (MODEL) PRICES (*Kalkulatív – modell – árak*): Centrally calculated prices, in each of which the content of social net income is of an identical percentage. Such prices do not occur in reality; they serve for determining how far the prevailing price proportions deviate from the model proportions.
CAPACITY CONTRACT (*Kapacitás szerződés*): A new type of contract introduced in 1968. When the buyer does not yet know exactly the assortment of goods he will need, he may contractually engage part of the supplier's productive capacity for a defined period, on condition that the exact specification will follow subsequently. Formerly, when the delivery contract (q.v.) was practically the only form of economic relations between enterprises, exact specification had to be given long before the delivery period. Thus it frequently occurred that the foresight of the buyer proved erroneous and, as a consequence, part of the goods delivered proved superfluous while other goods were insufficient.
CENTRAL DEVELOPMENT PROGRAMS (*Központi fejlesztési programok*): As a rule, these are complementary documents to the medium-term national economic plan, although the period they encompass does not necessarily coincide with the plan period. Such a program contains a number of co-ordinated measures involving several branches of the economy with a view to attaining some major development objective. This is the case, e.g., when the scope of the measures to be taken exceeds the competence of any single ministry, or when the importance of the objective in question requires direct supervision by government. Although the national economic plans contain the principal objectives and provide the means for implementing the development programs, the realization of each must rely on a special act of government, which includes the approval of details not contained in the national economic plan.
CHARGE ON ASSETS (*Eszközlekötési járulék*): This is a levy paid by enterprises in the form of an annual 5 per cent on the gross value of their fixed assets and on the value of their circulating assets. The charge on assets was introduced four years ahead of the new economic mechanism. Nevertheless, as an economic incentive acting towards a better utilization of all assets employed by the enterprise, it is in keeping with the new mechanism and with the new principles of pricing.
CIRCULATING (WORKING) ASSETS (*Forgóeszközök*): *see* Assets.
CIRCULATING (WORKING) FUND (*Forgóalap*): This is the part of circulating assets which is financed with the enterprise's own

means. In this respect the economic reform has brought about an important change, strengthening the financial autonomy of enterprises. Prior to the introduction of the new system (more exactly, beginning from 1957), any increment of circulating assets that was involved by the expansion of enterprise activities, had to be financed with bank credits. Thus the proportion of circulating assets for which the enterprise had to pay interest went on increasing and exerted a growing pressure on the cost level. On 1 January 1968 the circulating funds of enterprises were submitted to a general revision, and the amount of outstanding credits of this nature was transferred into the circulating fund of the enterprise in question. One of the consequences was that hereafter the enterprise had to pay, in this respect, only the "charge on assets" (q.v.) instead of the (higher) interest rates fixed for bank credits. As a result of this reform, an average enterprise is now able to finance some 60 to 70 per cent of its circulating assets from its circulating fund. The remaining proportion which is to be covered by short-term credits is thought sufficient for the central credit policy to exert an adequate influence on enterprise activities.

COMMISSION CONTRACT (*Bizományi szerződés*): This is now the predominant form of participating in export for such producing enterprises as are not entitled to independent export activity. Formerly, producing enterprises received from foreign-trade enterprises the domestic price of their products turned out for export, and were not interested in the price of those products really commanded on the foreign markets. The commission contract establishes a direct interest of the producer since he receives the forint equivalent (calculated at the uniform "foreign-trade price multiplier", q.v.) less the costs and commission of the foreign-trade enterprise. The latter is also interested in achieving the highest possible price, since the amount of its commission depends on it. Moreover, if the producer limits the minimum price, the exporter will receive an extra share of what he achieves above this limit. It is also possible for the parties to conclude a contract on a profit-sharing basis. Finally, if the producer is not satisfied with the activities of his commissioner, he may, with the consent of the minister of foreign trade, commission another foreign-trade enterprise. The same applies to imports.

COMMODITY FUND (*Árualap*): The aggregate volume of all commodities and services available to the population in a given year.

Compulsory contracting (*Szerződéskötési kötelezettség*): see Delivery contract.

Conception of technological and economic development (*Műszaki-gazdasági fejlesztési koncepció*): A document drawn up by the competent branch ministry (q.v.) for a determined sphere of activity, e.g. a branch of industry. When the subject-matter involves several branches of the national economy, that is, several ministries, the document is drafted by the National Board of Technological Development (q.v.). In the form of a study, the Board analyses the possible trends of technological development in general and from the viewpoint of the country, suggesting measures to be taken for ensuring progress in the most advisable direction. Such studies serve, as a rule, as preparatory work for national economic planning. The proportions are supported by calculations indicating the lower and upper limits of the expected costs and results. A more exact quantification follows only after the approval of the proposals and their co-ordination with the rest of the national economic plan. For the same reason, the documents often contain alternative propositions, since national economic planning must consider also such factors as cannot be weighed in the course of drawing up individual conceptions.

Contract work (*Bérmunka*): The supplier obliges himself contractually to perform a definite kind and amount of work and not, or not mainly to deliver goods.

Co-operatives (*Szövetkezetek*): The two fundamental types of economic organization are the state-owned enterprises (see Enterprises) and the co-operatives. The importance of the latter is greatest in agriculture (cf. Farming co-operatives) where they turn out about 75 per cent of the total output; their share in industrial production is about 5 per cent, whereas in the total turnover of retail trade it amounts to 33 per cent. The co-operatives were less effected by the economic reform than the state-owned enterprises as they have always had a much widera utonomy based on group ownership of their means of production.

Credits (*Hitelek*): In the sphere of finances, the state can influence economic activities indirectly, partly by the redistribution of incomes through the budget, partly by the credit system. While most budgetary channels are long-term regulators acting through the redistribution of enterprise incomes and through the financing of infrastructural and certain large productive investments, the credit channels ensure a more flexible and rapidly acting regulation, better adaptable to the changing needs since credit conditions (interest rates, terms of expiry, selectivity, etc.) can be modified in order to exert an influence upon the rate and pattern of development.

The principles of crediting are summed up in the "Directives of Credit Policy", a document approved by the government together with the national economic plan. But even in the course of one single year the practice of selective crediting may be adapted to the given business situation to produce a favourable effect on the implementation of the plan. Selectivity has a double significance. First, when granting credits, the banks, following the Directives, endeavour to prefer such credit applications as seem to promote the objectives laid down in the national economic plan. Second, within this general tendency, the banks tend to give priority to more profitable activities.

The average share of credits in financing the circulating assets of enterprises is somewhere between 20–30 per cent of the total of circulating assets used by them. What is referred to as the basic rate of interest on short-term credits (granted for not more than one year) is 8 per cent in 1971, in addition to which 5 per cent is levied for charge on assets (q.v.), while on the circulating fund (q.v.) only the 5 per cent charge on assets is being paid. Medium-term and long-term bank credits (2–3 years and up to ten years, respectively) are granted to enterprises wishing to invest in excess of their actual resources. The interest rates of these credits are different, but usually exceed the 5 per cent charged on enterprise assets, the latter being an expression of the minimum efficiency required.

Up to 1968, an overwhelming part of investments were financed from the state budget without obliging the benefited enterprise to repay them. (Nevertheless, from 1964, on all fixed assets used by enterprises—with the exception of certain branches—had to bear the "charge on assets" of 5 per cent mentioned above, in addition to the part of the depreciation allowance [q.v.] withdrawn for and redistributed by the budget.) Under the new system, the budget financing of productive investments is restricted to those approved by the government in the national economic plan (cf. Major individual investment projects and Targetwise aggregated investment limits), representing about 60 per cent of all investments in 1968 and about 50 per cent in 1971–1975. The remaining part is financed from the enterprise development fund (q.v.) or from bank credits to be repaid from the future income of this fund; finally, a small part is being financed by state loans (q.v.).

Credits are granted either by the National Bank of Hungary or by the Hungarian Investment – since 1 January 1972 Development – Bank (cf. Banks).

CREDITWORTHINESS (*Hitelképesség*): (of an economic unit); cf. Solvency.

CUSTOMS DUTIES (*Vámok*): The new tariff of customs duties introduced in 1968 has three colums: one of them contains the autonomous tariff rates, another is applicable to goods which come from countries falling under the most-favoured-nation clause; finally, the preferential tariff is applied mainly to imports from developing countries.

DELIVERY CONTRACT (*Szállítási szerződés*): This is a contract of the purchase and sale of products between socialist organizations under which the seller (supplier) is obliged to deliver the product specified in the contract at a later date or period, and the buyer (customer) to take it over and pay its price. In the past the delivery contract was the almost exclusive form of sale and purchase between enterprises. In most cases the enterprises were permitted to produce only such goods the sale of which they secured in advance by a delivery contract. On the other hand, the processing and trading enterprises were obliged to secure their purchases in advance by entering into delivery contracts with the suppliers. Under the new system the delivery contract continues to function as an important tool regulating the flow of goods and services between enterprises, but its application is no longer compulsory. "Compulsory contracting" occurs only in exceptional cases when national economic interests make it necessary to secure the supply of definite commodities for certain purchasers (see, e.g., Quotas) in a way that these are entitled to force the suppliers by legal means to conclude delivery contracts with them. Buyers, however, cannot be forced to enter into a delivery contract. The former rigid legal provisions concerning the obligatory stipulation of delivery and payment terms, penalties etc. have been abolished, so that the parties are now practically free to agree on all terms.

DEPRECIATION ALLOWANCE (*Értékcsökkenési leírás*): The rates of depreciation are established centrally. They are different for the various branches of production. As of 1 January 1968 the rates were revised; now they include not only the usual wear and tear but also technological obsolescence. The depreciation allowance calculated at these rates (on the basis of the gross value of fixed assets) is due partly to the state budget, partly to the development fund (q.v.) of the enterprise. In the new system the latter portion is much higher than what the enterprises were formerly permitted to retain for their own purposes. At present, an average enterprise may retain about 60 per cent of its depreciation allowances.

Development fund (*Fejlesztési alap*): The profits of an enterprise are, first of all, split up into two parts: one which, after the deduction of taxes and of the part due to the reserve fund (q.v.) will be transferred to the development fund, and another part which, after similar deductions, is used for the sharing fund (for the proportion of the two parts, see the entries Sharing fund and Wage multiplier).

The part of profits due to the development fund is usually taxed at a linear rate of 60 per cent (unlike the progressive taxation of the part due to the sharing fund).

In addition to this, also the part of the depreciation allowance (q.v.) left with the enterprise is transferred to the development fund. At present, this amounts to about 60 per cent of the total of depreciation allowances.

The enterprise may use the development fund for replacing scrapped equipment and for investments serving the extension or modernization of its productive capacity. If the investments involve an increase of the permanent stock of circulating assets, or if other causes require its increase, this must be also financed from the development fund.

Enterprises wishing to invest over and beyond the capacity of their development fund may apply for investment credits. The instalments of such bank credits are to be paid from the development fund. In cases of emergency, when the development fund is unable to meet all its obligations, the reserve fund (q.v.) may temporarily be tapped, with the obligation of repayment in five equal annual instalments.

Development loan (*Fejlesztési kölcsön*): The state may consider it necessary to promote certain investments by granting development loans. These are to be refunded from the income of the investment. Unlike the major incividual investments (q.v.) and the state loans (q.v.), connected with them, the implementation of investments subsidized by a development loan becomes compulsory for the investing enterprise only if it chooses to enter into agreement on the terms of the loan with the bank commissioned to act on behalf of the state. In principle, more than one enterprise may apply for development loan in connection with the same investment target, and the one offering the most advantageous terms is to have the loan.

DIRECTIVES (GUIDING PRINCIPLES) ON CREDIT POLICY (*Hitelpolitikai irányelvek*): cf. Credits.

ECONOMIC MANAGEMENT (*Gazdaságirányítás*): The reformed system of economic management rests on a combination of centrally planned conceptions and of impulses exerted by commodity and market relations. Such a combination is only possible if all major means of production are in socialist ownership. The state, as before, takes central decisions on the main objectives and proportions of economic development but leaves a fairly wide scope for influences coming from the market, i.e. for the genuine "commodity relations" between suppliers and purchasers. A large part of economic decisions have passed to the competence of enterprises and co-operatives. The intrinsic unity of management is ensured, in this system, by the fact that even the functions of the market are more or less determined by the conditions and rules laid down in, or coordinated with, the national economic plan.

ECONOMIC MECHANISM (*Gazdasági mechanizmus*): This term is understood to mean the entire system of *interrelations* between economic units, ministries and other supervisory authorities, planning agencies, banks etc., on the one hand, and a functional *interdependence* between the national economic plan and the socialist market, on the other. In the new system, the former preponderance of direct, obligatory instructions issued by the supervisory authority to each of the economic units have given way, in most respects, to the indirect influence of economic regulators and incentives and to that of the socialist market, which are expected to induce all economic units to act, while endeavouring to maximize their profits, in a way contributing to the achievement of the objectives laid down in the national economic plan. A firm reliance on the market does not contradict the principle of central planning and management; on the contrary, it enhances the significance of the latter since the market, instead of being simply the field of struggle between spontaneous processes, is itself influenced by the economic and administrative regulators meant to promote the achievement of the major objectives specified in the national economic plan.

ECONOMIC REGULATORS (*Gazdasági szabályozók*): While in the past the achievement of the objectives laid down in the national economic plan was ensured by dividing up the national plan targets into tasks allotted to individual enterprises, the new system avails itself of direct instructions or other administrative measures only in cases of emergency. As a rule, the economic regulators (cf. Regulators) are meant to channel the activities of all economic units in such directions of development and such proportions in the allocation of resources as are most favourable for the implementation of the national economic plan. The future development of an enterprise as a whole and the income of the people employed in it depend on the amount of profits earned, and the various economic regulators act in a way that an enterprise may earn the maximum profit when its behaviour best promotes the implementation of the national economic plan. In other words, the economic regulators, combined with the statutory rules and other measures issued by the state, create an "economic environment" in which the enterprises striving for maximum profits must operate in a way favourable to the implementation of the national economic plan.

The economic regulators act either directly (when the state takes decisions and gives instructions, e.g., in the case of certain major investment projects), or indirectly. In addition to economic regulators, other official prescriptions and provisions—e.g., the determination of the sphere of activities, building permits, export permits etc.—also influence the activities of enterprises.

The indirect economic regulators exert an influence on the entire scope of enterprise activities in one way or other. *Price policy* influences their gross sales receipts as well as the part of their incomes destined for purchasing production goods; *wage policy* effects their costs of labour; *fiscal policy* regulates the utilization of their income for paying taxes, for building up reserves, for investments and for complementing the individual incomes of their staff (part of these regulators having a stimulating effect on the enterprise as a whole or on the individuals employed by it are also called "economic incentives"); *credit policy* enables them to bring forward some of their future income for investments or for purchasing circulating assets, but also obliges them carefully to weigh the economic consequences of such expenditures and to adapt their investment decisions to the needs of the national economy; *trade regulations*, still valid in connection with certain scarce production goods induces them to economize on using such goods; *foreign-trade policy* opens additional markets for their sales and purchases, etc.

It follows from the nature of economic regulators that they must have a considerable stability so that the economic units may reckon with them and adapt themselves to them. In principle, the validity of such regulators is not restricted to any definite plan period. Nevertheless, the national economic plans must contain decisions regarding the extent to which the economic regulators will be applied (e.g., the upper limits of investment credits to be granted to each main branch of the national economy, etc.).

ECONOMIC UNITS (*Gazdálkodó egységek*): Throughout this book, this term is used to mean both the state-owned enterprises (cf. Enterprise), their unions, trusts, and the co-operatives (q.v.).

ENTERPRISE (*Vállalat*): Throughout this book an enterprise is understood to mean any economic organizational unit founded, owned and controlled by the state. Although, evidently, the activities, profits and losses of all such enterprises concern society as a whole, practical considerations require an accounting by separate units. Accordingly, each state-owned enterprise was, even under the old system, handled as a segregate unit carrying on economic activity. The new system has greatly widened their autonomy by freeing them from most direct interferences on the part of their supervisory authorities, that is, the branch ministries (q.v.) or local councils (q.v.) Nevertheless the supervisory authority continues to exert important functions by representing the state as the owner of the enterprise. It is entitled (a) to found, amalgamate, segregate or liquidate enterprises, (b) to determine the sphere of activity of each enterprise in the deed of foundation, (c) to appoint and discharge enterprise executives, to decide on their salaries and other rewards, (d) to audit and assess the enterprise activities, (e) to intervene with direct instructions in cases of emergency.

FARMING CO-OPERATIVE (*Mezőgazdasági termelőszövetkezet*): A large-scale independent socialist farming unit based on the voluntary association of its members and mainly on work performed by them. Its operations combine large-scale common farming and the individual cultivation of small plots allotted to each member (cf. Household plot). The farming co-operative is a legal entity functioning on the principles of group property and of co-operative democrary. Its supreme organ is the general meeting of members which elects from time to time the president and the board of operative management, discussed and approves the annual balance sheet and passes collective decision in all matters of major importance. Any resident of Hungary above 16 years of age may become a member of a farming co-operative.

The member is obliged to cede the land legally possessed by him or her to the common farm, except for the housing site and the household plot, and to take part in the works going on in the common farm. The co-operative pays the members a rent for the land thus ceded, and remunerates their work performed (cf. Unit of work performed).

The economic interests of the co-operative as a whole and of its members as individuals are centred around the annual "gross income" which means, in this context, the difference between the sales receipts on the one hand, and the sum of material costs and depreciation allowances, on the other. Since the assets of a cooperative are in group property, the division of the gross income into personal incomes accumulation and reserves (similarly to all other decisions of the co-operative) is not directly regulated by the state. It may be influenced only in an indirect manner by taxation (q.v.) and economic regulators (q.v.) acting on the economic interests of the members and the co-operative as a whole, and encouraging investment and production by various forms of subsidies (q.v.). Co-operatives handicapped by unfavourable endowments are supported by additional government grants to help them improving their conditions.

FINANCIAL BRIDGES (*Pénzügyi hidak*): In the Hungarian practice this term is understood to mean all specific (not generally applied) taxes, levies, price subsidies, etc., which make it possible or necessary to set producers' prices lower or higher than what they would be on the basis of the producers' calculations. By applying financial bridges, the state exerts an influence upon the prices. The possibility of their application is restricted, since a too wide application would result in a confusion and incommensurability in the prices and cost/income relations determined by them.

FIXED ASSETS (*Állóeszközök*): cf. Assets.

FIXED PRICES (*Hatósági – rögzített – árak*): cf. Prices.

FOREIGN-EXCHANGE BONUS (*Devizaprémium*): An economic unit entitled to perform direct foreign-trade transactions, when it has achieved outstanding export results, may be rewarded by leaving some of the foreign exchange acquired by its exports to its own disposition. Such foreign exchange may be used (otherwise in accordance with the relevant rules) for imports serving the development of the economic unit in question.

FOREIGN-TRADE LICENCE (*Külkereskedelmi engedély*): Foreign trade is controlled and influenced by the obligation of obtaining licences for export and import transactions. Licences are issued by the Ministry of Foreign Trade; they may be applied for only by economic units explicitly entitled to foreign-trade transactions. The import licence entitles the holder also to purchase (in a way prescribed by relevant regulations) the kind and amount of foreign exchange necessary for the transaction; the holder of an export licence is obliged to sell the foreign exchange acquired to the National Bank.

FOREIGN-TRADE PRICE MULTIPLIER (*Külkereskedelmi árszorzó*): As a rule, importers and final users of foreign goods pay the actual prices at which these goods have been purchased abroad, converted to forints on the basis of an officially established uniform "price multiplier" and the producers of export goods receive the price actually attained abroad, converted into forints in the same way. The multiplier expresses the average forint value (at domestic prices) of the quantity of goods (in a composition conforming to the actual export structure of the country) exportable at a price of one rouble or one dollar, that is, the average forint input needed to obtain a unit of foreign currency through exports. This, evidently, depends largely on the commodity pattern and on the efficiency of exports. In no way must this be looked upon as an "exchange rate" or as the expression of purchasing-power parity.

FOREIGN-TRADE PRICE RISK FUND (*Külkereskedelmi árkockázati tartalékalap*): Enterprises importing or exporting products which are particularly exposed to sudden and violent price changes may be obliged—or permitted, upon their request—by the Ministry of Finances to establish a special reserve fund separated from the reserve fund proper (q.v.). The fund is alimented by "windfall" price gains. The price gain transferred to this fund is not taxed, in order to make the enterprise interested in achieving such gain. Occurring price losses may be covered from the fund in the same proportions in which the enterprise divides up price gains between the fund and profits.

FREE PRICES (*Szabad árak*): cf. Prices.

FUNCTIONAL MINISTRIES (*Funkcionális minisztériumok*): Unlike the branch ministries (q.v.), some ministries and other central authorities supervise all branches of the national economy from a functional viewpoint. Such authorities are the Ministry of Finance, the Ministry of Labour and (in certain respects) the Ministry of Foreign Affairs and the National Office of Materials and Prices. In matters of methodic procedures also the National Planning Office is considered a functional authority.

FUNDS OF ENTERPRISES (*Vállalati alapok*): see Circulating fund, Development fund, Foreign-trade price risk fund, Reserve fund, Sharing fund, Technological innovation fund.

HOUSEHOLD PLOT (*Háztáji gazdaság*): Each member of the farming co-operatives is entitled to the personal use of a small plot of arable land measuring 0·30 – 0·60 hectare. Members may also own animals (except horses) privately, in compliance with the statutes of the co-operative. The co-operative member is free to dispose of the products of this household plot and animals but certain economic advantages are connected with the marketing of the animal products through the co-operative. The common farm of the co-operative promotes stock breeding in household plots by providing fodder and by lending help in organizational work. Household plots have a comparatively large share in the stockbreeding of the country.

IMPORT DEPOSITS: (*Importletét*): Enterprises investing from their own resources may purchase equipment for convertible foreign exchange if they deposit with a bank for a term of two years – a determined part of the foreign price of the equipment converted into forint. As regards the year 1971, the application of this rule is suspended, i.e., no import deposits are required.

IMPORT TURNOVER TAX (*Importforgalmi adó*): cf. Prices.

INCENTIVES (*Ösztönzők*): see Economic regulators.

INCOME REGULATION (*Jövedelemszabályozás*): This type of state regulation comprises the rules regarding the *division* of the net social income between state and enterprise; the *utilization* of the income remaining with the enterprise; and the *subsidies* q.v. granted to enterprises for various purposes. In current practice the method of profit taxation is sometimes also referred to as income regulation.

JOINT UNDERTAKINGS (*Közös vállalkozás*): State-owned enterprises are permitted to found – depending on the approval of the supervisory authority and of the Minister of Finances – common undertakings (in the form of autonomous legal entities and separate subjects of taxation). The necessary means are provided by the participants, and a pre-determined part of the profits is divided between them accordingly. Similar rules apply to agricultural producers' co-operatives which may found, be tween themselves or together with state-owned enterprises, joint undertakings for pursuing industrial, construction and trading activities.

Levy on wage increment (*Bérfejlesztési járulék*): Beginning from 1971, enterprises must pay to the state budget a levy on the increment of their wage bill caused by the rise of the per capita wage (q.v.) paid by them annually. The levy is to be paid from the sharing fund (q.v.) its rate is calculated as follows. The combined total of the annual wage bill and the annual sum of profits (before taxation) is divided by the annual average number of workers and employees, and the resulting "indicator of per capita wages and profits" is compared with the same indicator obtained for the preceding year. For every per cent increase of this indicator, a 0·3 per cent increase (against the preceding year) of the annual per capita wage is levied at the rate of 50 per cent, that is, the levy amounts to 50 per cent of the sum by which the annual wage bill has increased on this account. If the proportion between the growth rates of per capita wage and of the above-mentioned indicator is higher than 0·3 : 1·0, the excess increment of the annual wage bill is levied at progressive rates varying between 150 and 400 per cent. There are, however, cases of preferential treatment (c.f. Preferential treatment of wage increments.)

Limit prices (*Maximált árak*): cf. Price-system.

Local (municipal) councils (*Helyi tanácsok*): Local administration divides the country into nineteen counties and the area of the capital Budapest. The counties include incorporated towns and 1660 communities, the latter belonging to 215 rural districts. The population of each of these administrative units (with the exception of rural districts) elects a council which exerts the functions of a local state authority, and each council elects its executive committee which is the local organ of state administration. The rural districts have no councils of their own, their "district offices" are supervised by the county council. However, the 27 districts of the capital are controlled by elected councils. The executive committees of the counties and of the capital are entitled to found state-owned enterprises and to exercise the rights of property, auditing and supervision connected therewith. Development shows a trend towards an increasing financial autonomy of the councils. The state shares certain income resources with the counties and the capital, and these, with the councils, of lower instance. The councils of the counties and of the capital have the right to decide on their investment plans, and on the location, economic and technological data of investments under the "targetwise aggregated investment limits" (q.v.) allotted to them. In order to safeguard appropriate proportions in the development of the different regions of the country, the state budget may grant subsidies to certain backward areas.

MAJOR INDIVIDUAL INVESTMENT PROJECTS (*Egyedi nagyberuházások*): These are projects serving the creation of large new plants or a significant reconstruction of existing ones, each of which affects the national economy considerably (e.g. in industry, a project is considered as a "major" one when it increases the output of its branch by 25 to 30 per cent at least). As a rule, the lower limit of major individual investment projects is 100 million forints (200 or 300 million in the heavy industry). Each of these projects is to be approved by the government; the implementation of approved projects is compulsory.

MAXIMUM PRICES (*Maximált árak*): cf. Price system.

MIXED PRICES (*Kevert árak*): When the same commodity is being imported from both socialist and capitalist countries, or occasionally manufactured at home, it is sometimes reasonable to establish a uniform price for users. The "mixing" of prices is usually the task of a specialized trading of foreign-trade enterprise, but may also be carried out by the state budget (in the form of subsidies or skimmings). The mixing of prices must, however, be applied in such a way that it does not interfere with purchases at lower prices abroad.

MULTI-CHANNEL SYSTEM OF TRADE (in production goods) (*Többcsatornás termékforgalmazás*): Under the new system that has replaced the former, strictly centralized allocation of production goods, the enterprises are generally free to choose between the various sources of purchase, i.e. buying either directly from the producer, or from enterprises specialized in the trade of production goods, or from the wholesale or retail-trade enterprises, or, as the case may be, from importers or even directly on a foreign market (if they are entitled to perform foreign-trade transactions). Similarly, they may sell their goods directly to users or to trade organizations (in some cases also directly to private consumers), or even in foreign markets, if they are entitled to. The abolition of the former "compulsory trade channels" means that now, as a rule, there are no officially "appointed" buyers or sellers on the market. All buyers are free to choose the source most advantageous for them. For exceptions, cf. Trade regulations and Quotas.

MUNICIPAL AUTHORITIES (*Községi, városi hatóságok*): cf. Local Councils.

MUNICIPAL DEVELOPMENT CONTRIBUTION (*Községfejlesztési hozzájárulás*): As from 1971, almost all state-owned enterprises, industrial and consumers' cooperatives are obliged to pay 6 per cent of their profits before taxation to the territorially competent council. The farming co-operatives pay one per cent of their gross income. About two-thirds of this contribution go to the current budget of the councils and one-third is source of their development fund. If the activities of an enterprise extend over the territory of several councils, the parcelling up of the contribution is determined by the competent tax authority.

NATIONAL BOARD OF TECHNOLOGICAL DEVELOPMENT (*Országos Műszaki Fejlesztési Bizottság*): A government agency called upon to work out co-ordinated guidelines on the main trends of technological progress. (Cf. also Conception of technological and economic development.)

NATIONAL ECONOMIC PLAN AND PLANNING (*Népgazdasági terv és tervezés*): Planning has to be distinguished from the other two elements of economic magagement: *regulation* and *organization* (cf. Planned economic management). The three elements are closely connected and interrelated, yet they differ in character and in the life span of the measures they involve. Measures relating to regulation and organization are not necessarily bound to some definite period of time (the longer they last, the better), whereas planning on the national level may cover one year or several years (generally five) or many years (10 or 15). National economic planning, as a process, includes: the *analysis* of past development and present state of the economy, including the implementation of the current plan; a *forecast* regarding the exogenous and endogenous conditions of economic growth; *definition* of the main economic objectives (sometimes in several variants) and of the ways and means promoting their attainment; the *co-ordination* of all objectives in conformity with the available resources.

Under the former system of economic management and planning the "*plan objectives*" contained in the national economic plan were being split up between detailed "*plan targets*" of the various economic units (e.g., the planned amount of definite products or services, the amount and purpose of investments etc.). The implementation of all these plan targets had to be ensured by similarly detailed provisions allocating materials, labour, etc. to each enterprise. In addition, even other "*plan indicators*" (designing, as a rule, development targets expressed in relative numbers, as e.g. labour productivity, relative production costs, etc.) were determined for them. Accordingly, each enterprise received its "*plan instructions*" from its supervisory authority and was obliged to incorporate the prescribed targets and indicators in a "*plan proposition*". This was then submitted to the supervisory authority for approval. Any subsequent modification in the approved plan requires special permission from the supervisory authority. In the new system, no numerical plan targets or indicators are imposed on the individual enterprises—except for the implementation of major individual investment projects (q.v.) and such cases when interests of national defence or foreign-trade obligations undertaken by the government are at stake. The plan of an enterprise is approved by its manager, and can subsequently be modified by him. The national economic plan is only binding on the government and the central authorities of economic control inasmuch as it determines the general lines of their actions.

NET SOCIAL INCOME (*Társadalmi tiszta jövedelem*): cf. Profits

ORIENTATION PRICE (*Tájékoztató árak*): cf. Prices

PER CAPITA WAGE (*Egy főre jutó bér*): This is the annual amount of wages and salaries paid by the enterprise divided by the average annual number of its workers and employees. With the introduction of the new system, the former rigid regulating the rasing of the average wage level gave room to economic regulators acting against an excessive rise. The most important of these is the rule that the increment of the payroll caused by a rise of the average wage level is charged against the sharing fund (q.v.) of the enterprise.

PLAN INDICATORS (*Tervmutatók*): cf. National economic plan.

PLAN INSTRUCTIONS (*Tervkészítés*): cf. as above.

PLAN OBJECTIVE (*Tervcél*): cf. as above.

PLAN TARGETS (*Tervfeladat*): cf. as above.

PLANNED ECONOMIC MANAGEMENT (*Tervszerű gazdasági irányítás*): In our terminology, this system includes (a) *planning*, that is, the preparatory process leading to economic decisions and an instrument serving to specify the ways and means of their implementation (cf. National economic plan); (b) *regulators* based on the national economic plan and consisting of measures directly and indirectly influencing economic activities (cf. Economic regulators); (c) the *institutional* framework of economic activities.

PREFERENTIAL TARIFF (*Preferenciális vám*): cf. Customs duties.

PREFERENTIAL TREATMENT OF WAGE INCREMENTS (*Bérpreferencia*): With a view to ensuring desirable proportions in wages or to increase the effect of wage incentives in certain branches, or either to accelerate the growth of personal incomes in branches where performances are excellent, various measures may be taken within the scope of the present regulation system. For example, the levy on wage increment (q.v.) may be calculated in a manner differing from the usual; or the enterprise may be permitted to raise the annual per capita wage (q.v.) to a certain extent without charging the resulting increment of the annual wage bill on the sharing fund (q.v.). Most of the decisions ensuring such preferential treatment are valid for one year, and are established in the annual national economic plan; some are established for a five-year period.

PRICE SYSTEM (*Árrendszer*): The new economic system uses prices partly as active economic incentives and partly as indicators of the prevailing market conditions. The former gap between the levels of producer prices and consumer prices has narrowed down. The difference between the two levels is determined by the trade margin and by the turnover tax (cf. Taxes) and, in some cases, by the state subsidies of consumer prices. The tendency in both fields of prices is to achieve price relations more exactly corresponding to input proportions, to social preferences and to value judgements prevailing on the market.

The present price system is a mixed one, comprising five types of prices. Officially *fixed* prices are not permitted to alter in any direction; *maximum* prices must not exceed the officially established level; for the *limited* prices a "starting level" is set, as well as a margin (generally 5 to 10 per cent of the starting level, 15 per cent in rare cases) for possible rises; *free* prices are not subject to direct official influence yet are indirectly affected by financial regulators (cf. financial bridges); the earlier system of *informative* prices has been maintained in the field of artisanry, mainly with respect to services. Finally, for certain agricultural products there are *protective prices*, setting a limit below which the state purchase price is not allowed to fall.

The extent of application of the first four price types differs according to commodity categories. For home-produced *raw materials* and *semifinished goods*, fixed or maximum producer prices prevail for about 70 per cent of the production in these categories; for 2 per cent the prices are limited, and for 28 per cent they are free. For not more than some 20 per cent of the output of the *manufacturing industries* prevail fixed or maximum prices; there are limited prices for 3 to 5 per cent, and free prices for 75 to 77 per cent of the output. *Fixed* state purchase prices and other fixed prices occur also in *agriculture.* Here the fixed prices may be modified in consideration of the expected annual yields, or in order to influence the production pattern. As to consumer prices, for commodities making up about 50 per cent of all retail sales, there are fixed or maximum prices, for about 25 per cent the prices are limited and for another 25 per cent they are left free. (Housing rents, passenger transport fares and postal services are not included here; their prices are either officially fixed or maximum.) Different price types may occur even within the same group of consumer goods; the prices of qualities and sorts for mass consumption are officially regulated, while those of the more luxorious variants are free. (However, even the free prices of the finished goods are to a greater or less extent determined by the fact that many raw materials and semifinished goods have fixed or maximum producer prices, and that in most production processes there is a point where prices are subject to a certain extent of regulation.)

Even in the case of the processing industries, there are products whose price rise might have an intensive reverberation on the consumer price level; in such cases the enterprises must give a preliminary notice to the price authority on their intention of raising the price. The price authority may veto the rise, but an agreement with the enterprise is expected to take place within a definite time. The *trade margin* is officially established, but has an informative character only. The prices of imported goods are, as a rule, calculated on the basis of the actual price in foreign exchange and the "foreign-trade price multiplier" (q.v.) as well as the customs duty; in some cases also an import turnover tax is added.

PRODUCER PRICE (*Termelői ár*): cf. Price system.

PRODUCTION TAX (*Termelési adó*): cf. Taxes.

PROFILE PRINCIPLE (*Profil elv*): The production of certain commodities was formerly restricted to enterprises appointed by the central authorities; the list of goods to be produced was referred to as the "production profile" of the enterprise. These restrictions have been abolished in the new system (apart from stipulations in the foundation deed outlining in general sphere of activity of the enterprise). Specialization is, of course, desirable, but it should be achieved through economic incentives rather than through administrative prescriptions.

PROFIT (*Nyereség*): The sum of profits is what the system of incentives acting on the enterprise and its working collective relies upon. Technically speaking, profits are the part of sales receipts remaining after deducting the depreciation allowance, material, transport, wages and other costs, as well as such elements of the net social income (q.v.) as represent the minimum efficiency the enterprise is supposed to yield, namely the charge of assets (q.v.) and the wage tax (cf. Taxes). In other words, the profits of an enterprise equal the sales receipts, less the costs and a part of the net social income. The total of social net income produced by an enterprise includes, in addition to the above mentioned two elements, all other types of enterprise taxes and the part of profits remaining with the enterprise.

PROFIT BONUS (*Nyereségjutalom*): In addition to profit sharing (q.v.) at the end of the year, enterprise executives are entitled to a profit bonus. The amount of this depends on the ratio of the sharing fund (q.v.) to the annual wage costs. Relying on the annual assessment of the enterprise activities, the supervisory authority is entitled to reduce or raise the established profit bonus, depending chiefly on how far the decisions of the executives have been instrumental in promoting the perspective development of the enterprise (since inputs of this kind usually tell on the annual profits).

PROFIT SHARING (*Nyereségrészesedés*): The most important function of the sharing fund (q.v.) consists in making the workers and employees of the enterprise interested in profits. This function materializes partly in that they all are entitled to receive at the end of the year, a share of the annual profit sum, and partly in the regulations ruling that any rise in the average wages (q.v.) as well as the awards and bonuses granted during the year are payable from the profits, that is, they reduce the sharing fund (which see) formed therefrom. The annual shares in profits are distributed among workers and employees usually in proportion to their wages or, in some enterprises, also in proportion to the duration of their employment in that enterprise. In addition, enterprise executives receive profit bonuses (q.v.). When the enterprise shows a deficit, the wages of the bulk of the working staff are guaranteed by the state, but the salaries of the executives may transitionally be reduced to an established extent.

PROFIT TAX (*Nyereségadó*): cf. Taxes.

QUOTAS (*Kontingensek*): In home trade of certain production goods quotas may be determined for certain "appointed users", whereas other users, whose purchases are not regulated may meet their needs by the usual commercial methods. Regarding some products, only the purchases of the largest users are subject to the quota system. This means for them partly that they are not permitted to buy over and above their quotas, and partly that the purchase of the full quantity provided for in their quotas is secured. They are therefore authorized to force, by legal means, producers to conclude delivery contracts with them up to the amounts stipulated in their quotas. In some other cases the quotas are meant to supply, in the first place, *preferred users* with deficit commodities; other users have to be supplied in a commercial way, on the first-come-first-served basis. Also in this case, the preferred users have the right to force the conclusion of delivery contracts up to their quotas. These types of quotas affected only 28 domestic products in 1968, and only four in 1971.

Import quotas affected 21 materials and agricultural products in 1968, and four in 1971. The existence of an import quota does not necessarily imply the setting up of partial quotas for individual purchasers, if demand can be met with commercial methods. Yet, the foreign-trade authority issuing import licences (q.v.) must respect an import quota in double sense: it is obliged to issue licences up to the full extent of the quota, if there are applicants, and must not transgress its upper limit. The import quotas are established in conformity with the provisions specified in the national economic plan. *Export quotas* were applied in 1968 to 22 kinds of materials and industrial products, and to ten in 1971. Most of these quotas were aimed at safeguarding domestic consumption by setting an upper limit to exports. In some exceptional cases, however, the *minimum* of export may also be prescribed, e. g., in order to maintain the equilibrium of the balance of trade. Export quotas also have a binding force on the foreign-trade authority issuing export licences.

Purchases on the basis of a quota may be transacted only if its holder is able to pay for them. The issue of a quota does not involve the necessity of centrally providing the prospective buyer with financial means for the purchase. The beneficiary of an import quota is entitled to the necessary kind and amount of foreign exchange against the payment of its equivalent in forints.

REGULATORS (*Szabályozók*): In principle, the central will of the state may regulate economic activity in two ways: *either in the form of occasional instructions or prohibitions* binding on one or more economic units, or in the form of *general, permanent rules* embodied in laws, decrees etc. From this point of view, there are occasional and permanent regulators. Another, more important difference consists in that most of the occasional and some of the permanent regulators contain compulsory prescriptions for action or abstention, while others leave a certain freedom of choice between possible patterns of behaviour, attaching more or less determined consequences to each of the alternatives. The regulators of the first type, prescribing or prohibiting a certain behaviour may be called *administrative regulators*; the other type which permits alternatives and effects the choice between them by attaching different economic consequences to them might be referred to as *economic regulators* (q. v.)

Reserve Fund (of the enterprise) (*Tartalékalap*): After taxation, from the portions of the profit sum going to the development fund (q.v.) or to the sharing fund (q.v.) a certain amount (in 1971, one-eighth) must be withdrawn and be transferred into the reserve fund, until this fund reaches a sum equalling 8 per cent of the annual wage bill *plus* 1·5 per cent of the actual gross value of fixed and circulating assets, or else until it attains 80 per cent of the combined sum total of the sharing fund and development fund ever achieved. (Whichever is the higher should be taken as a basis.) In certain branches where risks are exceptionally high, enterprises may be obliged or permitted to form a special reserve fund on account of their costs (cf. Export–import price risk fund).

The reserve fund is meant to be used (a) for covering actual losses; (b) for complementing the development fund when this one is temporarily unable to meet its liabilities; (c) for complementing the sharing fund, when the proportion of the latter to the wage bill is lower than what it was in the preceding year. The amounts withdrawn from the reserve fund must be repaid within five years, from the amount of profits remaining with the enterprise after taxation. If an enterprise finds itself compelled to tap its reserve fund within two subsequent years, it must be submitted to economic auditing.

Sharing fund (*Részesedési alap*): The profits earned by an enterprise are divided between the sharing fund and the development fund (q.v.) in proportion to the value of the annual wage bill multiplied by a certain factor (cf. Wage multiplier) on the one hand, and of the fixed and circulating assets, on the other. After this, both parts are taxed. The part serving to aliment the sharing fund is taxed progressively (at rates varying between

40 and 70 per cent) according to the proportion existing between the amount of profits destined for this purpose and the amount of the annual wage bill. After taxation, a portion of the remainder (one-eighth in 1971) goes into the reserve fund (q.v.) and the rest remains in the sharing fund. This latter can be used (a) for complemening the individual money incomes of the enterprise'f workers and employees; (b) for benefits in kind granted to works ers and employees; (c) as a reserve for the next year. The *firs- part* ensures, in addition to profit sharing (q.v.) the payment ot premia, reward, innovation fees, housing contributions, scholarships and emergency aids. Also the levy on wage increment (q.v.) must be paid from this part of the sharing fund. Evidently, the greater the rise of the per capita wage (q.v.) the smaller will be the possibility of complementing incomes in a more differentiated manner. The *second part* covers enterprise spendings aimed at reducing the prices of catering, kindergarten fees, recreation costs, as well as enterprise contributions to social cultural and sports facilities. Up to a certain extent, this part of the sharing fund may be increased at the expense of enterprise costs.

SHIFTING OF THE TAX RATES (*Adótábla csúsztatás*): In the years from 1968 to 1970, taxation of the part of profits payable to the sharing fund (q.v.) changed from year to year in a predetermined manner. Namely, under the system introduced by 1968, the enterprises had to charge on their sharing fund every increment of their wage bill caused by the rise of the per capita wage (q.v.) against the level of 1967. Thus, the sharing funds of 1968 were charged by one year's increment and, those of 1969 and 1970 by the increment of two and three years, respectively. In order to counteract at least part of this cumulating burden on the sharing fund, the progressive scale of taxation of the part of profits due to the sharing fund was shifted downwards by two points annually. Since, however, the system of charging wage increments on the sharing fund was changed by 1971 (cf. Levy on wage increment), this practice was discontinued.

SOLVENCY (*Fizetőképesség*): An economic unit may be considered solvent according to the following criteria: regular sale of its products; regular meeting of its obligations (including taxes); a reasonable profitability of its activities; its capability to ensure the time repayment of the credit applied for.

SPECIALIZED TRADING ENTERPRISES (*Termelőeszközkereskedelmi vállalatok*): These organizations have been created under the new system mainly by reorganizing the former network of the so-called "stock-piling enterprises" (q.v.) to supply a wide sphere of smaller purchasers with production goods directly from stocks, by commercial methods. At present, such enterprises operate in fields where either the wide assortment of products turned out by an industrial branch or the large number of buyers make it advisable to concentrate sales in the hand of an organization disposing over well assorted stocks. Unlike the former "stock-piling enterprises", the new specialized trading enterprises have no administrative functions, they operate on strictly commercial principles.

STATE LOANS (*Állami kölcsönök*): The costs of certain major investment projects (q. v.) decided upon by the government are wholly or partially financed by state loans granted under contract to the future user and repayable from the development fund of the future enterprise. These loans differ from the usual bank credits in that their granting depends on the decision of the government rather than on the bank, and that the period of their repayment and the rate of interests are regulated by special government decisions.

STATE-OWNED ENTERPRISES (*Állami vállalatok*): cf. Enterprises.

STATE SUBSIDIES (*Állami támogatások*): Various kinds of budget grants (without the obligation of repayment) given to economic units in order to compensate losses (when their elimination by price adjustments is not feasible or desirable), to assert social preferences in the consumer price system, to promote exports and to help investment and modernization in agriculture.

(a) The direct method of covering the "planned losses" of an economic unit by budget grants is now applied much less frequently than under the former economic system. The trend is to eliminate such losses by price corrections and, in the long run, by creating adequate conditions for profitable production.

(b) Part of the officially fixed consumer prices have been established at a level lower than would be justified by the relevant producer prices and trade margins. The difference is covered by the state budget, in order to maintain the interest of producers and of the trading units in the production and realization of these goods. The consumer price subsidies are usually established in the form of percentage rates—similarly to turnover taxes—and are valid for sellers of such products.

(c) Subsidies on exports: As a result of the introduction of a uniform foreign-trade price multiplier (q.v.), the production of certain export goods has become unprofitable. If the interests of the national economy require the continuation of such exports, they may be subsidized from the state budget. The payment of such a subsidy is limited to a definite period. Sometimes the rates are gradually reduced to prompt the interested enterprises to eliminate the cause of loss. For a wide range of beneficiary enterprises, in 1971 the export subsidies payable on export goods of a homogeneous character have been established uniformly.

(d) In order to promote agricultural production, budget contributions are paid to farming units wishing to invest in building, plantations and productive equipment according to centrally approved schemes. The contribution varies between 10 and 50 per cent of investment costs. Moreover, special price reductions are accessible, under specified conditions, to farming units for the purchase of certain industrial products as fertilizers, pasticides etc. In this case, the contribution of the state budget is paid to the trading organization distributing these products.

STOCKPILING ENTERPRISES (*Készletező vállalatok*): Under the former system of distributing production goods, certain specially appointed trading enterprises were called upon to buy such goods from the producers and to distribute them among the authorized purchasers. Accordingly, they had to perform administrative functions. Under the new system they have been replaced with the "specialized trading enterprises" (q. v.) operating on commercial principles.

SUPERVISORY AUTHORITY (*Felügyeleti szerv*): Supervision of the enterprises is performed by the competent branch ministry (q.v.) or, in the case of local enterprises, by the competent local council (q.v.).

TARGETWISE AGGREGATE INVESTMENT LIMITS (*Célcsoportos beruházások*): Only two categories of investments must be submitted for government approval: the major individual investment projects (q.v.), and the targetwise aggregate investment limits. In the latter case the planned (productive or non-productive) investment objectives (e. g. housing projects, power grids, highway construction, etc.) are represented in the national economic plan by aggregate lump sums allotted to each objective. The lumpsums so determined may provide means for the implementation of several or many individual investments serving the same objective. The exact location as well as the economic and technological data of each individual investment depend on branch decisions, i.e., some are decided on by the supervisory ministry, others by the competent local councils.

Taxes (*Adók*): By considerably reducing the gap between producer and consumer prices, the price reform (cf. price system) has brought about important changes in the structure of budget revenues, since part of the difference between the two price levels flows into the budget in the form of *turnover taxes*. The share of this tax type in the total budget income fell from about 50 per cent in 1956 to 13–14 per cent in 1968. The reform has simplified the system of turnover tax: the number of individual tax rates has been reduced considerably. The income from *customs duties*, an almost negligible amount in the past, has reached some 5–6 per cent of the total budget income with the introduction of the new customs tariffs and the increasing volume of foreign-trade. Nevertheless, the combined share of all indirect taxes in the budget revenue shows a substantial decrease. The gap has had to be filled by direct taxes. These constitute now about two-thirds of the budget income.

The overwhelming part of *direct taxes* is borne by the enterprises. Some of their taxes directly depend on the amount of production factors used: they pay five per cent of "*charge on assets*" (q.v.) on the gross value of their fixed and circulating assets, and a 25 per cent charge on their wage bill, namely a *wage tax* of 8 per cent and a 17 per cent *contribution to social insurance*. Neither of the last two is deductible from wages. These charges represent the minimum of net income any enterprise is expected to yield. The *part of depreciation allowances (amortization) due to the budget*, amounting at present to 40 per cent on an average, can be considered as another tax on fixed assets; the rest flows into the development fund of the enterprise (q.v.).

Finally, the new system has introduced a *tax on industrial sites*; this amounts to about 5 per cent of the value of the plot. The *profit tax* depends on the amount of profits actually achieved. The part destined for the enterprise's sharing fund (q.v.) is taxed progressively at rates varying between 40 and 70 per cent; the part going to the development fund (q.v.) is taxed at a linear rate, which generally amounts to 60 per cent. The *production tax* is applied only in a few branches (e.g., to mineral-oil processing) and is meant to level out certain differences in production conditions effecting profits, by withdrawing the part due to the differential rent.

Technological improvement fund (*Műszaki fejlesztési alap*): This type of enterprise fund was instituted in 1959, that is, well ahead of the introduction of the new mechanism, but has been maintained under the new system. Unlike other enterprise funds, this one is alimented on account of the *costs*. The price of certain products and services contains a factor termed "allowance for technological improvement" of different rates, thus constituting part of the sales receipts. This fund —which must be distinguished from the "development fund" (q.v.)—serves to cover costs (other than those of investment) connected with technological improvement. But, whereas prior to 1968 the values of this fund marked the upper limit of such expenditure, under the new system it represents rather its minimum. The point is that spending on technological improvement can be charged against production costs in every enterprise, regardless of the existence of a separate fund for technological improvement. Another difference is that formerly the supervisory ministry used to be entitled to tap enterprise funds for covering the costs of central measures aimed at technological improvement (e.g., buying information and documentation, drawing up new standards, etc.). Instead of this, the enterprises now pay a fixed percentage of their funds' income to the competent ministry and the National Board for Technological Development (q.v.) to cover such spending and risk as go beyond the means of the individual enterprise, and they are free to use the rest.

TRADE REGULATIONS (*Termékforgalmazási rend*): Prior to 1968 a large number of production goods (2,400 in 1954, 400 in 1966) were subject to centralized allocation. The economic reform has, also in this respect, introduced the "multi-channel system of trade" (q.v.). The wide assortment of certain types of production goods or the wide range of small-scale purchasers has made it necessary to create "specialized trading enterprises" (q. v.) explicitly for the purchase and sale of certain production goods. But not even these enterprises have a monopoly position or any "administrative" function. Agreements between producing and trading enterprises aimed at preventing any consumer or processor from directly purchasing from a producer, or at marking the areas to be served by each of the participants (rayonning) can only be concluded with the permission of the supervisory minister, and the permission may only be issued with the consent of all parties concerned.

Evidently, the abolition of most former administrative restrictions could not cure the imbalances existing with respect to various (mostly imported) production goods. The new regulation of trade has necessarily increased the responsibility of the central planning and controlling authorities for the maintenance of equilibrium between supply and demand. For this end, and with due regard to the interdependence between market equilibrium and price, the former National Price Office has been transformed into a National Office of Prices and Materials. The "commodity balances", known also in the former system of planning, have not been abandoned: in 1968 these balances comprised the sources of supply and the quantities needed of 143 individual kinds of materials and other production goods (including 28 products of the engineering industry). For a certain transition period, administrative restrictions have been maintained on goods with respect to which imbalances were likely to become inevitable. Such restrictive measures are: *central allocation* (now practised only for distributing raw meat); quotas (q.v.), *compulsory contracting* (c.f. Delivery contracts and Quotas), and *compulsory trading channels*. This last kind of regulation affects now only eleven commodities.

TRUSTS (*Trösztök*): The former system of economic control and management frequently applied the practice of creating trusts, i.e., economic organizations comprising several enterprises, as tools of administrative management. Before 1968, trusts often acted as medium-level authorities inserted between the supervisory ministry and the enterprise. In compliance with the new principle of enterprise autonomy, most of these trusts have been dissolved. For the prolongation of their existence or for the foundation of new ones, a special government decision is required. Most of the surviving trusts are "vertical" ones (e.g., the bauxite-aluminium industry, the extracting and refining of mineral oil). The "horizontal" trusts have, as a rule, been abolished, except for electric power production and distribution, where national interests require the existence of a national grid.

TURNOVER TAX (*Forgalmi adók*): cf. Taxes.

UNION (*Egyesülés*): Autonomous state-owned enterprises may voluntarily form "unions" in order to pursue certain activities jointly. Hungarian unions substantially differ from organizations of a similar name in other socialist countries. In the framework of a union each enterprise maintains its independence, and the union is entitled to handle such matters only as are xplicitly defined in the union contract. The leading executives of the union are elected by the participating enterprises, pending the approval of the supervisory authority. One enterprise may belong to several unions. The foundation of a union is subject to approval by the competent minister. In certain cases the minister is entitled to instruct enterprises to form a union for a definite period of time not exceeding five years.

WAGE MULTIPLIER (*Bérszorzó*): Before taxation, enterprise profits are divided into two parts, the one being due to the development fund (q.v.), the other to the sharing fund (q.v.) In principle, the division corresponds to the proportion existing between the annual wage bill and the actual value of the fixed and circulating assets. Yet, before calculating this proportion, the wage bill is multiplied by a factor, in order to emphasize the incentives arising from the sharing fund. Initially the multiplier was 2, but as from 1971 it is 3, and even higher multipliers were or are used in some branches where the proportion between the value of assets and the wage bill substantially differs from the average. Thus the wage multiplier in ferrous metallurgy is now 5; it is 4 in the aluminium industry, 6 in coal mining and 7 in forestry.