Note of a meeting between Mr Peter Veress, Hungarian Minister of Foreign Trade, and Lord Cockfield, Chancellor of the Duchy of Lancaster, held at the Ministry of Foreign Trade, Budapest, on Friday 7 September 1984

Present:	Lord Cockfield Mr P W Unwin (HM Ambassador, Budapest) Mr A K Galloway (PS to Lord Cockfield)	Mr Veress Mr Antalpeter (Director General, MFT) Mr Kollar Mr Bene (Commercial Counsellor, Hungarian Embassy, London)

After the opening courtesies Lord Cockfield said that the last 12 months had seen an increase in trade between the UK and Hungary. In the final analysis the level of trade was determined by the level of prosperity. The UK was now coming out of recession at a satisfactory if not a fast rate. Last year there had been a 3% increase in the national product and a similar increase was expected this year. This would amount to two years in which the rate of growth in the UK was at or near the top of the EC league. It was important to sustain this, since growth made a big improvement in a country's economic position. In the 1950s and 1960s, a period of growth and prosperity, growth had averaged 2½% to $2^3/_4$% a year. If the present rate could therefore be maintained the prospects were good.

Lord Cockfield said that a very important factor was growth in export trade. It was an important issue in raising the level of activity in the economy.

Lord Cockfield asked Mr Veress what his feelings were on the prospects for the Hungarian economy. Improvement in the UK economy had come as the result of very firm Government action. Inflation was now down and productivity up. Competitiveness had also improved. These were factors which underpinned the recovery. The Hungarians had also made changes in the running of their economy. How did Mr Veress see the current position and the future?

Mr Veress said that between 1973 and 1978 Hungary had taken an erroneous view of the post-1973 situation. It had been thought that the Hungarian economy could be protected from the effects of the oil price crisis. This rather naive view had been wrong. The Hungarians had allowed for a 4% to 5% growth rate and some increase in living standards.

In order to achieve this Mr Veress said, Hungary had had to import more from the Rouble area and from the covertible currency area. Up to 1979, with interest rates of 5% to 6%, the Hungarian economy and the National Bank and their reputation did not

suggest a credit risk to the West. If exports did not cover the cost then it would be possible to borrow more.

This view was wrong, said Mr Veress. There was a shortfall in 1978. Import had been free in those days. Hungarian currency could be freely converted. In 1978 the passive balance of convertible trade exceeded $1 billion - nearly 45% of total exports in a year.

Mr Veress said that this situation was disastrous, and could not be allowed to continue. From 1979 much more attention was paid to the balance. In 1980 and 1981 with interest rates high and with a political crisis over Poland and Afghanistan the situation became one of "rien ne va plus". Suddenly everything was a risk, and the reaction of foreign capital was that it would be best to leave Hungary. Large amounts were withdrawn from the Hungarian Bank, and a day-to-day liquidity problem became apparent. It had been necessary for a new policy to be created or developed

Mr Veress said that a decline in living standards would have been politically very difficult, and Hungary did not want to risk re-scheduling, because of the cost. It had therefore been necessary to reduce the internal application of funds. Both public and private consumption had to be controlled to give the economy time to come out of the tunnel. The Forint was to be kept strictly under control, and the budget had to sit on the shoulders of the national economy. It was a strict fiscal policy with controlled living standards.

Mr Veress said that interest rates at 12% were far too high. Money was too expensive, and if industry was unable to develop then it would lag behind. This would have heavy consequences in the longer term. Hungary now needed to return to normalised import. Supplies from the Socialist countries had been stronger than expected, and this had helped survival.

Mr Veress said that the volume of imports from the convertible area had increased by 4%. It was now better in total than it had been for 3 years. It was not now possible to blame lack of progress on import shortage. But development and technology were still not getting enough resources. If Hungary could develop good relations with the IMF and put up a good export performance while increasing imports about 50% of the income from exports would be used in improving technology.

Mr Veress said that external circumstances were not very good and exports were below their scheduled level. The active balance was smaller than had been foreseen. Either more credit or fewer imports were therefore necessary.

Mr Veress said that there were also other problems. In the major area of Hungarian exports - agriculture and the food industry - prices were very low. The same was true for steel and aluminium,

though there was some improvement in textiles. The terms of trade this year would cause a bigger-than-expected loss.

Mr Veress said that the Hungarian economy was better placed than it had been a year or so ago, but was still behind schedule. The liquidity of the economy and the National Bank was not in question. The IMF people were quieter now, but 1984 was not yet entirely in the Hungarians' hands, and there could be no relaxing.

Mr Veress said that so far as international trade was concerned relations with West Germany, Italy and Austria had now reached a level which matched the economy, but those with the UK, France and the Netherlands were far from being at a reasonable level. But after much effort there were some encouraging signs.

Mr Veress said that the tradition of trade between the UK and Hungary which had existed before the war had gone after 1945, and had had to be started from scratch. For 20 years after the war Hungary had been able to sell all it wanted to the Eastern bloc, West Germany, Italy and Austria. It had, however, become evident that Hungary could not rely on trade with so few partners, and international factors required the expansion of trade with countries such as the UK which showed a readiness to understand the Hungarian economy.

Lord Cockfield said that the UK market was the most open in the world. In Britain the market tended to be favourable towards imports. Shoppers would buy goods from anywhere if they were of the right quality, design and price. The United States talked about free trade and had the world's most restrictive import policy; and Japan was impossible.

Lord Cockfield said that there were people in the UK who demanded the imposition of import controls, but the Government had stood out against this. 30% of GNP was tied up in international trade. This could not be put at risk, and the UK must therefore maintain open trading. This meant that the UK suffered in some specific areas, but the country as a whole benefited.

Lord Cockfield said that the problem in the UK was supplier selling. The distribution system was efficient, and if the supplier had the right goods then they would sell. It was essential to go to people such as Selfridges or the House of Fraser. They were the people who bought.

Lord Cockfield asked how improving the performance of state industry was tackled in Hungary. In the UK, generally speaking, all capital invested in these industries had produced a rate of return of zero. The policy now in the UK was to privatise, and this had proved, by and large, very successful. In the past management had always felt that they would be bailed out. Now they had to do it themselves.

Mr Veress said that state industries in Hungary were of very low efficiency. Technical work was poor and discipline was weak. Planning and financial forecasting were also very bad. Serious underestimation meant that the Government was forced to pay out when projections of expenditure turned out to be too low. Those responsible went unidentified. Also equipment and technology were out of date because those involved did not know of the latest developments and because second-hand technology was cheaper.

Mr Veress said that there were three sources of investment in Hungary: the State; enterprises which did not have a budget allocation; and co-operatives. In the case of State investment there was now much more careful preparatory work and more control of details and of inputs and outputs. In the case of the enterprises there was now a strict condition that the State would not finance them, and that project costs had to be within the forecast. Rates of return had previously been handled very superficially but were now taken much more seriously. A payback period of between 5 and 12 years was expected.

Mr Veress said that more development was being given to Western firms. The Austrians were doing well here. They had built in 1½ years a hotel which Hungarian constuctors had estimated would take 3.

Mr Veress said that absolute guarantees were no longer given. Control was more scientific, and much less was left for contingencies than had been the case before.

Lord Cockfield asked whether, since Mr Veress had said that poor management was a problem there was any education of managers. Were there business schools? How were managers motivated?

Mr Veress said that a number of Hungarian engineers and managers got their knowledge overseas, or as importers. Many Hungarians worked overseas on a contractual basis. They knew how things should be done, but there was no way of forcing them. The new system, however, encouraged people to do their utmost by paying them more if they did and less if they didn't. The price paid in the past for higher living standards had been debt. People now had to improve their living standards by working harder. It was planned to change the whole system of incentives both financial and disciplinary.

Lord Cockfield commented that the problem with discipline was that all one had to do was to match the average performer. What was needed was to get the average up the level achieve by the outstanding few.

Mr Veress agreed and said that it was better to rely on financial incentives. But this gave rise to political problems, since it conflicted with the principles of egalitarianism.

Lord Cockfield said that it was a very difficult problem, and one which had not yet been solved in the UK, though there had been an improvement. Proper accounting was essential to enable individual people and their results to be identified. If there was proper control then people took a pride in what they did. Without it they felt that their individual achievements would only be lost in the mass of figures and were not motivated to perform well.

Mr Veress said that there were individual profit centres in Hungarian enterpises. There was also an experiment with small working associations, which could be within or outside an enterprise. This enabled people to organise their work better and to choose the members who would work with them. The efficiency of work had been 30% to 50% better. But the experiment had been very risky, and there had been a great deal of disapproval. 4% of people were able to increase their earnings, but the remaining 96% wanted to know why.

Lord Cockfield commented that there was no nexus in the popular mind between work and payment. Agreeing Mr Veress said that in Hungary it was said that the salary was the fee for merely turning up. Unless people could accept that higher living standards could be achieved only with better working then nothing would be achieved.

Lord Cockfield asked whether there would be political problems if people could not expect higher living standards. Mr Veress said that there would be social unrest.

Lord Cockfield said that the solution to economic problems lay in increased efficiency not investment. Investment consumed resources but increased efficiency did not need to cost anything. People did not necessarily need to work harder: they needed to work better. Mr Veress agreed. He said that 10% to 20% of effort was wasted because of low efficiency. The general standard of management was very low.

Lord Cockfield said that he would like to ask some questions about design and quality. West Germany was very good in this area. The UK had fallen behind, but had started quality control and standards. There had been a major drive in Britain. The British Standards Institute had been given a better status.

Mr Veress said that on the question of design there was a gap between the intellectual capability of the Hungarians and the execution. Hungarian design was very good, and the country exported designers to West Germany and Austria. But discipline was poor. Quantity was the basis of planning in the Socialist Countries. Such factors as the interchangeability of goods were neglected, and there was commonly a lack of spare parts, for example for cars and tractors from the German Democratic Republic. Spares had had to be imported from West Germany!.

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Lord Cockfield asked whether the Hungarians could not manufacture the spare parts themselves. In the UK there was now not so much emphasis on producing finished cars; but a large component industry had developed. The Hungarians should make their own spares.

Mr Veress said that Hungary did export spare parts for bicycles: but the problems of spares was general in the Socialist countries. One of Hungary's aims was to produce more spare parts, especially electronic components. The Eastern bloc was well behind in this field, and at a conference in Moscow it had been agreed that capability should be increased, especially in robotics. There was now a serious compulsory electronics programme. This was an area in which the evelopment of the technology could take years.

After further courtesies the meeting closed.

A K GALLOWAY

September 1984

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