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Economic Growth Potential and Growth Strategies

How should the growth potential of Central European economies be assessed during the process of structural change? We believe that the determination of medium-term growth in Central European economies will require the consideration of special factors. Such factors will be identified to project the medium- and long-term economic growth of Hungary.

Re-emerging Economies

We define Central European countries, including Hungary, as re-emerging economies. Unlike other so-called emerging economies, Central European countries are rated highly in both regarding GDP and social life (including education and culture). However, income flow is disproportionally low compared with the existing level of social life. Economies characterized by such unbalanced aspects may be properly defined as re-emerging rather than by the usual concept of emerging.

Central European countries have already possessed fundamental conditions which may not exist in typical emerging economies. In this sense, their societies have reached a certain stage of maturity. Even though the dynamic growth potential of emerging economies, required to create fundamental special conditions, cannot be expected from them, they are expected to grow steadily to a high level.

In other words, they are able to achieve moderate and steady growth by building a system to utilize the existing fundamental conditions in a more effective and efficient manner. In this respect, they are re-emerging economies. The on-going structural change is necessary for these countries to build a system for operating the existing economic growth factors effectively.

Is this definition applicable to all economies in transition? With regards to having the fundamental conditions for social development, countries that have been subordinated to the former Soviet Union generally lack the necessary conditions, this however is not a uniform assessment. Former Yugoslavia (excluding Slovenia), Bulgaria, and Rumania have a lower level of social development in general, compared with Central European countries. They are unable to achieve substantial economic growth easily because of both the low level of existing growth factors and the lack of conditions for operating these factors effectively. This matter will be discussed in detail in the following section.

Therefore, economies defined as re-emerging here are Hungary, the Czech Republic, Poland, and the Slovak Republic. Obviously, these four countries are under the strong influence of Germany as well as the historical heritage of the Habsburg Empire. It may be safe to say that their historical backgrounds make them re-emerging economies. In more symbolic usage of words, re-emerging economies in Central Europe might be defined as "the modern resurrection of the Habsburg Empire".

Growth Factors in Transforming Economies

There is "a gap in the market evolution" of economic factors in transition economies. Since their national economies were virtually closed to the rest of the world, the economic factors in these countries were not properly evaluated in market terms. The revaluation process of undervalued economic factors within the framework of market value is the economic substance of the structural change. in other worlds, this is a way of changing the value rating system.

This process is focused on the changing of the relative price system and the absolute level of prices. Prices which were previously determined by the administration will be reviewed in accordance with market conditions, and this revaluation will continue for a long time This should not be considered, as western economists have argued, to be simply an administrative process which can be carried out in one stroke by abolishing administrative restrictions on prices. Instead, it should be regarded as a long-term process of economic adaptation parallel with the institutional change and economic growth, since the change of value in economic factors is inevitable.

In this case, the domestic price system will be revised first through imported products, and the revision will be reflected in exported products. On the other hand, domestic products for domestic markets exempt from administrative restrictions will be subjected to repeated price revisions to compete on the market with imported products. this is a process of repeated gradual interaction and may continue for at least a decade from the initiation of structural change.

Among other things, the revaluation of labor resources is important. This will be initiated by the influx of foreign companies as a direct factor which will continuously push up the level of wages. In the long term, the wage gap between the West and the East will disappear. the revaluation of labor resources is expected to continue for a very long time. In 1995, six years after the structural change began, the level of wages in Central European countries remains one-seventh or one-tenth of that in Germany or Austria. This fact makes us recognize that the leveling of wages between the West and the East will take a considerably long time. It should be remembered that the transfer of capital and technology from the West to the East is still in its early stage.

Table 1

Comparison of Minimum Wages among Central and Eastern European Countries (monthly wages in 1995)

Poland	$ 100
Hungary	$ 90
Slovak Rep.	$ 79
Czech Rep.	$ 78
Rumania	$ 35
Bulgaria	$ 33

Note: Generally, average wages in these countries are in the range of two or three times of minimum wages. *Source:* ILO

The above-mentioned revaluation of products and labor resources is a significant factor which will certainly elevate the GDPs of re-emerging economies in the medium to long term.

Besides these factors, there are also other factors which may raise the GDP. One of them is that economic activities which not conventionally existed will appear as a result of the transition to a market economy and raise the GDP. Another factor is that some existing national assets, which have not conventionally been evaluated in economic terms will acquire market value, in the course of transition to a market economy and thus, elevate the GDP.

An example of the former is a rapid increase in small enterprises. the liberalization of private enterprises banned under the old regime unleashes people's economic vitality and results in the rapid increase of added value. In 1995, about the one million self-employed people were registered in Hungary. Many of them are engaged in retail and other various service industries. these are fields of business whose income flows are scarcely captured by official statistics, partly because they were not included in GDP statistics under the old system.

Similar problems also face advanced market economies. However, transition economies do not have much experience in statistical techniques and taxation and cannot capture added value produced in these fields. For this reason, the GDPs of transition economies are likely to be always underestimated. the nominal GDPs of re-emerging economies seem to be underestimated especially in comparison of those of Western countries. Examples of the case are real estate, tourist resources, inventions and specialties. although some may be revaluated lower than before, the value of excellent companies' assets may rise following the transition to a market economy.

The above-mentioned factors will cause a real increase in the GDP only when prerequisites are satisfied: i.e., the steady development of a market economy, the development of foreign trade, the influx of capital and technology by direct investment, a favorable system for fostering private enterprises, and the steady promotion of privatization. Unless these requirements are met, the factors themselves will never be manifested. On this point, there is a large variance between Central European economies and other transition economies.

Official GDP and Purchasing Power Parity GDP

In the previous section, the main feature of re-emerging economies was described as the process by which structural change facilitates the revolution of economic factors and eventually raises the GDP. To clarify this point, the GDPs of Central European countries will be compared in terms of official exchange rates (official GDP) and purchasing power parity (purchasing power parity GDP).

Table 2

Comparisons of Per-capita GDPs of Four Central European Countries in 1994
(in USD)

	Czech Rep.	Hungary	Poland	Slovak Rep.
a. Official rate GDP	3489	3981	2294	2324
b. Purchasing power GDP	8883	6332	5040	5989
c. a/b	0,39	0,63	0,46	0,39
d. a/EU average	0,21	0,24	0,13	0,14
e. b/EU average	0,52	0,37	0,30	0,35

Note: Data on purchasing power parity GDPs were obtained from the Vienna International Comparative Economic Research Institute.EU averages used in calculations (d. e.) was USD 17 000.

Judging from purchasing power parity GDPs, it is obvious that the economic strength of Central Europe is currently underestimated. What should be noted is, that it is a mistake to simply argue that "the current exchange parity is undervalued" by referring to the current official exchange rate which is much lower than the purchasing power parity. Purchasing power parity is merely a theoretical calculation, which does not provide appreciation for the real flow of income. It cannot be said that the real exchange rate is always low because the parity from calculations is low. Purchasing power parity merely represents potential but does not determine the real flow of income. The gap does not determine the real flow of income. The gap between the purchasing power parity and the official exchange rate is interesting only when projecting a long-term trend of exchange rates, which should be distinguished from short-term fluctuations.

As shown in the preceding discussion, the very process of revaluation of economic factors is the process by which the GDPs of Central European countries will approach purchasing power parity GDPs. Exchange rates will be adjusted for purchasing power parity as economic transition, privatization, and foreign capital flow are promoted. These countries' GDPs in dollar terms will tend to rise at a higher rate than the rate of increase in value added.

In this process, the GDPs in dollar terms can be expected to rise at a very high rate. As discussed in the next section, this trend is already clear in the Czech Republic whose GDP in dollar terms has increased by over 10% annually despite the sluggishness of the real GDP. As shown in this case, the increase differs from that in domestic value added. Transition economies are characterized by "the effect of raising exchange rates through the revaluation of economic factors". The increase of GDP in dollar terms will continue until the completion of economic transition.

If the process continues steadily, Central European countries will not take much time to achieve half the EU average GDP per capita (USD 8 500). In particular, the Czech Republic and Hungary will probably achieve such a level in about five to seven years. Of course, as is repeatedly stated, conditions for promoting the revaluation of economic factors must be provided for its achievement.

Paradox of GDP Growth

As far as the official GDPs of Central European countries are concerned, a rapid growth in GDP is not in sight. As you can see easily by simple calculation, it is impossible to make their GDP double by a few percentage annual growth in five to seven years. To the contrary, according to official GDP statistics, even Central Euroepan countries recorded minus growth until 1993. In this situation, how can they raise their GDPs?

Table 3

Two Types of GDP Growth Rates

		1990	1991	1992	1993	1994
Hungary	Real growth rate	–3,50	–11,90	–3,0	–0,8	2,0
	GDP per capita (USD)	3189	3221	3595	3727	3981
	Dollar-based growth rate	–	1,0	11,6	3,67	6,82
	Deviation rate	–	12,9	14,61	4,47	5,32
Czech Rep.	Real growth rate	–1,20	–14,2	–6,4	0,9	2,6
	GDP per capita (USD)	3050	2358	2713	3024	3489
	Dollar-based growth rate	–	–22,69	15,06	11,46	15,38
	Deviation rate	–	–8,49	21,46	12,36	–12,78
Poland	Real growth rate	–11,60	–7,0	2,6	3,8	5,1
	GDP per capita (USD)	1547	1999	2198	2232	2294
	Dollar-based growth rate	–	29,22	9,95	1,55	2,78
	Deviation rate	–	36,22	7,35	–2,25	–2,32
Slovak Rep.	Real growth rate	–2,50	–14,5	–7,0	4,1	4,8
	GDP per capita (USD)	2702	1902	2055	2074	2324
	Dollar-based growth rate	–	–29,61	8,04	0,92	12,05
	Deviation rate	–	–15,11	15,04	5,02	7,25

Note: Real growth rates were taken from official statistics issued by these countries. Deviation rates represent dollar-based growth minus real growth rates.

However, as was stated in the previous section, it should be noted that growth rates in these countries' dollar-based GDPs are extremely high, as they have continously revaluated their currencies to the dollar in real terms. This is the very "effect of raising exchange rates in the process of economic revaluation".

As far as this region is concerned, official GDP growth rates show a contradictory tendency to dollar-based GDP growth rates. There is, a "paradox of GDP growth". This phenomenon is notable.

Table 3 compares growth rates in rwal GDPs based on the domestic currency with dollar-based GDPs. Generally, dollar-based GDP growth rates may be expressed as the summation of real growth rates and real exchange rates in parity to the dollar as follows:

$$DGDP\ (USD) = DGDP\ (REAL) + DFOREX\ (USD)$$

Obviously, deviation rates in Table 3 are nothing but real change rates in parity to the dollar.

As shown in Table 3, Central European countries have continously revalued their own currencies to the dollar, with some exceptions. At least the Czech Republic and Hungary have shown very high growth rates in their dollar-based GDP. As long as this trend continues, it will not be difficult for them to double their dollar-based GDPs in five to seven years. According to our projections, the revaluation of their currencies to the dollar will continue until the completion of economic transition. the rate of growth may be determined by the pace of the transition to market economy and privatization.

Another phenomenon observed in Table 3 is that the growth rate of Poland's dollar-based GDP is not high, contrary to recent commonly held views. In the case of Poland, it is notable that the zloty has actually tended to be bearish to the dollar, and the growth rate of its dollar-based GDP is lower than that of its real GDP. Nevertheless, the currency will probably be revalued to the dollar in the long term.

The influx of short-term capital into the Czech Republic to profit from exchange differences can be also interpreted under these cirsumstances. Even if the upward trend of exchange parity continues, it is needless to say, that the parity will not rise at all times.

Table 4

Indices Related to Hungary's GDP

	1990	1991	1992	1993	1994
Real growth rate (%)	–3,50	–11,00	–3,00	–0,80	2,00
Dollar-based growth rate (%)	10,30	1,00	11,61	3,67	6,82
Consumer price elevation (%)	28,90	35,00	23,00	22,50	18,80
Producer price elevation (%)	22,00	32,60	12,30	10,80	11,30
Devaluation to the dollar (%)	6,94	18,70	5,60	16,51	14,21
Real devaluation to the dollar (%)					
a.	21,96	16,30	17,40	5,99	4,59
b.	15,06	13,90	6,70	–5,71	–2,91
GDP deviation rate (%)	13,80	12,90	14,61	4,47	4,82

Note: Price elevation rates are on the annual average. Devaluation rates to the dollar are on the annual average. Real evaluation rates in row a. are consumer price elevations minus devaluation rates to the dollar. Real evaluation rates against the dollar.

Hungary's Growth Rates in Two Periods

Looking at Hungary's GDP up until 1994, its growth may be clearly divided into two periods. One is a three-year period from 1990 to 1992. In this period, other countries suffered a substantial decline in industrial output and a fall in GDP due to the collapse of COMECON. However, a huge amount of foreign capital flowed into Hungary, imports from abroad increased suddenly, and consumer prices rapidly soared. At the same time, the favorable trade account and the flow of foreign capital contributed to a two-digit real revaluation against the dollar. This had a reverse effect on the dollar-based GDP, which rose in spite of a fall in real GDP.

The other period is from 1993 until the present. The deficit in the trade account swelled, and the devaluation rate against the dollar became large, exceeding the rate of increase in production prices. As a result, the parity was devalued in relation to producer prices but somewhat revalued in a real sense in relation to consumer prices as before. In this period, the dollar was continously devalued against the German mark and the Japanese yen. This trend has helped Hungary's dollar-based GDP to continue to rise.

As shown in Table 4, GDP deviation rates are not completely consistent with real revaluation rates to the dollar. However, it may be said that the variance is due to a tolerable error in calculation (a problem seems to arise in calculating GDP deflators to determine the real GDP).

Altough the dollar-based GDP is likely to grow continously in 1995, the rate of increase will probably be small compared with that in 1994 because of significant devaluation by crawling peg. However, it is very likely that a nearly two-digit real revaluation against the dollar will be registered in 1996 because the external equilibrium is recovering. The dollar-based GDP is expected to grow against a high rate.

As long as the transition to market economy, privatization, and the flow of foreign capital continue at a steady pace, the current trend will remain for at least five to seven years. If an annual growth rate of 10% in dollar terms is achieved, the per capita GDP will exceed $ 8000 by the turn of the century and reach about half the EU average. Unless this scenario is significantly interrupted mid-process, Hungary will be able to join the EU in the early 21st century.

1. Setting Up a Division for Long-Term Strategies

After the end of the World War II, the Japanese government has announced medium-term growth targets from time to time, providing guidelines on the direction of the Japanese economy to private companies. In the case of Hungary, the Planning Agency in charge of long-term economic strategies was abolished in order to abandon the so-called planned economy. It is gradually becoming clear that the economy is managed under a three-year short-term plan prepared mainly by the Ministry of Finance.

On the other hand, the initiatives of the Ministry of Finance are severely criticized by members of the Socialist Party. They propose that a minister or a new division should be established to draw up economic strategies. However, this proposal has not been put into action because the Liberal Democratic Federation is opposed to such a post or division. As long as its economic management focuses on short and medium term fiscal revenue and expenditure, the directions and goals which Hungary should pursue will remain uncertain.

Joining the OECD and EU is a political goal rather than an economic one. These developments will be the results of economic growth but will not produce any economic results. Determining economic goals is a necessary step for Hungary to join the EU. Moreover, in a wide perspective of strategies, the country needs to determine very-long-term goals and visions targeting economic growth after joining EU.

Accordingly, a permanent division or department needs to be established to develop long-term economic strategies and create policies for implementing them. It is recommended that this matter should be discussed again within the government.

2. Long-term Strategies in Two Phases

When considering long-term economic strategies, a total of 15 years may be assumed to be a significant period. This period of time may be divided into two phases: a seven-year phase from 1996 to 2002 as a gestation period for joining the EU; and an eight-year phase from 2003 to 2010 for actually joining the EU. Generally, medium term is five years, long term is eleven years, and a super long term is fifteen years. Hungary as a transition economy should consider long-term strategies in such a time span.

In the above mentioned two phases, Hungary will apparently have different problems regarding economic strategies. For, as already stated, in 1996 the country will enter the final stage of structural change and privatization and this phase will last five to seven At that point, the country will make more progress in reevaluating its economic resources and will be able to achieve a relatively high growth in dollar-based GDP. Economic growth may be achieved without much difficulty, owing to the undisturbed completion of transition to a market economy and privatization.

However, if the structural change and privatization are to be completed, the surplus energy for growth will be used up in the completion. The re-evaluation of economic factors will be brought to an end, and the effect of real exchange parity revaluation will gradually disappear. How can Hungary as an ordinary market economy develop further in an expanded Europe? This question will have to be seriously considered in the final stage. To respond to this question, the country needs to develop long-term strategies for further development after joining the EU.

3. Growth Strategies Prior to Joining the EU

In brief, Hungary's target for growth is to double its GDP in the seven years from 1996 to 2002. That equals a per capita GDP of about $ 8 500. As previously stated, the target can be achieved not only by growth in real GDP but also by continous real revaluation against the dollar.

Of course, this target cannot be achieved automatically. Hungary must base its economic development on exports, just as Japan does. On the assumption that the transition to market economy and privatization will be succesfully completed, Hungary must determine an export target corresponding to the GDP target and strongly promote policies for achieving such a target. In the case of Hungary, the value of exports equivalent to a GDP of $ 8 500 per capita is $ 30 billion. Conversely, the GDP per capita may exceed $ 8 500 if productivity rises to a level such that, exports of over $ 30 billion per year can be achieved.

To achieve the above mentioned target, Hungary needs to develop strategies to triple exports in the coming seven years. This target cannot be achieved simply through the transition to market economy and privatization. The country needs to expand productivity and export capacity further, by inviting direct investment from abroad. It is essential to reinforce Hungary's productivity and export capacity by receiving new direct investment of at least about $ 20 billion in the coming seven years.

The Hungarian government is required to determine such a target and to develop policies and an organization for achieving it as soon as possible. For this purpose, the government must achieve a national consensus on long-term strategies by all means.

4. Economic Strategies After Joining the EU

In the second phase (from 2003 to 2010), before which the surplus energy for growth would be used up, Hungary will have no choice but to depend on scale expansion and improvement in productivity for further growth in GDP. The second phase will be a turning point in its development: i.e., whether the country as an ordinary market economy will continue to develop as a medium-developed country (region) in Europe or develop into an advanced country in Eastern region of Europe with some special features distingushed from others. In terms of GDP, it will be a daring attempt to increase GDP per-capita from $ 8 000 to the EU average of $ 17 000.

The first factor in economic growth in the second phase will be the capital accumulated in the first phase. That is to say, capital accumulation between 1996 and the early 21st century will determine economic growth capacity in the early 21st century. Accordingly, the transfer of capital and technology by promoting direct investment and introducing foreign capital in the coming five to seven years is a major factor, which may determine whether Hungary becomes a medium-developed country in Europe in the early 21st century or not. Regarding this point, the promotion of direct investment is particularly important.

If Hungary can introduce $ 20 billion of foreign capital in the coming seven years, it will become a country (region) which will play the role of a hub in Eastern Europe after its joining in the EU. This means the realization of Hungary's desire to become a gateway to the East and the West or the North and the South. The country will acquire a clear role in Europe. Therefore, the government should determine national goals to become the hub of Eastern Europe and explore measures to attain them. It is an essential requirement that Hungary should attract an overwhelming sum of foreign capital and develop a policy for inviting foreign companies.

For the leap into the 21st century, another significant problem along with the role of being a hub is to utilize human resources within the country. Hungary must make the best use of its comparative advantage on basic science. To do so, government must adopt a policy to encourage research and development which will give rise to applied technology. The government should give research opportunities to qualified but unemployed scientists and technicians by reorganizing national research facilities on the one hand and take preferential measures for the advancement of national science and technology on the other. These initiatives should include maximum incentives for cooperation between research institutes and companies, and in-house research and technological development.

It is not difficult for Hungary to become an ordinary country or a second-class economy in Europe. To outgrow such a status, Hungary must have a comparative advantage in one field or another so that it will not be inferior to advanced countries. Switzerland and Austria, which do not have a strong industrial base, have achieved a high level of national income because of first-class tourist resources. To catch up with these countries, Hungary must have something as marketable as their resources. Excellent capabilities of research and technological development and an overwhelmingly influential function as the hub of the East will certainly change a small country in Central Europe into a first-class economy.

Bringing this idea to fruition will require strong political will and effort. In this respect, Hungary needs to learn from Japan how to develop the strong will to attain a goal by all means, and how to organize and fulfill its potential. It is not planning, but organization and implementation skills which Hungary lacks the most.

It is recommended that Hungary should set a goal to join EU by doubling its GDP in seven years and become one of the advanced countries in Europe in fifteen years, and it should also develop, organize and carry out necessary policies to attain this goal.

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ÖSSZEFOGLALÓ

Gazdasági növekedési potenciál és növekedési stratégiák

Hogyan állapítható meg a közép-európai országok növekedési potenciálja a szerkezeti átalakulás időszakában? A közép-európai országokat (Csehországot, Lengyelországot, Szlovákiát és Magyarországot is) „újra feljövő" gazdaságokként határozzuk meg. E gazdaságoknak más, feljövőnek mondott országokhoz képest számos előnyük van a GDP alakulását és a társadalom életét tekintve, de a jövedelmek szintje a társadalom életének jelenlegi szintjéhez, érettségéhez hasonlítva aránytalanul alacsony. Ez a kiegyensúlyozatlanság különbözteti meg őket az általában feljövőnek tartott gazdaságoktól.