

~~SECRET~~

138

INTELLIGENCE MEMORANDUM

PROBLEMS OF THE HUNGARIAN ECONOMY

CIA/RR IM-440

13 November 1956

WARNING

THIS MATERIAL CONTAINS INFORMATION AFFECTING THE NATIONAL DEFENSE OF THE UNITED STATES WITHIN THE MEANING OF THE ESPIONAGE LAWS, TITLE 18, USC, SECS. 793 AND 794, THE TRANSMISSION OR REVELATION OF WHICH IN ANY MANNER TO AN UNAUTHORIZED PERSON IS PROHIBITED BY LAW.

CENTRAL INTELLIGENCE AGENCY

Office of Research and Reports

~~SECRET~~

S-E-C-R-E-T

FOREWORD

Despite the confused situation in Hungary, this memorandum assumes reestablishment of a Soviet-dominated regime. It is further assumed that recognition will be given to the need for correcting conditions which have led to recurring crises in the Hungarian economy.

- iii -

S-E-C-R-E-T

S-E-C-R-E-T

CONTENTS

	<u>Page</u>
Summary and Conclusions	1
I. Recent Developments	3
II. Internal Economic Situation	6
A. Resources	6
B. First Five Year Plan (1950-54)	7
C. The "New Course" Policy	9
D. Present Weakness of the Economy	10
III. Soviet Domination of Hungarian Economic Affairs	12
A. Hungarian Economic Policy	12
B. Trade and Economic Collaboration	13
C. Financial Assistance	14
D. Soviet Ownership of Hungarian Industry	15
E. Armaments Production	16
IV. Evidence of a New Look for the Hungarian Economy and Possible Consequences	16
A. Reorientation of Trade Toward the West Despite the Impact of Other Bloc Countries	16
B. Emphasis on Consumer Goods in Relation to Heavy Industry	17
C. Collectivization Program	17
D. Adherence to CEMA Agreements	17
E. Hungarian Activity in the Underdeveloped Areas	18
F. Increased Economic Cooperation with Yugoslavia	18

S-E-C-R-E-T

CIA/RR IM-440
(ORR Project 16.1656)

S-E-C-R-E-T

PROBLEMS OF THE HUNGARIAN ECONOMY*

Summary and Conclusions

Any Hungarian regime installed under the aegis of the USSR probably will be committed to the preservation of a Communist economic program. It is also likely that, as a result of the deep-seated nationalism displayed during the recent uprisings, Soviet policy-makers will insist that a more strict discipline be imposed on Hungary's political and economic policies. When the Soviet forces have reestablished order, when the extent of physical damage is ascertained, and when measures are initiated to restore the normal operation of the economic system, the USSR may apply a formula for future Hungarian development consistent with the current policy of amelioration which the USSR is purveying to its own people, to the other Satellites, and to the Free World. Under this policy it is likely that the Hungarian regime, with Soviet consent, will attempt to return to a policy somewhat similar to that of the "new course" of 1953-55, under which efforts will be made to eliminate disproportions in the economy in order to improve the supply of basic materials and food, reduce production costs, and avert the repetitive crises to which Hungary has been subject. This policy may be supplemented by progressive decentralization of economic planning and perhaps some increase in worker participation in plant management along Yugoslav lines.

Under these conditions the economic policies toward which Hungary may move are, in general, as follows:

1. Reduction of the rate of growth in heavy industry and acceptance of greater dependency on imported raw materials, because of the paucity of natural resources.
2. Reallocation of investment funds, materials, and labor force from heavy industry to consumer goods and agriculture.

* The estimates and conclusions contained in this memorandum represent the best judgment of ORR as of 13 November 1956.

S-E-C-R-E-T

S-E-C-R-E-T

3. Efforts to increase the availability of consumer goods and lower retail prices.
4. Continued development of trade with underdeveloped countries outside the Sino-Soviet Bloc as a means of obtaining certain raw materials in exchange for Hungarian manufactured products.
5. Development of cooperation with the Yugoslav government on the basis of mutual advantage.
6. Development of Hungarian agriculture to provide for total requirements of the country's own population and to furnish some of the exports necessary to obtain foreign exchange.
7. Incentives to private farmers in the form of fewer exactions, greater facilities for production, and deemphasis of forced collectivization.

Regardless of the policies of the new regime, Hungary's economic problems cannot be solved at once. The manner in which the uprisings were repressed will make it difficult for the regime to win the cooperation of the people. In contrast to the Nagy government, a Hungarian administration dependent on Soviet force is less likely to take a strong position on behalf of Hungarian economic interests. The USSR, in order to maintain its own prestige, may retain to itself the right to aid in rehabilitating the economy and providing emergency relief. Even if the USSR and the Hungarian regime revise the Hungarian Second Five Year Plan (1956-60) in accordance with Hungarian capabilities, readjustment of industry and rehabilitation of agriculture will require time.

Perpetuation of the Nagy government might have led to a reorientation of trade toward the West, with a corresponding change in the internal Hungarian economy. If, because of the violence and nationalism of the Hungarian uprising, the independent action advocated by the Nagy regime is curbed, then Hungary probably will be tied more closely to the economies of the Soviet Bloc, Yugoslavia, and the underdeveloped areas.

It is within this framework as well as in the context of its internal shortages and capabilities that Hungary may have to approach its economic problems. Next to the smallest of the European Satellites in area, with but 9.9 million persons at the beginning of 1956, Hungary

- 2 -

S-E-C-R-E-T

S-E-C-R-E-T

accounted for about 10 percent of the population of the European Satellites, but only 6 percent of the gross national product. Except for abundant supplies of bauxite, Hungary is deficient in the mineral resources necessary to support an engineering industry. Despite these deficiencies, Hungary attempted to build a steel industry and to increase its machine-building potential to the detriment of the development of consumer goods and agricultural production. Resulting disproportions forced a recasting of these plans under the "new course" in 1953-55 and have contributed to the recent popular upheaval.

Under Soviet domination, Hungary's trade was reoriented away from the Free World. Soviet takings from Hungary in reparations and unfavorable terms of trade have been considerable, and Soviet financial aid to Hungary has been limited. Under the 1956-60 plans of the European Satellites, as coordinated by the Council of Mutual Economic Assistance (CEMA), Hungary is scheduled to occupy a position in the Bloc more in keeping with its economic capabilities. Hungary is deficient, however, in the minerals in which the other Satellites are also deficient and depends on the USSR for iron ore. Although Hungary can exchange certain manufactured products with the other European Satellites, it may find more profitable trading partners in underdeveloped areas of the world.

I. Recent Developments.

Political changes and the related economic policies of Hungary during the last few years have generally followed the line laid down by the USSR, but at the same time Hungary has reacted in a more extreme manner than other Satellites to successive changes in policy. At the time of Stalin's death in early 1953, Hungary, along with other Satellites, effected a separation of Communist Party officials and government officials. Matyas Rakosi was both Premier and First Party Secretary at that time. He retained his job as First Secretary of the Hungarian Workers Party (Communist) but stepped out of his position as Premier. When Imre Nagy became Premier on 4 July 1953, his first act was the announcement of the "new course" economic policy, which had been approved by the Central Committee of the Communist Party in June 1953. Although the Central Committee had endorsed the change in policy before its announcement, Nagy became identified

- 3 -

S-E-C-R-E-T

S-E-C-R-E-T

with the "new course" in a peculiar way. Realizing how inadequate Hungary's resources were to support full-scale industrialization, Nagy stated that Hungary must "cut the garment to fit its cloth," thus supporting a modification of heavy industry goals. He also advocated that the country should not attempt to build a monolithic economic structure but should revive trade with the Free World. Nagy also stood for liberalizing state controls to permit a higher level of consumption to be supported by increased production of food and consumer goods. Rakosi, on the other hand, as a Moscow-trained Communist and as a strong man in the execution of Soviet policies, has been identified in the popular mind with the earlier economic policies of the Communists. The First Five Year Plan (1950-54) and especially the 1951 revision of that Plan, which placed an intolerable burden on the economy, were manifestations of the earlier economic policies. Although Rakosi ostensibly endorsed the Party resolutions of June 1953, he took the platform 1 week after Premier Nagy had announced the "new course" to place restrictions on the policies announced by Nagy concerning the right of members to withdraw voluntarily from agricultural cooperatives. The "new course" policy was not accepted by all members of the Hungarian Workers Party, and when industrial production not only failed to improve but actually worsened during 1954, Rakosi took the lead in the condemnation and removal of Nagy from office. The Party resolutions condemning his policies were centered on his "rightist deviation" in failing to place primary emphasis on production in heavy industry and in not emphasizing the necessity of increasing labor productivity. Rakosi was in control of Hungarian economic policy from January 1955 until 18 July 1956, when he was forced to resign as First Secretary of the Hungarian Workers Party.

During 1955 and 1956 the economic policy of Hungary did not totally revert to the pre-"new course" pattern of exaggerated industrialization, but there was a partial return to emphasis on the development of heavy industry. Rakosi also instituted more severe enforcement of discipline in such areas as labor productivity and the state collection of farm produce. He again brought pressure to bear on independent farmers to join the cooperatives.

Rakosi was supported by Moscow, and it was believed to be in deference to Tito's wishes that the Soviet officials finally ceased to sustain him in office. The strong division of opinion within the Hungarian Workers Party, which made a unified political or economic policy impossible, doubtless had its influence on the Soviet decision to discontinue its support of Rakosi. On 18 July 1956,

- 4 -

S-E-C-R-E-T

S-E-C-R-E-T

another Moscow-trained Communist, Erno Gero, who had served the Party in Hungary from early postwar days, was appointed to the vacancy as First Party Secretary, and Andras Hegedus, supported by Rakosi but more or less a figurehead, remained as Premier. On 23 October 1956, following popular riots and demand for a return of Nagy, it was announced that he would become Premier again. This followed Nagy's recent rehabilitation in the Party without recantation of the essentials of his economic beliefs.

Nagy's second term of office proved to be of shorter duration than his first. Had he consolidated his position, it is probable that he would have pursued his former course, including the increase of agricultural production by raising the income of independent farmers and deemphasizing collectivization, by the encouragement of foreign trade with countries outside the Sino-Soviet Bloc, and by a general reorientation of the Hungarian economy away from the effort to build up industry so rapidly that extreme restriction on consumption was forced on the people. Danger of effective opposition to this policy by the Party was offset by the removal, in obedience to popular demand, of First Party Secretary Gero, on 24 October, and his replacement by Janos Kadar, generally regarded as a Titoist. Like Nagy, Kadar was known as a dedicated Communist, who differed from Rakosi somewhat as the present regime in the USSR differs from the position of Stalin. Kadar, a member of the Rajk group which had been condemned for defending Tito, had only recently been rehabilitated.

Nagy broadened representation in the Cabinet to include non-Communist members and negotiated for removal of the Soviet forces; and when that failed, he announced Hungary's repudiation of the Warsaw Pact, declared its neutrality, and appealed to the UN for the support of the Free World. Striking in the early hours of 3 November, the Soviet troops quickly overran Hungary, placed Nagy under arrest, and installed a new puppet government headed by Kadar. Although placed in power by Moscow, future Hungarian regimes will not necessarily oppose the program outlined above. An independent economic orientation toward Yugoslavia may, however, be held in check by the USSR.

An unknown quantity is the influence of Tito and the example of Yugoslavia as a counter to the Moscow domination of the Hungarian Workers Party and the Hungarian government. The Yugoslav system of Communism is more decentralized in its control of planning and finance. Also, the collectivization of farming has not been pursued there as an aim of the state.

- 5 -

S-E-C-R-E-T

S-E-C-R-E-T

II. Internal Economic Situation.

A. Resources.

The population of Hungary as of 1 January 1956 was 9,861,314. The surface area of the country is 35,092 square miles. Estimated in US dollars (1955 value) the gross national product (GNP) of the country was US \$3.62 billion,* or about 6 percent of the total for the 6 major European Satellites. The per capita GNP in 1955 was \$370, lower than the other European Satellites with the exceptions of Rumania, Bulgaria, and Albania.

Hungary is grossly deficient in the mineral resources necessary to support its metallurgical and engineering industries. Hungarian planners have attempted to establish an iron and steel industry in Hungary, although 85 percent of the required iron ore and nearly all of the metallurgical coke must be imported. Except for manganese, Hungary also lacks alloying materials. Nonferrous ores, with the exception of bauxite for aluminum, are not found in sufficient quantity to supply Hungarian industrial requirements. Hungary is somewhat better endowed with brown coal, lignite, and petroleum, but even the production of these fuels cannot meet the increasing requirements of Hungarian industry. Deficient in hydroelectric power potential, the country depends on coal as the primary fuel for electric power. Not only is coal insufficient in quantity but most of it is poor in quality and decreasing in average energy content. The aluminum industry, in particular, has been limited in growth by lack of sufficient electric power. The petroleum industry has not been able to make up for the deficiency in coal as was planned. The failure of the petroleum industry to meet its planned goals in 1956 was largely due to water seepage in the oil wells which in turn reflected previous high rates of exploitation and a lack of adequate investment to protect the wells.

Hungary also lacks many other important raw materials for supplying its industries, such as timber, pit props, wood pulp, leather, rubber, cotton and other fibers, pyrites, and other chemical materials. It has been engaged in a long-term effort to increase domestic production of raw materials. The Second Five Year Plan (1956-60) includes a program to produce substitute materials of

* Unless otherwise specified, all dollar values in this memorandum are in terms of US dollars.

S-E-C-R-E-T

S-E-C-R-E-T

various kinds and a greater effort to find domestic sources for imported raw materials and to develop the necessary technology to make possible their commercial processing.

Manpower is more abundant in relation to industry requirements in Hungary than in the more industrialized Satellite countries such as Czechoslovakia. Hungary has long had a surplus of agricultural labor and few industries to which farm labor could be transferred. Before the current uprisings, technical personnel had not been difficult to obtain, as Hungary had trained more engineers and technical men than were needed. In order to reduce "nonproductive" work, clerical workers were frequently ousted from their jobs and forced into manual work.

One of Hungary's best resources is good agricultural land. A report in 1955 claimed 91.7 percent of the land surface as agriculturally productive. About 15 percent of this agricultural land is forest land, and about 63 percent is arable. In recent years, Hungary has failed to utilize this resource up to its potentialities partly because of poor management and partly because of the deterioration of the soil resulting from the lack of fertilizers.

B. First Five Year Plan (1950-54).

After a Three Year Plan (1947-49) devoted primarily to the reconstruction of war-damaged industry and the restoration of production, Hungary embarked on its first long-term plan in 1950. When the First Five Year Plan (1950-54) started, Hungary had almost complete state ownership and control of manufacturing, mining, transportation, banking, and foreign and domestic wholesale trade. The most important exception to Hungarian state ownership was the Soviet holdings of former German assets in industry. The only fields in which private ownership was important were farming, crafts, and retail trade, particularly farming.

The original version of the First Five Year Plan was ambitious in its production, investment, and construction goals, but not completely unrealistic. The first year of the Plan had not been completed before a revision was made which increased the 5-year investment goal over 40 percent, from 50.9 billion forints to 85.0 billion forints. The goal for the increase of gross industrial production over the 5-year period was revised upward, from 86 percent to 210 percent. These upward revisions were Soviet inspired and were officially justified

- 7 -

S-E-C-R-E-T

S-E-C-R-E-T

as necessary to meet the exigencies of the Korean War. The accomplishment claimed officially in both investment and gross industrial production -- investments of 67 billion forints and a gross industrial production 155 percent greater in 1954 than in 1949 -- was somewhat higher than the original Plan but substantially below the revised Plan. The growth rate for industrial production was very high at the beginning of the 5-year period, but the rate of increase was lower with each succeeding year of the Plan. The growth rate for industrial production during 1950-55 was as follows:

Growth of Industry Above Previous Year*

Year	Percent	
	Socialist Industry	Total Industry
1950	36.9	26.8
1951	34.1	27.5
1952	25.8	22.2
1953	11.9	11.3
1954	3.2	4.5
1955	8.5	9.6

Although a regressive rate of growth is to be expected from a progressively higher annual base, the decline in rate was unusually severe. General economic disruption was threatened by the severe imbalances that had developed as evidenced by an absolute decline in the output of heavy industry in 1954. Within the sector of heavy industry the output of the machine industry and the building materials industry declined in 1954, whereas the output of metallurgy and mining remained about the same as in the previous year. Only the chemicals industry showed a significant increase in output.

Although the effects were most obvious in 1954, the real breakdown of the productive machinery in Hungary had already occurred in 1953, and serious trouble was encountered in 1952. Compounded of many elements, the most immediate cause of the leveling off of production was the chronic shortage of materials and power. Most raw materials came from foreign sources, principally from the USSR and from other European Satellites. Deliveries were undependable

* Based on 1949 prices.

S-E-C-R-E-T

and of uneven quality. In addition to problems in the supply of raw materials, other obstacles to efficient production were obsolescent and poor equipment, poor technology, lack of trained specialists, production for plan fulfillment goals instead of balanced and useful production, low worker morale, and inexperienced management. Labor productivity instead of increasing actually declined in 1954. In 1955, productivity and output were considerably improved. In 1956, however, the shortage of coal and oil caused a temporary suspension of certain types of transportation. Until the raw materials supply is insured and other inefficiencies are remedied, industrial production is subject to interruption. Although production will be achieved at a high cost, the products are not likely to be of a quality that can be sold on a competitive world market.

Agricultural recovery and development have been much more difficult for Hungary to achieve than industrial development. Production of bread grains has not equaled the prewar average in any year except 1951. It has been necessary for Hungary to import wheat for its own use, whereas in the prewar years, grain was exported. Cattle numbers have not reached the prewar average, but the hog inventory is higher than prewar. Production of sugar beets as the basis of an export industry, has shown a sizable increase. Fodder crops are insufficient to maintain a flourishing livestock industry.

The problems of Hungarian production in agriculture indicate the lack of support given in the form of investment in buildings, implements, fertilizer, insecticides, and soil and crop improvement. The independent peasants have been unwilling to invest in their strips of land, because they are uncertain of holding the same piece permanently. Reassignment of land frequently takes place when most of the villagers form a cooperative farm. Independent peasants are likewise unable to obtain needed farm implements or building materials for improving their farm buildings. The entire system of crop collection has forced peasants to enter the cooperatives. Because of heavy taxes and low prices paid for their crops, the independent peasants have had little incentive to farm the land productively.

C. The "New Course" Policy.

The "new course" was a policy of necessity and was intended primarily to provide an interim program for the 2-1/2 years before the Second Five Year Plan started in 1956. The new Plan was expected to reemphasize heavy industry. The change in policy, however,

- 9 -

S-E-C-R-E-T

S-E-C-R-E-T

constituted recognition by the Communists themselves of the disproportionate development of the economy under the First Five Year Plan and the resulting slowing up of production. Several types of imbalance and error were to be remedied, as follows: (1) the development of the engineering industries without commensurate development of their materials and power base; (2) the overemphasis on industry in contrast to the stagnation of agriculture; (3) the failure, due in part to a heavy capital investment program, to supply consumers with a sufficient quantity of consumer goods and food products; (4) the failure to create conditions for, or give assistance to, the independent farmers; and (5) the failure to take advantage of trade with the "capitalist countries." Hungary's implementation of reform from mid-1953 to the end of 1954 probably was as extensive as its means would allow. It was unevenly applied, however, and it granted more concessions to farm cooperatives than to independent farmers. There was a year and a half of welcome relief from pressure to join cooperatives, after which a new drive was started to collectivize the farms. Prices of consumer goods were reduced, but meat and fat were generally omitted from the list of reductions. Investment in such programs as irrigation projects, state machine tractor stations, fertilizer plants, and the purchase of breeding stock for state farms gave little immediate help to the independent peasants who tilled two-thirds of the land. More of the produce was withheld by the peasants for private use or sale, and collection quotas were not fulfilled. Labor discipline was poor, and productivity was not improved. After a year and a half of the "new course" program, agricultural production was still low, and consumer goods were still in short supply, with very little decline in their prices.

D. Present Weakness of the Economy.

At present, the problems of increasing agricultural production in Hungary have not been solved, crops are subject to frequent drought, and insufficient reserves have been accumulated to provide for crop failures. Consumer goods are scarce, poor in quality, and high in price. The state reduced production in light industry during 1956 in order to save imported materials. The sale of machinery and equipment abroad was described by the planning office as not up to expectations, and the problem of obtaining sufficient foreign exchange to pay for required imports has been extremely critical. During the past 3 or 4 years, Hungary has resorted to all kinds of devices to obtain small amounts of foreign exchange. Hungary is indebted to several Western European nations for trade credits and has earmarked

- 10 -

S-E-C-R-E-T

S-E-C-R-E-T

its anticipated foreign trade assets in advance in order to obtain wheat and other supplies. Total trade is in balance but not trade with countries outside the Bloc. Hungary also owes the USSR for the purchase of the Soviet share in joint Soviet-Hungarian companies, for occupation costs, and for credits for gold settlement of Hungarian debts. Hungary has recently arranged to pay the Yugoslav government its reparations debt -- an agreement calling for \$85 million to be paid in exports over the next 5 years. It is estimated that, before this settlement, Hungarian foreign debt amounted to at least \$228 million (at the official rate of exchange).

Availability of food in Hungary during the consumption year 1 July 1955 through June 1956 has been measured in terms of the "food balance," or the total energy output of calories in the food supplies. This statistical device for measuring the level of living in respect to food does not reveal disparities existing in consumption levels between various population groups nor the respective quality of their diet. The indigenous production of major foodstuffs consumed at home, measured in caloric energy, was 79 percent of the prewar average level in the food year 1953/54 and 92 percent in 1954/55. The level for 1956 is expected to be lower than that of 1955, as agricultural production is reported to be 8 to 9 percent lower than in 1955 because of unfavorable weather conditions and delays in the supply of chemical fertilizer. The index of average daily per capita caloric intake, a measure of total food availability, compared with an average prewar period, is estimated as follows:

<u>Year</u>	<u>Index</u>
Prewar (1933-37)	100.0
1951/52	96.0
1952/53	88.0
1953/54	93.0
1954/55	92.0
1955/56 (preliminary)	100.2

Average food consumption appears to have reached the prewar level for the first time in 1955/56. It appears that the average worker can expect no improvement and possibly a deterioration in his diet during 1956/57, based on the current report on agricultural production.

- 11 -

S-E-C-R-E-T

S-E-C-R-E-T

Housing is in even more critical supply than food and light industry products. The rate of building from 1949 through 1954 hardly met the needs of the growing population and has not been at all sufficient to take care of repair and replacement needs in the existing stock of houses.

III. Soviet Domination of Hungarian Economic Affairs.

A. Hungarian Economic Policy.

The economic policy of Hungary has been directed by the Communist Party, which in turn is dominated by the USSR. Comparison of the history of economic policy decisions in the Satellites points to close coordination by Moscow. All the major policies are announced, reversed, or otherwise changed at approximately the same time in each of the Satellite countries after resolutions enunciated by the Central Committee of the Communist Party in each Satellite. It was thus determined for the European Satellites that the new Five Year Plans would start simultaneously in the major industrialized Satellites and would be coordinated to attain a division of labor and industrial specialization in each country. The Council of Mutual Economic Assistance (CEMA) was given the job of engineering this cooperative planning. A series of meetings have been held by CEMA, and permanent committees have been appointed to coordinate different sectors of the Soviet Bloc economy. These meetings are reported to be free discussions in which the technical representatives of each country argue their own interests, but the final decisions are said to be dominated by the Soviet member. Ex-Premier Hegedus recently announced the special areas of production that had been assigned exclusively or in part to Hungarian industry. The output of the country, or countries, assigned to these areas is to be sufficient to supply all the European Satellites. Each member of the Bloc thus becomes obligated to purchase its import requirements for these products from other Bloc members. Diesel railway locomotives and buses of over 4 tons, for example, were to be exported exclusively by Hungary, and other Satellite countries would have their own specialties. Other products were to be jointly produced by two countries. According to these plans, the Hungarian industrial structure would be rationalized along lines of comparative advantage. Hungary has agreed, for example, not to produce passenger automobiles and not to increase its production of passenger coaches and freight cars. These arrangements, although advantageous in some respects, may give more rigidity to the Bloc trade structure than in the past because the agreements will limit trade outside the Bloc.

- 12 -

S-E-C-R-E-T

S-E-C-R-E-T

Hungary's principal problem of obtaining a dependable flow of industrial raw materials was tackled by the Bloc conferences arranged by CEMA but was not solved for the immediate future. Two important arrangements discussed at the recent Berlin conference sponsored by CEMA called for Hungary and other interested Satellite countries to assist in the further development of Soviet iron ore deposits in return for a share of the ore, and of Polish coal deposits on the same basis. Hungary found that it would be impossible to undertake the latter obligations until 1959.

B. Trade and Economic Collaboration.

Soviet policy has dominated the reshaping of the geographic pattern of Hungary's foreign trade. Hungary formerly earned necessary foreign exchange in the West by selling processed foods such as sugar, flour, and poultry for which its raw material supply was ample and the products of a few industries such as electrical equipment in which it had developed competence. After World War II the USSR became the chief market for the foods and consumer goods as well as for certain industrial goods which Hungary produced. The USSR, by means of trade agreements, reparations requirements, and other influences, compelled Hungary and the other European Satellites to change the pattern of trade from a predominantly Western orientation to one in which Soviet Bloc trade prevails. The postwar shift in the flow of trade is demonstrated in the following tabulation:

	<u>Percent</u>		
<u>Trade Movement</u>	<u>1949</u>	<u>1954</u>	<u>1955</u>
Imports from			
Soviet Bloc	46.2	68.0	54.9
Free World	53.8	32.0	45.1
Total	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Exports to			
Soviet Bloc	51.9	73.6	66.5
Free World	48.1	26.4	33.5
Total	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

- 13 -

S-E-C-R-E-T

S-E-C-R-E-T

The percentage of Hungarian trade with the Soviet Bloc was much smaller in 1955 than in 1954. In 1955 the USSR changed its policy drastically by curtailing its orders to Hungarian industry for textiles, foods, and other manufactures, with a corresponding diminution of raw materials shipments to Hungary. This sudden change created difficult transitional adjustments in the Hungarian economy. Although 22 percent of Hungary's total trade in 1955 was with the USSR and its most readily saleable products are exported to the USSR and the other Satellites, it does not obtain an equal percentage of its raw material and food needs from Soviet Bloc sources.

Hungary is linked with each country of the Soviet Bloc and with many countries outside the Bloc through a series of bilateral clearing agreements. Both a long-term master agreement and annual agreements within the framework are executed with each member of the Soviet Bloc. In addition, Hungary has other technical and economic collaboration agreements with other Communist countries, implemented by a permanent Mixed Commission for Economic Collaboration. In addition to exchange of technical documents and personnel, the collaboration includes joint investment projects which are becoming increasingly important to the economy.

The negotiation of special agreements for collaboration on development of various industries has frequently been arranged by CEMA. Little is known, however, concerning the authority which this body has exercised in these negotiations. Most of the agreements appear to make sense from the point of view of economic advantage to both or all countries involved.

C. Financial Assistance.

The USSR has granted Hungary 4 loans, totaling \$64 million,* 1 each year since 1953, for the purpose of reducing the chronic Hungarian foreign exchange shortage arising from the import of essential raw materials and food. The most recent of these loans, amounting to \$25 million, was granted in October 1956. These loans are not expected to be more than a stopgap for the foreign exchange shortage which rises from the inefficiency of Hungarian industry. The credit extended by the USSR was one of the few instances of assistance given Hungary. Other loans have been extended for military assistance or

* Conversion of forints to dollars at the official exchange rate of 1 forint = US \$0.085.

S-E-C-R-E-T

S-E-C-R-E-T

for the purchase of the joint companies and have constituted a drain on the Hungarian economy without compensating benefit to production. Altogether, Soviet loans to Hungary since the issuance of the first credit in 1949 have totaled \$455 million* -- 8 percent of Soviet loans within the Bloc.

D. Soviet Ownership of Hungarian Industry.

A large share of Hungarian industry was claimed by the USSR after World War II under the Yalta agreement. The Soviet armies stationed in Hungary dismantled and removed a great deal of industrial equipment without permission of the Allied War Commission and without recording it for reparations credits. The final policy of the USSR was to take over and run those industries in which the Germans had held stock. These companies were under absolute Soviet control until October 1952, when the USSR sold its holdings in many of the companies and invested the amount realized in 4 large joint companies, in each of which the USSR owned 50 percent of the stock.

These joint companies controlled the bauxite and aluminum industry, petroleum extraction and refining, civil air transport, and inland water shipping. The last-named company owned some of the principal coal mines in Hungary. The USSR exercised complete control over these companies until it decided to sell its share of each to the Hungarian government in late 1954. Technicians, managerial personnel, and other experts from the USSR engaged in running the plants returned home when the company properties were handed over to the Hungarians. Until the joint companies were sold, the USSR retained ownership in a Hungarian bank which did all business for the companies. This bank was sold to Hungary at the same time as the joint companies were sold.

The compensation for the joint companies was reported to total 2 billion forints (\$180 million at the official rate of exchange). At the same time, a loan of equal amount was granted Hungary to permit payment in installments. The first payment on account is 250 million forints, due in December 1956. One of the provisions of the sale agreement of "MASZOBAL," the bauxite and aluminum company, was the provision that the USSR retained the right to import the best quality of bauxite. Exports of bauxite to the USSR are believed to be about 60 percent of the total production, thus leaving the poor grade ore for the Hungarian aluminum industry.

* Conversion of forints to dollars at the official exchange rate of 1 forint = US \$0.085.

- 15 -

S-E-C-R-E-T

S-E-C-R-E-T

Although Soviet ownership of Hungarian industry is technically at an end, it is reported that representatives of the USSR were to be assigned to each company to look after Soviet interests. The USSR frequently stations its own representatives in Hungarian export industries to inspect the quality of exports to the USSR and thus has a choice of the best quality of products.

E. Armaments Production.

Armaments production in the European Satellites is under Soviet control. Hungary has certain production assignments for the European Satellite armies which include an infantry rifle, an automatic rifle, mortars, 57-mm antiaircraft guns, and searchlights. It is probable that Hungary has also been assigned to the production of small arms ammunition.

IV. Evidence of a New Look for the Hungarian Economy and Possible Consequences.

Although the new Hungarian regime may adopt a more liberal policy toward consumer welfare, it may be impossible for the new government to rehabilitate the Hungarian economy in a short period, and if so, any spectacular change in the level of consumption is not to be expected. Destruction incident to the revolution, together with disruption of production, and the creation of a hostile public opinion probably will hinder fulfillment of the existing economic plan and retard any proposed reorientation of the economy.

A. Reorientation of Trade Toward the West Despite the Impact on Other Bloc Countries.

A reorientation of Hungarian trade toward the West started, in a mild way, in connection with the "new course" policy. It was favored by the Nagy government as helping to solve Hungary's raw materials problems. At that time, Nagy favored building up agricultural production as a source of export commodities, but subsequent governments emphasized engineering products instead. There is reason to think that the USSR in 1955 encouraged the Satellites to increase trade with underdeveloped areas and to exchange manufactured products for industrial raw materials and foodstuffs. It has been Hungary's intention to increase its trade with those areas. This policy would therefore not be a new one but might be given more support by the new government. Hungary is offering factory and construction machinery

- 16 -

S-E-C-R-E-T

S-E-C-R-E-T

and equipment for export. It has taken contracts for entire projects such as power plants and bridges. It plans to take raw materials and food products in trade. The Second Five Year Plan calls for an overall increase in trade of 40 percent during the period 1956-60. The plan rejects consumer goods as an economical field for exports because of their costs in raw materials. Processed foods, however, would still be exported.

Changes in this general plan are likely to be small and a matter of degree. If the new Hungarian regime succeeds in raising agricultural production to furnish a surplus for export, it will accomplish what neither the old nor the "new course" policies have been able to do so far.

B. Emphasis on Consumer Goods in Relation to Heavy Industry.

The emphasis on consumer goods in relation to heavy industry in Hungary is involved with the export policy in that it would be unnecessary to produce more textiles for domestic use if exports of textiles are reduced. Consumer durables are still produced in insufficient quantities to meet domestic demands. These articles compete directly with heavy industry for steel and factory capacity. It is probable that a government trying to improve popular morale and productivity would plan to increase the production of these items, but in doing so it would run into scarcities of steel, coal, and power as well as the necessity of paying for imported materials. It is therefore unlikely that immediate plans for consumer durables will be substantially increased.

C. Collectivization Program.

Unless the USSR adopts a punitive policy toward the Hungarian regime, it is probable that forced collectivization will be postponed. Only by such a policy, together with reduced taxes and increased incentives, can the peasants be induced to increase production and deliveries of agricultural products.

D. Adherence to CEMA Agreements.

Under Nagy it appeared that Hungary would seek to develop trading relationships outside the Bloc more profitable than those inside the Bloc. Once an exporter of bauxite and grain, Hungary

- 17 -

S-E-C-R-E-T

S-E-C-R-E-T

now has little to offer the West on competitive economic terms. Any effort to reorient substantially the Hungarian economy toward the West would strain CEMA agreements. It is doubtful if the new regime would possess the political force to oppose future Soviet plans for CEMA. Most of the CEMA arrangements for joint investment and use of resources are valuable to Hungary and probably will be retained.

E. Hungarian Activity in the Underdeveloped Areas.

Trade between Hungary and the underdeveloped areas of Asia and the Near East is likely to prove mutually advantageous and therefore will be continued under any new economic policy that may develop. Even if further development of heavy industry is retarded, Hungary can produce a surplus of machinery and equipment, provided the materials and power situation is stabilized.

F. Increased Economic Cooperation with Yugoslavia.

One of the principal developments likely to occur under the new Communist leadership in Hungary is increased cooperation with Yugoslavia in economic development. Several areas for this cooperative development exist in the complementary resources of the two neighbors. Yugoslavia has resources of iron ore which Hungary once planned to use in its large steel combine, before the Cominform break with Tito. Hungary can use an additional source of iron ore. The two countries will find it mutually advantageous to develop Danube River shipping and also to cooperate in damming the river and building power stations. Yugoslavia is mountainous and has numerous possibilities for the development of hydroelectric power. By cooperation, the two countries can be mutually helpful -- Hungary by furnishing the machinery and technical ability for the development of these sites. Thus Hungary's industries could be supplied with a larger amount of electric power. This development is incipient in the exchange of consultation and agreements already begun under the old government.

- 18 -

S-E-C-R-E-T

Approved For Release 1999/09/21 : CIA-RDP79T00935A000400170002-1

S-E-C-R-E-T

S-E-C-R-E-T

Approved For Release 1999/09/21 : CIA-RDP79T00935A000400170002-1