INSTITUTE OF CURRENT WORLD AFFAIRS

BFH-2

Vienna, Austria
December 28, 1983

Mr. Peter Martin
Institute of Current World Affairs
Wheelock House
4 West Wheelock Street
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Dear Peter:

One of the most puzzling problems in studying the economies of socialist countries, which are partly insulated from the world market, is how to compare their incomes and standards of living with those of the West. Statistical measures of prices and incomes can have very different meanings in centrally planned economies than in western market economies. As a first time observer in Hungary, I was interested in the visible, non-statistical differences between living standards there and in West European countries.

My initial impression was of stepping into a middle income developing country, like Mexico or Colombia, but without the extremes of poverty and wealth. That impression faded as the European character of the country asserted itself, and the second impression was of going back in time, to a Europe of two or three decades ago. Cars are significantly smaller and less powerful than in western Europe, and there are more trucks and buses relative to the number of private cars. In the smaller towns there are many more people walking and riding bicycles and everywhere the public transportation is heavily used. People wear darker clothing, and the shop windows are small and dimly lit. The impression of early postwar Europe is strongest in central Buda, where there are buildings that are still being reconstructed from war damage done in the siege of 1944-45.

There are numerous inconsistencies in the Hungarian standard of living that make it difficult to pinpoint where Hungary's consumption levels would rank in the non-socialist world. Public transportation in Budapest is cheap, ubiquitous and probably as efficient as anywhere in the world, but the telephone system may not be as good technically as Mexico's. On the other hand, Hungary has three times as many telephones per capita as Mexico. But how does one weight the ten years it can take to get a telephone connection in Hungary?

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Food consumption levels are also difficult to compare with market economies. Hungarians consume about the same calorie equivalent per capita as the Scandinavian countries and about the same amount of meat per capita as the Austrians or French. These food consumption levels are achieved, however, at a cost to the average worker of about 45% of his income, which is very high by developed country standards.

The variations in consumer tastes and production structures, and different internal relative prices make standard of living comparisons between countries difficult. The most common measure is dollar GNP per capita. With this measure the total value of an economy's production is calculated in per capita terms and converted to dollars using the current exchange rates. Unfortunately, calculating dollar GNP per capita for Hungary, or for any other socialist country, doesn't necessarily produce a meaningful statistic. For one thing, the centrally planned economies do not calculate GNP for their own uses. They use a measure called Net Material Product, which can be converted only approximately into Gross National Product. Furthermore, converting GNP into dollars at official rates of exchange for the dollar introduces further distortions, because these exchange rates are often either over- or undervalued.

The World Bank does compile and publish statistics on GNP per capita for most countries of the world. It only began fairly recently to include the centrally planned economies. When the World Bank first began publishing statistics for the socialist countries, they were concerned about the problem of accurately measuring their income levels. Two economists who had consulted with the Bank on how to rank Hungary's income and standard of living, or as they put it, "how to find a meaningful way to insert Hungary into the family of nations," were present at the economic conference I recently attended in Budapest.

One method of ranking countries' standard of living is to use an index of social indicators. These would include not only numbers of autos, telephones, houses, televisions and the like, but also literacy rates, infant mortality rates, life expectancies, and health care measures. Using these sorts of indicators, Hungary was ranked as 23rd in the world, whereas its GNP per capita was ranked only 41st. In contrast, for example, Austria was ranked 14th on the combined social and economic indicators scale and Mexico was ranked 56th. While a social indicators index may in some cases be more accurate, it does have some problems. The choice of indicators can be arbitrary: perhaps press freedoms and civil liberties should be included in evaluating the quality of life. Calculating the total index is also expensive and time-consuming. The World Bank economists concluded that some form of improved income measure was needed, one that would be easy and inexpensive to calculate. They came up with a statistical technique for adjusting the World Bank GNP data on Hungary, and other socialist countries.

Application of the adjustment technique to Hungary raised Hungary's GNP per capita to $4,400, or almost double the existing World Bank figures. The Bank's economists felt this was a fairly realistic level. Unfortunately, during the two years they had been working on the project, Hungary had become a member of the Bank and started negotiating for loans. Now, $4,400 may have been a more respectable slot in the "family of nations," but from the Hungarian perspective it had a fatal flaw: it was above the income level that gives a country preferred borrower status with the World Bank. The upshot of the event was that the Bank went back to using its original numbers, the Hungarians got their loan, and the economists got their consulting fees and some papers to give at conferences.

Aside from such political considerations, it's not at all clear what would be the most appropriate estimate for Hungary's GNP per capita. Some Hungarian economists at the conference objected to making a statistical adjustment that corrects Hungarian per capita income but ignores questionable GNP statistics in, for example, some Latin America countries with overvalued currencies. Further discussion revealed that there was not even a consensus on whether Hungary has an undervalued or overvalued forint, relative to the dollar. Without some agreement on that point, it's not possible to make much progress on estimating its "true" dollar income per capita, or to rank Hungary's standard of living relative to other countries.

Perhaps one of the most relevant comparisons is with another small country like neighboring Austria. Before the war, when Hungary and Austria both had market economies, Hungary's income per capita was approximately two-thirds that of Austria. The World Bank's official estimates indicate Hungary's per capita income today is less than half that of Austria. On the other hand, Hungary's official growth rate has been higher than Austria's, which suggests that the World Bank's estimate is probably too low. Despite the growth problems of the 1950's and the problems in adjusting to world price shocks in the past few years, Hungary's per capita income appears closer to two-thirds that of Austria than one-half. At any rate, if there is anyone who can figure out what it means to live twice as well as someone else, the World Bank would probably like to hear from them.

Sincerely,

Bruce T. Hall

Bruce Hall

Received in Hanover 1/9/84