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Reforming and Privatizing Hungary's Road Haulage

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Options for restructuring the Volán group — the current provider of Hungary's public passenger and freight transport services and the largest enterprise in Hungary's road transport industry.

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This paper — a product of the Transport Division, Infrastructure and Urban Development Department — is part of a larger effort in PRE to analyze the options for restructuring and privatizing state-owned enterprises in the countries of Central and Eastern Europe. Copies are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Barbara Gregory, room S10-049, extension 33744 (28 pages) October 1991.

Hungary's road transport industry emerges from decades of socialist organization with a few large public sector enterprises, highly integrated in terms of spatial coverage and range of operations, and thus singularly lacking in the division of labor and the specialization that characterize the road transport business in market economies. Volán, the main national transport organization, combines subsidized passenger transport with every type of public road haulage. Other large enterprises specialize in international haulage or serve the transport needs of specific branches of the economy. Also, state enterprises in industry and trade have their own trucks and use them for work that overlaps with the operations of the public haulage organizations. But outside the public sector there now exists a substantial sector of small-scale private trucking businesses. The private truckers work for but also compete with the large state-owned transport organizations. Competition, intensified by the decline of the economy, has given rise to insistent demands for regulatory control of market entry and access.

In the first sweep of postcommunist reform, the main public sector road transport organizations were broken down into their constituent provincial branches. The successor entities were to operate henceforth as autonomous firms. But the crucial ownership relation remained obscure and ambiguous. No clearly defined owner came to determine the firms' objectives. The managerial objective was therefore to protect the position of manager and staff by maintaining the status quo for each enterprise. The incentive to restructure the entities to maximize their net worth was therefore lacking. But restructuring of many of the units seems essential if they are to function viably in a competitive market economy. The separate units are unusually large by the standards of Europe's market economies, are encumbered

with functions and assets or properties that are irrelevant to normal trucking activity, and are uneconomically diversified in their work.

Bennathan, Gutman, and Thompson explore the options for reforming this industry, which is peculiarly suitable for small and medium scale entrepreneurship but also peculiarly subject to stringent regulation. The first element in any reform has to be the establishment of unambiguous ownership and the assertion of control by or for the owner. That is a precondition for privatization and for adapting state-owned entities to market requirements. Questions about the pace of privatization in different forms are more controversial. The authors' recommendations are intended to reduce the risk that wholesale disposal of haulage enterprises of doubtful viability will later generate strong pressures for protective regulation and bail-outs. They suggest:

- Basically restructuring the Volán group by separating passenger transport completely from freight haulage.
- Adopting a program of staged privatization, starting with the outright disposal of a target number of entities with fair prospects of commercial survival.
- Helping commercialize all state-owned entities under the control of a separate office (preferably a private specialist consultancy) combining trustee functions with technical, accounting, and legal guidance, and subjecting the entities to the discipline of financial targets.
- Actively promoting the sale of haulage assets from the state-owned entities to middle-class and typically small-scale entrepreneurs.
- Getting the government committed to a liberal system of road haulage regulation (operator licensing) and to maintaining open, competitive access to operations in international haulage.

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**HUNGARY:
REFORMING THE ROAD FREIGHT INDUSTRY**

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HUNGARY:
REFORMING THE ROAD FREIGHT INDUSTRY

ABSTRACT

The Object of the Report

(i) The Volán units (previously unitary but now formally dismembered) provide public transport service for both passengers and freight, and make up the largest enterprise in Hungary's road transport industry. Immediately after separation in 1989, the Volán group of units employed 67,000 persons and operated 12,672 trucks and 8,010 buses. In 1989 Volán carried 34 percent of Hungary's professional road haulage tonne-kilometers.

(ii) This report focuses on options for restructuring the Volán group. It therefore also considers the content and implementation of Hungary's overall road transport policy as well as related questions of finance and taxation, all of which define the conditions under which the Volán successor enterprises, however transformed, will have to prove themselves.

Characteristics of Hungary's Freight Transport

(iii) Hungary currently uses two to three times as much transport (tonne-kilometers of freight per unit of Gross Domestic Product--GDP) as the most closely comparable market-based, Western European economies. Efficiency gains in transport through restructuring will have a correspondingly large impact on the economy. Transport intensity has already been declining, and should decline even faster as the composition of output and the organization of industries adapt to the demands of an open market economy. Road haulage, however, will face partly offsetting trends: total demand for transport will fall as the economy changes, but the type of transport will also change, favoring the higher quality service offered by road, and reducing the relative use of bulk oriented, lower quality rail transport. Rail has been losing market share steadily to road but Hungary remains unusually dependent on rail, and the shift has much further to go, assuming the market is allowed to work. The stock of trucks in Hungary is thus still small by comparison with market-reliant countries of similar population and density.

Road Freight Transport

(iv) Road haulage in socialist Hungary was organized and developed in ways characteristic of socialist economies. In the socialized sector, the function of professional haulage was provided by a number of "Branch" transport enterprises (each attached to one branch of industry or trade and controlled by the relevant line ministry), and by Volán which combined "public" road freight haulage with the transport of passengers outside the larger urban centers. Alongside this socialized professional haulage was a large body of "own-account" haulage by industrial and agricultural enterprises. Own-account operations are a common element of freight transport in all countries, but in Hungary, as in other socialist countries, its larger role and rate of growth reflect the organizational tendency to high integration of production and the limited scope for retaining enterprise earnings and for deploying them freely in pursuit of profitability.

(v) Since 1982 there has also been a relatively rapid growth of truly private haulage, its share rising in 1989 to 18 percent of total tonne-kilometers (23 percent of tonnes). This rapid growth of private entities testifies to the potential profitability of road haulage when carried on at the modest scale of the typical private operator in Hungary, and

when it is managed by its owners in competition with the publicly owned and managed trucking units as they exist today. By the same reasoning, the areas of comparative advantage of small-scale, owner-controlled haulage business are defined by the market segments that private operators are invading. Private entry should thus have made for improved efficiency. Persistent inefficiencies in the system, however, are indicated by the continuing high share of own-account operations in tonnes ("tonnes lifted") and tonne-kilometers ("tonnes moved"), well above the corresponding shares in countries with lightly regulated road transport industries. The high own-account share is associated with an unusually narrow difference between the average lengths of haul of professional and own-account haulage, meaning that there is a greater degree of overlap between the types of work performed by own-account and professional haulage than is to be found in countries where road haulage is shaped by the competitive process.

The Volán Enterprises

(vi) Volán's former structure was based on the logic of socialist industrial organization, modified by Hungary's economic reforms and decentralization policies since 1968. As with other entities in Hungary it is marked by high integration: by the combination of freight with passenger transport; by its original position as the sole enterprise for domestic "public" road haulage (international transport with the non-ruble area being originally the exclusive province of the Hungarocamion enterprise); by a singular absence of specialization and therefore by participation in every kind of road haulage -- local, short distance, long distance, delivery and distribution from the railway, consolidation, construction industry transport and parcel services; by the number and size of light and heavy workshops, and by a large role in manual and mechanized cargo handling. The truck fleet is accordingly diversified in types and, while not markedly over-aged by the standards of West European economies, seems technically obsolete.

(vii) The liberalization policies of the 1970s and 1980s, followed by the severe recession of 1989 and 1990, have released competitive pressures in road haulage between the two sectors of socialized enterprise, professional or own-account haulage, and from the growing private sector. Specifically, Volán has lost its share in the short distance haulage market, and in distribution and delivery services. Its traditional mainstay of long-term industrial contracts has shrunk and will shrink further as industrial enterprises are transformed and divided, and as managements are both freed and forced to concentrate on objectives of profitability. Many Volán units have entered international haulage. In the present depressed conditions this has come to account for a significant and growing share of business and revenues for some units.

Reorganization

(viii) In 1988, in the course of Hungary's structural reforms, the unitary Volán enterprise was divided into 26 formally independent enterprises. Nineteen of these are simply the former Volán branches, each headquartered in one of the country's 19 counties. Eighteen among them, accounting together for 80 percent of Volán tonne-kms of haulage, are also heavily engaged in passenger transport which provided in 1989, on average, 46 percent of enterprise revenues. The combination of passengers with freight is as unusual in the road haulage enterprises of market economies as are the sizes of the units resulting from the separation. The mean employment of the mixed companies is 3,000 persons, and their freight haulage fleets range from 328 to 1,035 units, with the mean above 500. They typically own large workshop facilities, storage and agencies, apart from the social facilities (such as holiday hostels) usual in socialist industrial enterprise.

(ix) In terms of their legal status, the Volán successor entities are state enterprises under the direct supervision of a state administration. As such, the initiative for transforming the state-owned enterprise into a business organization lies with the respective founding body (the Ministry of Transport in this case), subject to the consent of the Minister of Finance. The enterprise itself may equally start the process on its own initiative. Upon transformation, the property in the new business organization, --the shares or parts in a Limited Liability Company or the stock of a Public Limited (joint stock) Company-- passes wholly into the hands of the State Property Agency for later management or disposal.

(x) Taking advantage of the 1988 Act on Economic Associations, the different Volán managements have formed numerous subsidiaries, most frequently organized as Limited Liability Companies owned by the mother enterprise on its own or in partnerships with individuals working in the enterprise. To some extent these reflect logical (but possibly unexpected) management responses to incentives created by Hungarian tax law. However open to charges of asset-stripping (when contributions of individual managements or groups of workers are not fairly valued, or when transfer pricing between mother and daughter inflates the value of equity in the subsidiary), these creations are short-run responses to the problem of uncertain ownership. They do permit some new resources to be attracted to road haulage and haulage-related enterprise, and the transparency of accounting and the accountability of some management decisions may also have been strengthened in this way. But inasmuch as the resulting sets of entities are substantially interlocked and, furthermore, not really distinct in activity, no stimulus to competition or improved efficiency results. The ultimate solution to the problem of ownership and control of state-owned enterprise may indeed have become somewhat more complicated and is, in any case, still to come.

Options for Restructuring

(xi) Any scheme for the reorganization of the Volán units has to be judged on its potential for raising the productivity of resources in Hungary's road haulage and contributing thereby to the revival of the economy and of employment. Experience in Hungary and elsewhere indicates that progress in productivity requires freedom to compete. Enterprise viability in a competitive setting argues, in turn, for flexibility in the enterprise, allowing the management to acquire inputs and intermediate services from the most economical source and to drop unprofitable activities while emphasizing profitable ones. Reorganization should give scope for energetic, market-oriented management and offer appropriate incentives. At the same time, any scheme that passes these tests should also guard against the dissipation of state property. The report identifies a series of initiatives which should form elements of any restructuring program, and then discusses choices for implementing restructuring and privatization.

COMMON ELEMENTS:

Separation of Freight from Passenger Transport

(xii) The Volán combination of freight and passenger road transport is unusual in market economies and difficult to reconcile with the competitive organization of road haulage. Passenger transport, in Hungary as elsewhere, receives subsidies and it is unwise to combine subsidized with unsubsidized services in one enterprise, with essentially one workforce and under one management. Under competitive conditions, if trucking companies are to survive, they must be commercially oriented and able to respond quickly to demand patterns that are likely to change quickly. This requires a style of management that is

essentially different from the accountability-driven decision making of publicly funded institutions. Next, given the essentially insoluble cost allocation problems, the destination and use of the subsidy become uncertain: freight could be used to generate subsidies for passengers; more precisely, some freight could subsidize some passengers. Furthermore, passenger transport enjoys generally the status of a public utility, with the associated fiscal and legal advantages, and if some road haulage is shielded in this way, as cannot be avoided when both services are performed by the same enterprise, the conditions for fair competition with the private sector would be breached. The managerial requirements of the two services are thus totally different. Restructuring of Volán, on any option, thus requires separation.

(xiii) Separation might be initiated by attempts at strictly separate accounting within the same enterprise. One doubts however, whether such strict compartmentalization in accounts and finance can be adequately policed, not least because of the presence of substantial common facilities. Nor would such an enterprise attract the best management to either branch, or allow competent managers full scope for developing their part of the business.

(xiv) The alternative option is then separation of establishments: in legal and fiscal status, in physical and financial assets, finance, management, personnel, wage scales and employment contracts and, where indicated, in terms of location.

(xv) While passenger services may be placed under the control of the subsidizing authorities, central or local, common facilities such as workshops could be divided up if sufficiently specialized in trucks or buses but might otherwise be organized as separate, commercial establishments, ultimately for sale. Alternatively, one entity might perform services for others for a fee.

(xvi) Separation of establishments in this way poses major institutional tasks. Volán entities should be guided in the valuation and accounting methods required by the operation, and in the treatment and disposal of common facilities. These are tasks falling on the Ministry of Transport, presumably with advice from the Ministry of Finance and the State Property Agency.

Restricting Future Government Involvement in Trucking

(xvii) Although the exact shape of the future Volán units remains to be developed, the principle of independence of freight activities from public support has been established and should be maintained. This is especially important in the area of financing, where the Volán units in the past have enjoyed access to public investment funding and have not been required to pay capital costs equal to the opportunity cost elsewhere in the economy. Continued access to below cost capital by Volán units would mean an unfair competitive advantage vis a vis the emerging private sector which government policy seeks to promote. While awaiting restructuring, Volán units should be required to find all of their new capital on the same terms as the private sector.

Regulation of Entry, Rates and Licensing

(xviii) Entry and rates in the trucking business have effectively been deregulated. Existing, and new, entities are free to charge market-based rates, and may carry any commodity from anywhere to anywhere (domestically). This policy has already paid substantial dividends in promoting competition for better service and more efficient rates. There is evidence that this policy may soon come under attack from those who seek

controlled, territorial franchises: experience elsewhere has also shown that this temptation should be resisted. Trucking deregulation, while often politically contentious and financially uncomfortable for those directly affected, has uniformly proven to lower costs and improve quality, and thus lead to growth in the road haulage industry so long as adequate competition is assured. Regulation should therefore be limited to insuring potential carrier fitness and technical capability. The European Community has developed and is implementing standard requirements for carrier fitness and capability, as well as socially oriented requirements relating to vehicle design and driver working conditions. Since the direction of development of the Hungarian economy will be increasingly oriented toward Western Europe, adoption of these regulations should be considered.

(xix) The privately owned trucking sector in Hungary has been growing at 50 percent per annum since 1981, and now supplies about 18 percent of the nation's tonne-kms. If this trend is not limited by government restrictions, an increased role for the private sector will be realized, specifically for small ("middle class") enterprise and thus in line with Hungarian policies.

(xx) Competition in Hungary's road haulage is already reshaping the industry, redrawing the market areas of different forms of organization and operation and leading to a division of work that one expects to see in a market-oriented economy. The process has further to go, and there will be some losers.

But, the restricted scale of road haulage in the country also limits the cost to be expected from this structural adjustment, while the gains should be considerable.

Taxation and Road User Charges

(xxi) If the temptation to regulate and restrict entry into road haulage (to protect existing enterprise, and thereby hold up structural transformation and employment for new private entrepreneurs) is to be resisted, there are other instruments of control that need to be strengthened. Chief among them are the fiscal instruments. There is no obvious reason in economics for taxing the net revenue or the sales of professional haulage at rates different from those that apply to other production. Above all, all road users should be made aware of the cost that they cause to the road (through wear and tear) and to other users (through congestion); they should therefore be charged according to those costs, and the same charge should apply to all users making similar use of the roads, irrespective of their organizational status. When confronted with the true cost of their activity, different groups will change their operations and some, possibly in the large group of own-account operators, will curtail it. Hungary should therefore review, rationalize and possibly diversify its system of road user charges.

Opening Access to International Traffic

(xxii) Most Volán units (and Branch units interviewed) believe that international traffic is one of the few markets available for growth in profitable road traffic in the near future. The same will be true for any potential new entrants into the trucking business. It is important, therefore, that access to the bilateral permits for international traffic be available to all potential carriers on a non-restricted basis, and that existing carriers, including the Volán units and Hungarocamion not receive preferential treatment for those permits that are available. The best method for ensuring this access is a periodic auction, which would insure that those carriers which can make the best use of the permits can depend on getting them. If auctioning is not thought compatible with international

arrangements, then every effort should be made to insure equal access for all carriers subject only to the soundness of the vehicle, technical proficiency and commercial probity. We suggest a double system of rationing by period allocation and spot allocation of permits in short supply. Consideration should also be given to making permits available to freight forwarders who could then transfer the permits to those carriers who gave the forwarder the most favorable terms of service.

Develop Leasing Capability

(xxiii) Trucking companies in western economies make intensive use of leasing because of the need to use their scarce capital in the most productive ways. Leasing appears to be developing in Hungary, especially for new equipment: there is probably little that needs to be done in this area except to make sure that the emergence of a healthy leasing activity is not hindered. Assistance may be forthcoming from leasing companies of other countries, and from multilateral financial institutions.

(xxiv) Leasing of used equipment, as may be necessary if the unneeded equipment of the Volán units, the Branch enterprises and former own-account operators is to be productively employed, presents special problems of valuation and pricing according to the condition of the vehicles. Consideration should be given to the establishment of a specialized leasing company, perhaps under the auspices of the Volán Custodian discussed below, to facilitate the leasing of trucks and other equipment which will be released from service by the present operators. Leasing may also be extended (as it is in other countries) to workshops and structures.

CHOICES IN RESTRUCTURING AND PRIVATIZATION:

Restructuring Freight Haulage Enterprises

(xxv) Several entities in the Volán group are specialized in road haulage or ancillary activities. One large haulage enterprise (Volán Tefu), serving Budapest, was recently transformed into a joint stock company, with the stock currently held by the State Property Agency. Another large unit (Tomegaru) is specialized in haulage for the construction industry and could, after reshaping ("repackaging") be separated into units organized as Limited Liability Companies. Further specialist units, engaged in freight forwarding, packaging, heavy lifts or computer technology, are of modest size and should, upon transformation into separate businesses, stand a fair chance of sale in the market or of buy-outs.

(xxvi) The candidates for restructuring are then the large block of 19 county enterprises, 18 of them engaged in both freight and passenger transport. Considering only the road haulage components, and thus assuming separation of freight from passengers to have been accomplished as a prior step in any reform, the resulting haulage units are characterized by their large average size. They are further characterized by the mix in their operations of very dissimilar road freight activities, and by the long-run effects of their original constitution as enterprises serving a county as their market area.

Choices for Privatizing the Existing Volán Units

(xxvii) There appear to be two alternative strategies for privatizing the Volán units (or, at least, those activities remaining after the near-term sale of activities and assets discussed above). The first could be the organized merger of the existing units into several

(five, or so) larger units. The objective of such a change would be to create new units which are large enough to be efficiently commercialized, and then privatized as joint stock companies which could eventually be widely held by the public (as was decided for Volán Tefu). The second approach would work with the existing units. The stronger units will be aided and guided toward near-term privatization (perhaps 3 to 4 units in the first year). The remaining units would, over a roughly 4 year period, be permitted to continue to operate while adapting themselves to the changing conditions of demand for trucking services: a custodian would oversee this process and would guide the units into the private sector as rapidly as conditions permit.

(xxviii) The first approach would follow the precedent set by the transformation of Volán Tefu. This approach was apparently developed with the hope that it would minimize administrative effort and that it would proceed quickly. But it also envisions that decisions be made immediately as to the appropriate units to merge, and requires that the larger units eventually be publicly held as joint stock companies. It may well also have underestimated the complexity of restructuring the existing units. The second option, a stepwise restructuring of the individual units in the course of privatization, would offer the opportunity to privatize the units in smaller pieces, probably through sale as limited liability companies rather than as joint stock companies. Experience in other countries and now also in Hungary indicates that the most effective form of trucking enterprise is one of smaller enterprises controlled by owners -- and therefore not of joint stock companies. We recommend the second option.

The Institutional Task

(xxix) The option of stepwise market-driven transformation would leave the management of individual Volán enterprises, throughout the adjustment period, with substantial functions and discretion, and would give them incentives to reorganize and reshape their units in order to privatize them. The organizing and reshaping would include disposal of unproductive assets, relocation of operations, or entering or exiting various business activities, among other things. The stepwise option would also leave the state with a portfolio of enterprises, commercialized or not, but in any case some of which may not have completed the privatization process, throughout much of the period allowed for transformation. The portfolio will need supervision, and the enterprises retained in it will need guidance, advice and control when assets or units are proposed for sale or for contribution to joint ventures. The resulting functions of financial supervision and expert advice argue for the appointment of a Volán Custodian, possibly a bank acting for the State Property Office and supported when necessary by expert assistance on technical or commercial problems. Active intervention by the Custodian and the assumption of the initiative in transforming, winding up, or privatizing entities would be exercised as required during the adjustment period in order to keep the privatization process on track, but also at the end of that period with respect to the disposition at that time of any Volán units which might remain in the portfolio.

HUNGARY

REFORMING THE ROAD FREIGHT INDUSTRY

I. The Study Objective

1. Hungary has chosen to reform its economy, moving away from central planning and toward a market-oriented system. This change will impose particularly demanding requirements on the transport sector, basically causing a shift in approach from a primarily production orientation to a system which is flexible and focussed on customer needs. One key element in developing a flexible response on the part of transport is the trucking industry. Although entry into the Hungarian trucking industry has been liberalized and there are estimated to be several thousand small, private trucking companies, the continuing concentration of a large part of public trucking services within one firm, Volán, while typical of socialist economies, runs counter to the standard industry model in market economies and results in inefficiencies and levels of service inadequate for future needs. This paper focusses on identifying the concepts and measures which should be considered in reorganizing the road haulage component of the Volán group, representing 21% of the total tonne-kilometers in Hungary's road sector. A substantial reorganization and reorientation of such a large portion of the industry and the pressure of economic forces released by such reforms are sure to have positive effects for the trucking industry in general.

2. There have already been substantial changes in the structure of Volán through government measures as well as in the structure of the rest of the trucking sector. This report discusses the status of the industry and the changing nature of demand and supply relationships. It reviews the present structure of the Volán group and its markets, and examines criteria for restructuring the group and for privatization. It further examines the regulatory regime required to support the restructuring of the industry and general economic growth and also other issues relating to institutional support for privatization, and access to international markets.

II. Features of Hungary's Freight Transport

Transport Intensity

3. By the standards of Europe's market economies, Hungary's economy is transport-intensive. In terms of tonne-kilometers of freight per dollar of GNP (the denominator of the ratio being much at the mercy of exchange rates and differences in the method of national income accounting), Hungary exceeds Europe's market economies by a factor of 2 to 3 or more (Figure 1).¹ The apparent high transport component of GNP is consistent with the share of value added by transport and communications in GDP at Producer Prices. In Hungary, this share has been hovering between 8.5 and 9.5% throughout the 1980s while typical values in Western Europe lie between 4 and 7%, only Belgium reaching 8.5%. The immediate significance of such high transport intensity is that efficiency gains in the sector would have a relatively large beneficial impact on the economy. It should be noted, however, that transport

¹ The larger t-km/GDP ratios of the large countries of North America are explained by relatively low population densities. Thus, North American data is not included in Figure 1.

Figure 1

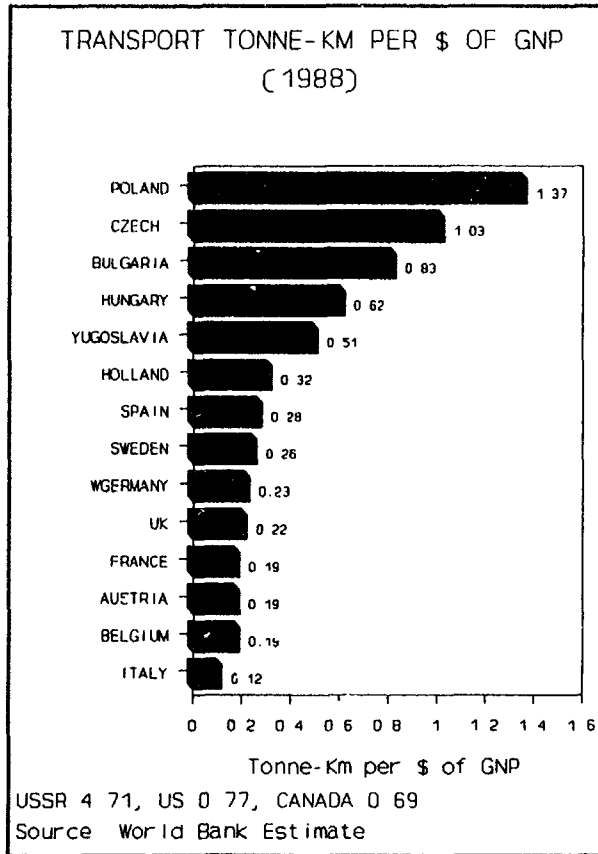
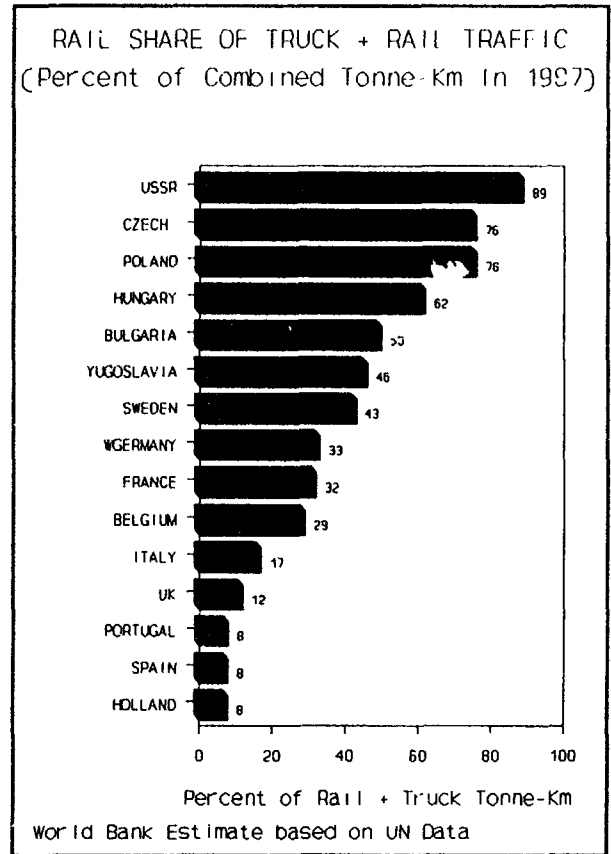


Figure 2



intensity, as measured by the above indices, has been declining in Hungary, although not significantly in recent years. This decline should continue as a result of changes in commodity composition and the organization of production, especially with a decline in the share of large-scale agriculture and some heavy industrial outputs. These changes will continue as the restructuring of the economy proceeds.

Rail Versus Road Modal Split

4. While the continuing decline in transport intensity will act as a limit on the growth of the total market for transport services, road haulage should benefit from a countervailing trend, a shift of cargo from rail to road. Presently rail represents 62% of rail plus road tonne-km in Hungary, significantly higher than in European market economies (Figure 2). The change in Hungarian commodity flows and composition should bring about a significant shift from rail to road transport as in the other countries, and as is already evident in Hungary (Figure 3). In the decade prior to 1985, public road haulage increased its share relative to rail of each of the major commodity flows (Table 1). The pace of this shift should accelerate in the coming years.

Figure 3

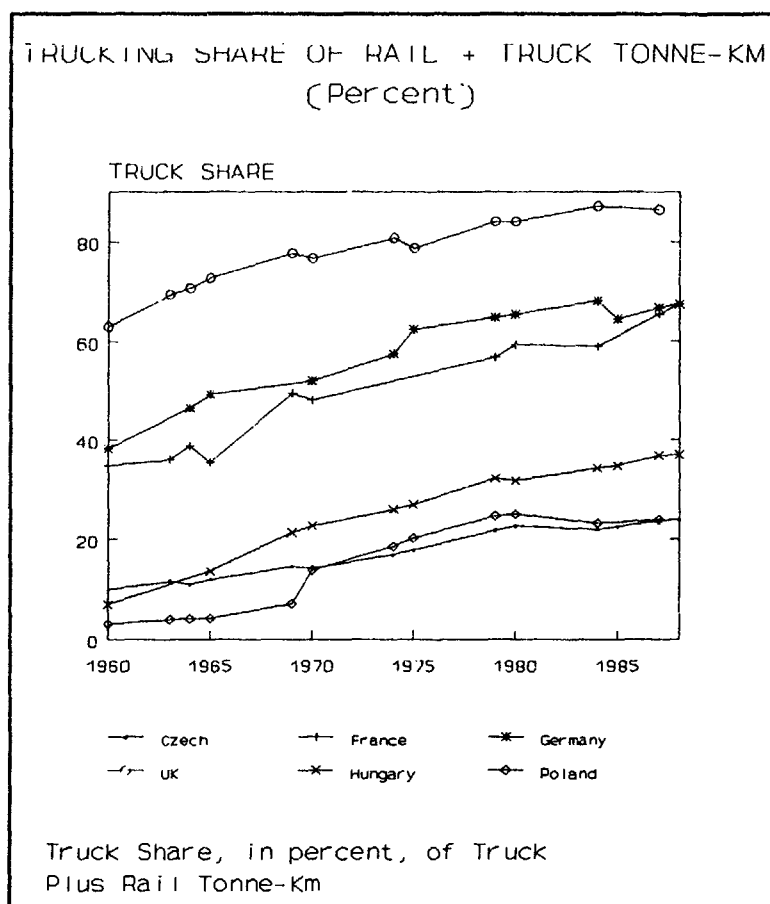


TABLE 1
Road Haulage Trends by Commodity Class

	Growth (%) in Total Commodity T-Km Between 1975 - 1985	Truck Share (%) of Truck Plus Rail Tonne-Km		Percent of 1985 Road Tonne-Km By Commodity
		1975	1985	
Fuels	12.2	4.1	7.6	5.8
Ore & Other Mining Products	-14.3	8.4	11.9	3.5
Building Materials and Products of the Building Material Industry	-20.4	22.8		18.6
Products of Ferrous & non-Ferrous Metallurgy	-1.9	9.3	18.5	8.5
Basic Materials of Light Industry & Rubber	-11.6	6.7	22.3	6.5
Other Industrial Finished & semi-Finished Product	21.7	14.6	26.9	21.0
Agricultural Products	14.8	13.2	14.8	5.6
Products of the Food Industry	18.7	37.4	44.9	11.4
Piece Good	82.8	79.1	100.0	9.4
Goods not otherwise classified, & Special Goods	73.6	33.6	24.4	9.7

Note: Percentages are based on truck and rail traffic only.
Traffic by other modes is excluded.

Stock of Goods Vehicles

5. The relatively small scale of road transport is reflected in the reported total size of the country's truck fleet with 180,000 trucks in 1988. This compares with other European countries of approximately the same size population but differing population density: Austria with 235,000 units and similar population density; Belgium with 310,000 units and much higher density; and Sweden with 246,000 units and much lower density. The liberalization measures of the 1980s have resulted, however, in a fairly rapid growth of the Hungarian fleet (about 6% per year from 1980-1988), much faster than the growth in tonne-kms performed or tonnage lifted.

6. This growth in motorization, given the initial stock of vehicles and the shift from rail to road, seems quite appropriate in terms of vehicle numbers. Judging from the Volán fleet, the age composition of the Hungarian fleet is comparable to European standards (see para. 20 below). Of more concern are the technical standards of the trucks and their obsolescence compared with European fleets. Also, though less detailed information is available, the privately-owned fleet is acknowledged to be somewhat older than the Volán fleet.

General Organization of Trucking Industry

7. "Professional" haulage in Hungary relates to the state-owned enterprises providing transport "for public use", essentially the Volán group; Hungarocamion which specializes in international transport; and at least six special haulage enterprises, which, until very recently, served the transport needs of particular branches of the economy or provided specialized services. "Private" haulage, or trucking services not run by the state, has developed rapidly since the liberalizing measures of 1982 and is free to work for hire or reward. In market economies this type of haulage is part of "professional" trucking. Parallel to these services are "own-account" trucking operations by non-transport enterprises, principally for their own transport needs. It is the significant level of this last type of service compared to other countries that is an indication of inefficiencies in professional haulage and distortions in government policies which made the acquisition of transport equipment by non-transport enterprises a relatively easy way of retaining and investing available funds.

8. A comparison of the relative participation of the various types of trucking services in Hungary with those in other countries is provided in Table 2 which compares Hungary, first with Sweden and the U.K., both of which permit free entry into haulage for hire or reward, and second, with France and Belgium which regulate the industry and control entry into professional haulage. In terms of tonnes lifted, Hungary's own-account operators have a larger share than their counterparts in the two deregulated countries, but a lower share than France and Belgium. A stronger contrast appears in the tonnes moved (tonne-kms) by own-account compared with the countries with free-entry trucking. These broad aggregates hide important differences in the nature of the work performed by vehicles and fleets, but a relatively high share of own-account fleets in tonne-kilometers performed indicates that transport costs are higher than necessary. An elevated role of own-account transport can usually be correlated with the type and intensity of regulations on the use of vehicles by different enterprises and with the efficiency with which licensed public haulage performs its work. Poor efficiency of the public haulage sector and low service reliability drives non-transport enterprises to acquire their own fleets: an unduly low perceived cost of capital by non-transport firms with own-account trucking operations can strengthen this process.

TABLE 2
Transport of Goods by Road: Percentage
Distribution by Mode of Working

Column No.		Tonnes Lifted (tonnes)			Tonnes Moved (tonne-km)		
		Own-Account (percent) (1)	Professional Haulage (percent) (2)	Private Haulage (percent) (3)	Own-Account (percent) (4)	Professional Haulage (percent) (5)	Private Haulage (percent) (6)
Hungary	1989	47	30	23	39	43	18
	1987	51	34	15	42	49	9
	1981	60	40	na	47	53	na
Sweden	1983	23	76	in (2)	16	84	in (5)
U.K. (1)	1987	41	59	in (2)	29	71	in (5)
	1983	48	52	in (2)	36	64	in (5)
France (2)	1983	64	36	in (2)	38	62	in (5)
Belgium (3)	1988	55	45	in (2)	51	49	in (5)

(1) Excluding trucks below 3 tonnes gross vehicle weight

(2) Excluding trucks below 3 tonnes payload

(3) Internal transport

9. In deregulated or lightly regulated transport sectors, enterprises with own-account fleets tend to assign long-distance carriage to professional haulage which works with larger vehicles (except in certain cases such as the transport of liquids in tankers). Own-account fleets are typically acquired and used for other purposes, working under the control of the non-transport enterprise, and chiefly for near-distance carriage where the requirements for flexibility and customer service are highest. These are simply the effects of the economics of trucking where there is free access in the industry. The contrast between the tonne-kilometrage share of own-account operators in Hungary and in European countries that have deregulated road haulage are therefore also to some extent associated with differences in the average lengths of haul in domestic road transport (Table 3).

TABLE 3
Average Lengths of Haul in Road Haulage

	Professional Haulage (km)	Own-Account Haulage (km)	Ratio Professional to Own-Account
Hungary, 1989	25	21	1.19
Volan, all haulage	31	21	1.48
Volan without Tomegaru (1)	28	21	1.33
Sweden, 1989	74	44	1.69
U.K., 1987	91 (2)	53 (2)	1.72
U.K., 1983	88	54	1.63
France, 1983	123	42 (3)	2.93
Belgium, 1989	45 (4)	40 (4)	1.13

(1) Tomegaru is specialized in transport for construction

(2) Vehicles above 3 tonnes gross vehicle weight

(3) Vehicles above 3 tonne payload

(4) Domestic haulage

10. The relatively high share of own-account operations, and the relatively high length of haul in that mode of working, together with further evidence on the wide diversity of Volán operations indicate the presence of distortions in Hungary's road transport markets and a resulting uneconomic overlap between professional and own-account services. The reason does not appear to lie in regulatory restrictions on entry since those disappeared in the 1980s, but rather in the regime under which state enterprises were operating, in the very diverse tasks assigned in the past to public haulage enterprises, and thus generally in the lagged effects of changes in Hungary's past economic order. Gradual liberalization and growing market orientation of the economy, and the reform of state-owned professional haulage will lead in time to a more economic allocation of road transport between own-account and professional operators.

Growth of Private Haulage

11. The growth of private haulage since the restrictions on such operations were lifted in 1982 raises further questions about the adequacy and efficiency of the state-owned professional haulage enterprises. Since 1981, tonnage lifted by private operators has been growing at some 50% per annum, reaching its present share of 23% of the tonnage hauled (18% of tonne-km). Over the same period, the tonnage lifted by socialized professional haulage declined steadily, by some 2% per annum, and that of Volán by 3% per annum. Between 1981 and 1989, the tonnes lifted by private operators rose by 158 million tonnes, almost twice the 86 million/tonne growth in tonnes lifted by all operators.

12. Entry by private operators is clear evidence of the need for better transport services and of the willingness of the private sector to engage in such entry and the associated investments. It has been argued that this growth was aided by a variety of fiscal incentives available to private but not to state-owned enterprises, notably accelerated depreciation and the exemption of small enterprises from taxation penalties when wage bills exceed declared norms.² In any case, the effect of private operators has been to reduce the scope of state-owned professional haulage specifically in local and near-distance transport as suggested in the discussion of own-account transport. The average length of haul of private haulage in 1989 was 20 km, against an average 25 km for Volán or the 28 km of special, branch-tied enterprises (Table 3). In 1981, before private haulage was permitted on such a scale, Volán's average length of haul was 20 km.

III. The Volán Group

Organization of Volán Enterprises and Range of Operations

13. The Volán group forms the largest enterprise in freight haulage in terms of tonnes and tonne-kilometers handled. In 1989 it provided 34% of the total volume of "professional" haulage and its fleet stood at 12,672 units. It employed 67,321 people which includes those who work with the Volán passenger services as well as trucking services. During 1989, Volán was divided into 28 independent entities, joined only by their common membership in the Volán

² The social obligations falling on state-owned enterprises but not on smaller private enterprise have also been cited as constituting a disadvantage in competition. But since those obligations resulted in benefits to labor, private enterprise which did not provide such services would have had to compensate its labor, in a situation of full employment, with a higher wage.

Union.³ As with the prior Volán enterprise, practically all of the units have the status of a State Enterprise under the supervision of state administration. Two of the enterprises are freight-only operations based in Budapest, while 19 others are simply the former Volán county branches, divided geographically among the country's 19 counties. These county enterprises, with the exception of the freight only operation in Pest, combine passenger and freight transport -- which is customary in a socialized economy but not elsewhere.

14. The 18 county enterprises providing mixed services generate 80% of the total Volán tonne-kilometrage and are all heavily involved in both passenger and freight services. The mean percentage of passenger revenues, as assigned by the accounting systems, in the total transport-related revenues of these enterprises was 46% in 1989. Only 3 of the 18 firms derived less than 40% of their revenue from passengers and only 4 derived over 50%. The largest passenger share was 60%; and the smallest, 35% (Table 4). The average number of buses per enterprise in 1989 was 370. This substantial mixture of services represents one of the greatest concerns and a major impetus for further restructuring. The accounting complexities, the differing tariff and cost recovery policies and the differing management and operational requirements of the 2 types of service potentially hinder the rational development of the trucking sector and distort the competitive position of Volán vis-a-vis private haulage.

TABLE 4
Volán Units: Relative Roles in
Bus and Trucking Activities

Trucks as Proportion of Trucks + Buses	Passenger-Km As Proportion of Pass.-Km + Tonne-Km	Pass. Revenue As Percent of Pass. Revenue + Freight Revenue			
Volan Unit	Volan Unit	Volan Unit			
TEFU	100.0	TEFU	0.0	TEFU	0.1
M. DUNA	100.0	M. DUNA	0.0	M. DUNA	0.1
TISZA	69.7	VASI	71.8	VASI	35.4
JASZKUN	65.6	ZALA	74.7	TISZA	36.2
ZALA	65.2	TISZA	76.1	ZALA	37.2
KOROS	64.6	BORSOD	76.9	ALBA	41.2
BORSOD	64.1	KOROS	80.1	KOROS	41.3
VASI	63.8	JASKUN	80.5	BORSOD	41.7
KAPOS	63.7	ALBA	82.1	JASZKUN	43.2
KUNZAG	63.3	KAPOS	83.5	VERTES	44.4
KISALFOLD	62.2	KISALFOLD	84.3	NOGRAD	45.5
ALBA	62.0	SZABOLCS	84.4	KUNZAG	46.2
HAJDU	60.6	KUNZAG	84.8	SZABOLCS	46.5
SZABOLCS	60.4	BALATON	86.9	KAPOS	47.0
VERTES	59.0	HAJDU	87.5	KISALFOLD	47.5
GEMENC	53.9	VERTES	88.0	BALATON	48.3
NOGRAD	52.6	NOGRAD	89.3	MATRA	51.6
MATRA	51.7	GEMENC	90.0	HAJDU	52.1
BALATON	48.6	MATRA	90.4	GEMENC	57.0
PANNON	44.9	PANNON	90.8	PANNON	59.7
VOLANBUSZ	0.0	VOLANBUSZ	100.0	VOLANBUSZ	100.0

³ Act VI 1988 on Economic Associations defines a Union as an economic association formed by legal entities for the sake of promoting the efficiency of their own operations, for the harmonization of their economic activities as well as for the representation of their professional interests. It is a non-profit organization.

Range of Operations

15. With the exception of Volán Tomegarú which seems almost wholly dedicated to very short-haul carriage for the construction industry, all the Volán enterprises engaged in professional haulage are general, multi-purpose transport companies. They combine local, short distance with long distance operations. Since 1978, Volán units have been permitted to participate in international haulage which now represents one-third or more of haulage revenues of many of the enterprises. Traditionally, the main area of activity was work on multi-year contracts with large state-owned enterprises, the contract providing for a specific volume of tonnes per year, charged at a flat rate ("unit rate") per tonne. The same enterprises also provide bulk carriage; transport of construction materials; consolidation and distribution; delivery to and distribution from railway stations; spot market provision of truck and driver to clients for work under the client's control; small volume, rapid distribution by van ("taxi for goods"); and vehicles on lease to clients for operation by the client's personnel. In addition, they were under an obligation to provide country-wide, small load distribution (parcel service) for consignments under 500 kg weight. Haulage work of the county enterprises and the specialist enterprises are thus highly diversified and their equipment is correspondingly varied in sizes, design and purpose.

16. A further feature, not common in the haulage enterprises of market economies, is the substantial volume of handling, both mechanical and manual, which the enterprises provide with their own machines and operators. In several units, revenues from handling account for 10% or more of total revenue attributable to haulage. The relative importance of the activity is reflected in the employment figures of the entire Volán group: 13,775 truck drivers; 1,353 loading machine operators; and 5,885 loading labor.

17. Lastly, enterprises also provide freight forwarding services on a small scale (a separate Volán enterprise specializes in freight forwarding), offer workshop services to outsiders and engage in further unspecified commercial activities.

Size of Firms

18. **Employment.** The second significant feature to be noted in the Volán successor enterprises is their size. The two freight-only enterprises have staff levels of 6,600 in Volán 1eű in Budapest and 1,400 in Duna Volán in Pest County. The smallest of the 18 mixed operations employed 1,800 people and the largest, 4,800 with the overall mean being 3,000 per firm for all. Administrative or "non-blue collar" workers form a substantial element in these large work forces representing about 21% of total staff. The freight-only enterprises had one administrative worker for every 3.5 or 3.75 non-administrative workers. In mixed operations, the ratio of administrative staff to other workers is around 1:3. These ratios and overall levels of employment suggest probable administrative overstaffing in the firms.

19. **Vehicle Fleet.** A more graphic measure of the relative size of Volán firms is the vehicle fleet. The three freight-only enterprises had 2,510, 799 and 418 trucks in Volán Tefu, Duna Volán, and Volán Tomegarú respectively. The average stock of freight vehicles in the 18 county enterprises in 1989 was typically between 500-550. The largest mixed service firm had 1,035 units (Borsod Volán, serving the large and heavily industrialized county around Miskolc), and the smallest, 328 units (Nograd Volán). Such large fleets are unusual for freight haulage in Europe's market economies. The average number of trucks per firm in the professional haulage industry of those countries is much smaller than the average Volán unit (Figure 4).

The cumulative distribution of professional haulage trucks by size of firms' fleets (Figure 5) compares the fleets of the Volán entities with those of all operators in the professional haulage business of three other countries. Volán accounts for no less than 33% of all Hungarian trucks

Figure 4

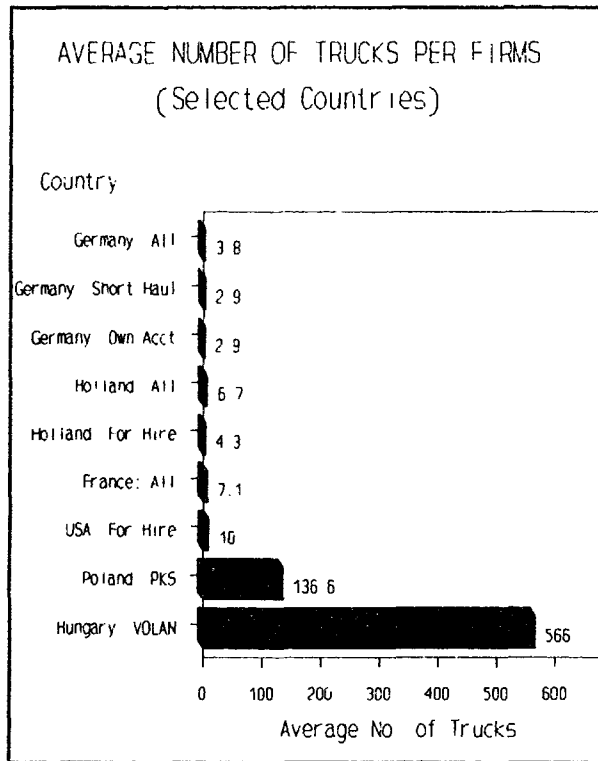
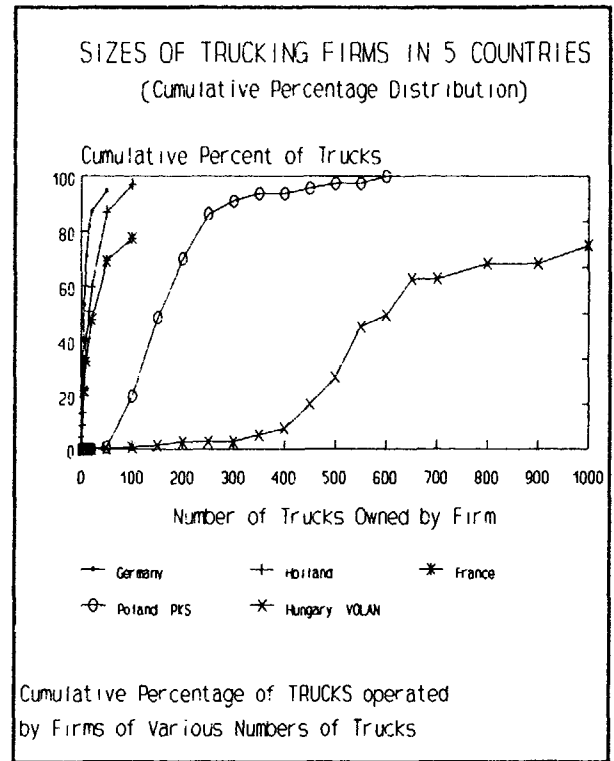


Figure 5



which means that at least 33% of Hungary's professional haulage fleet is operated by companies with over 327 units. This compares with France, the Netherlands and Germany as follows:

Concentration of the Fleet

Country	Trucks per Largest Firms	% of Fleet Operated By Largest Firms
Hungary	over 327 units	33.0%
France	over 200 units	15.0%
Netherlands	over 100 units	6.4%
Germany	over 40 units	5.1%

Adequacy of the Fleet

20. In the total Volán truck fleet, 37% are described as "fully depreciated". Using the present allowed rate of depreciation for tax purposes, the proportion implies that 63% of trucks are less than 7 years old. While this proportion does not tell enough about the age composition of the stock, it indicates at least that there is not an excessive amount of overaged vehicles. The sizes and types of vehicles, however, are not what would be expected in a modern Western European professional haulage enterprise. There is a large amount of vehicles with 3 to 6 tonne capacity and a relatively small number of semitrailers and tractors. This predominance of small and medium capacity vehicles is related to the broad range of services provided by Volán enterprises. Dump trucks make up 20-25% of a typical firm's fleet further indicating the wide range of services within a single enterprise. The typical truck configuration is to use a "rigid" vehicle whose capacity is extended by attaching trailers as opposed to using tractor and semi-trailer combinations; and relatively large parks of trailers, roughly one for every two rigid trucks, are the norm. Thus, in terms of trucking technology now common in European market economies, Volán's fleet seems not so much overaged as rather obsolete. There are instances of more modern vehicles in a few firms, mainly for international trade, but these are relative exceptions.

Assets and Facilities

21. The high degree of integration which characterizes the average Volán enterprise is seen both in the diversity of haulage activities and in the range of their assets and facilities. In common with other state-owned enterprises in Hungary and other socialist economies, Volán units provide various social services to their staff. They own resting and lodging houses and holiday homes. They maintain a wide network of representatives in company premises throughout the county as well as storage areas and stores, consignment sheds, packaging units and cold storage facilities.

22. Most important, the firms maintain extensive workshops. In several enterprises, workshops perform not just maintenance but also the rebuilding of vehicles. Large units produce springs and small parts and components. Even a unit that uses its workshops only for maintenance and running repairs has 15% of its total establishment in its workshops, as maintenance workers and fitters. The degree of integration and the extent of workshop tasks appears from the relation of workshop capacity (maintenance bays) to fleet size which in at least one county enterprise is 1:1. Another unit reports workshop repair hours per year which come to about 48 days per vehicle. Even assuming that one-half of the work done in those workshops is for outside customers, the scale of the workshops and the work done for the owned fleet are surprisingly large. Part of the explanation, given the principle of integrated operations, may be the state of the vehicles in those fleets, combined with what was formerly a shortage of vehicles relative to demand.

Alternative Forms of Ownership

23. With the exception of Volán Tefu, the large freight enterprise which was transformed into a joint stock company with its shares held by the State Property Agency, none of the other enterprises have undergone a transformation of legal status. They have, however, taken advantage on a large scale of the rights of enterprise management to transform parts of their enterprises into separate companies⁴ under various forms established by the Company Act (Act

⁴ Act XIII of 1989, The Transformation Law, Section 18.

VI 1988 on Economic Associations). Individual county enterprises have created 20 or more such formally independent units. The most popular legal form of offshoot company is the Limited Liability Company and also the Deposit Partnership.⁵ There are also a small number of Unlimited Partnerships⁶ and a number of Affiliated Companies.

24. The creation of these independent or at least free-standing and quasi-private satellites⁷ was in some cases probably motivated by fiscal incentives such as the exemption of companies with revenue below FT 20 million from the tax on the wage bill and offers of accelerated depreciation available to private enterprise. But there are also real advantages in this formation of legally distinct entities, with their internal and external relations ordained by modern company law, standing apart from the problematic ownership conditions of the mother enterprise. They are in principle capable of attracting new capital from third parties, including foreign parties, to joint ventures which benefit from additional fiscal advantages in the liability to profits tax and the Value-Added tax.⁸ Not the least benefit from separating units from the main enterprise and endowing them with a legally distinct character is the potential effect on accountability of management, and the greater transparency of economic or commercial results of different branches.

25. Against such potential benefits must be set possible disadvantages that have attracted much public comment in Hungary. The founding of new entities does unavoidably create certain new property rights. If these arise from contributions made by managers and workers of the mother enterprise out of their private resources, there should be no objection, so long as contributions that give rise to claims on profits are fairly valued. Transformation obviously becomes problematic when valuations are distorted. Private contributions may then get valued high relative to contributions from the (state-owned) estate of the mother enterprise, and transfer pricing between daughter and mother enterprises may become a means of raising the profits and the wealth of the private partners.

26. The significance of the multiplication of the new companies for the restructuring of Volán is limited. The question of ultimate ownership and control is obviously not solved by this process; if anything, it has been marginally complicated. Nor has it led to more competitive behavior of Volán sub-enterprises, or greatly enlarged the freedom of managers. The tendency has been to separate out units with a homogeneous activity, essentially departments of the Volán enterprise. The mother enterprise is the main, if not the exclusive, owner of the daughter entity and controls its management. While some units sell services to third parties, the normal relation seems to be that of interlocking units, subservient to, and

⁵ Corresponding to the German Kommanditgesellschaft, or the French Societe en Commandite.

⁶ Corresponding to the German Offene Handelsgesellschaft or the French Societe en Nom Collectif.

⁷ The liability of the partners in an Unlimited Partnership, or of the Full Partner in a Deposit Partnership (corresponding to the Komplementaer in the German KG) is unlimited. The mother enterprise will thus bear full responsibility in practically all these cases.

⁸ Act XXIV of 1988 on Foreign Investment in Hungary, Articles 15 (2)(a), and 17.

under the control of, the central founding enterprise. Thus, whatever its theoretical managerial merits, these new sub-companies have not resolved the issues relating to the organization and operation problems of large, multi-purpose transport enterprises organized according to the country's administrative (county) divisions.

IV. Experience in a Climate of Recession

27. Hungary's economy has been stagnating for several years. In the past two years it has been in plain recession. Industrial production declined by over 3% in 1988 and again in 1989, and by 10% in the first 4 months of 1990. The volume of investment (in the public sector) has been falling steadily since 1987: construction has been declining accordingly. For individual enterprises, in the transport sector and among its clients, the impact of recession was associated with policy reforms that freed many prices and withdrew controls on the range of permitted production and service activities (the permitted 'profiles') and on quantities. The effects of recession and delayed adjustment are reflected in steadily rising volumes of inter-enterprise debt. Hungary's exports, however, grew substantially in 1989 and grew further in the first half of 1990.

28. The effect of stagnation and recession on the trucking industry was, first, some withdrawal of own-account operators from road transport and a transfer of their haulage to new, small private companies or one-man operations, sometimes in the form of period contracts which integrated the new operators into the firm's activities. Own-account operators have been selling vehicles, retaining the smaller capacities (5-6 tonnes, and below) while contracting with private entities for carriage by large vehicles. Other own-account operators, having reduced their own capacity, resorted to state transport enterprise services. Generally, there was a substitution of spot and short term for long-term freight contracts.

29. Some of the Branch (or Special) transport enterprises reduced their fleets and increased their reliance on subcontracting with private operators. Branch transport enterprises are themselves of substantial size (the former BSZV, originally the transport enterprise for Trade, has a workforce of 6,000 and 1,300 vehicles), and like Volán and many other Hungarian enterprises, are transforming branches or departments into self-contained companies (usually Limited Liability Companies).

30. In 1989, a year that did not yet reflect the full impact of recession, the Volán group lost 19% of its business in terms of tonnes lifted, and 4.5% in terms of tonne-kilometers. A tentative calculation suggests a decline by 13% in domestic tonne-kms, and an increase by 15% in international transport. Eleven of the Volán enterprises engaged in professional haulage reported in 1989 operating losses from their freight business. Activity and operating results will have worsened further in 1990. The combined stock of trucks was reduced by 9% in 1989, and the numbers of staff directly connected with freight transport (truck drivers and loaders) fell by 12%. Much more rapid reductions in trucks and staff are indicated for 1990.

31. There is much commonality in the experience of the Volán units. The recent period has generally shown some increase in international transport and, of course, much striving after it. Domestic haulage, however declined:

- It declined particularly severely in the transport of parcels.
- The demand for bulk transport declined.
- The demand for dump trucks declined as construction activity fell.
- There was general experience of a fall in consolidating and distributing work.

- Domestic long-distance transport has fallen more than short-distance.
- Small payloads have declined more than medium-sized payloads, being taken away by private operators.
- The earlier mainstay of many Volán freight operations, long-term contracts with state-owned enterprises, can no longer be relied on. Clients are now opting for spot or short-term contracts (up to one year).

32. Competition is being experienced from the Special Transport Enterprises, or their successor organizations, and, in the market for local transport, from private haulers.

33. It is exceedingly difficult to distinguish between the effects of recession on the freight transport industry, and those of more permanent changes in the structure of the economy as a consequence of the general economic reforms. Since the management of individual enterprises must also find it difficult to make the distinction, their reactions are bound to be based on expectations formed with little basis in past experience. Our judgement, however speculative, is that the trend from rail to road will continue, and that demand for international road haulage to Western Europe will also grow, though perhaps not at the high rate of recent years. In domestic haulage, the demand for longer distance operations will revive and grow as the composition of national output and the structure of industries adapt themselves to an open, market-oriented regime. The market for local and short-distance freight transport will also grow, but will be subject to strong competition from smaller, locally based units (unless held back by regulations). Construction industry demand will obviously revive and should grow as Hungary improves her infrastructure, but should be subject to stronger cyclical swings than in past decades. Own-account haulage will have a smaller share in the total volume of road transport than in recent years, and it is likely to be more concentrated than in the past on short-distance work. Own-account fleets (including those of the railway) will, however, take over part of the work in consolidation and distribution. Stable, long-term freight contracts between large commodity-producing enterprises and transport companies will not resume their past importance for professional haulage enterprise: other types of contracts, more suited to the needs of shippers operating in a more open and competitive economy, will grow in importance.

V. Volán: Options for Restructuring and Transformation

(i) Purposes and Conditions

34. The principal object of any proposal to restructure and transform the Volán group and its components must be to raise the productivity of present and future resources employed in Hungary's freight transport. Hungary's policies for a change in her economic system envisaging the transition to a substantially private market economy point the directions in which that object can be pursued with success.

35. Extensive experience in Hungary and in other countries shows that a competitive environment is required to induce and maintain progress in the productivity of industries and activities. Transport policy in Hungary, and the measures adopted for restructuring and transforming the Volán group, should therefore also assure competitive conditions in the freight transport sector.

36. Conditions in Hungary's economy and the progressive transformations in the outputs and organization of her industries argue the need for assuring flexibility in the structure of freight transport enterprise, particularly because of the intermediate goods character of freight transport. The typical size and structure of freight transport enterprise in Europe's market economies are themselves evidence for the survival value of flexibility.

37. Organization and changes of organizational form are a means to the end of the best attainable level of productivity and profitability. Ultimately, these ends have to be assured by the quality of management. There is no reason to believe that the Volán managers lack competence and quality in the technical aspects of freight haulage. If there is a deficiency -- not necessarily of personal competence but rather of experience -- it is commercial management. The success of restructuring Volán will depend ultimately on the commercial skill, drive and imagination of the managers.

38. The transformation of state-owned enterprise of various kinds raises problems of ownership and of rights, or perceived rights. A condition for the transformation of Volán (as of other enterprise), accepted by Hungary's policy, is that state property must not be dissipated in the process of transformation. Options for the restructuring of Volán can only be considered if they promise compliance with this condition.

(ii) Passenger Transport (the mixed enterprises)

Case for Separating Passengers from Freight

39. Passenger transport in Hungary receives subsidies and will continue to be subsidized to some extent. That is also the case in other countries, but the combination of subsidized passenger transport with (by policy) unsubsidized freight haulage in one and the same enterprise is unusual outside the socialist or former socialist countries. A primary argument against such mingling is that it permits cross-subsidies between a socially supported service and another that should be market oriented and market dependent if it is to be kept to good standards of resource use. In the past, Volán freight revenues have at times subsidized passengers. Recently, freight has been the weak branch, and in undivided enterprises it will be difficult to prevent flows from passenger revenue, including the subsidy, to the freight establishment. Moreover, passenger transport is treated as a public utility (and one that is politically sensitive). Public utilities are typically subject to a separate fiscal and financial regime: there is no reason why this should extend to freight transport, and especially to only one part of the country's freight transport. Under the present rules, where non-passenger related revenues provide less than one-half of enterprise revenue (and 8 of Volán's mixed units earn roughly half their revenues from passenger services), the wages paid by the entire enterprise may be raised at a higher rate than wages in other industries before attracting a surtax on the wages bill. A further strong argument against the combination of passenger with freight operations in the same enterprise consists in the totally different managerial requirements of the two activities.

40. The separation of passenger from freight transport appears essential to the reform of the present Volán enterprise, and an indispensable condition for the restructuring of the freight operation. Two broad options can be considered.

The Option of Internal Separation: Separate Accounting

41. One option, which has the support of some in the senior management of Volán, is a complete separation in the accounting and the management of freight and passenger transport performed by the existing Volán units which would in all other respects retain their present configuration. This, if feasible, would cause the least immediate disturbance in the present organization of the group. Such common facilities as can be separated out (such as workshops) would become separately accounting departments or entities and 'sell' their services to the passenger and the freight departments. The fiscal regime for the separately accounting freight branch would be assimilated to that applicable to any freight haulage enterprise in the country. We doubt the feasibility of such a surgical separation in the accounts and consider it likely that, if adopted, it would further enlarge the overheads of the total enterprise, passengers and freight together. We also doubt whether it would attract the best managerial talent to each of the two activities within pre-existing Volán units. Instead, it would tend to perpetuate the status quo.

The Option of Separating Establishments

42. The alternative option consists of organizational separation and division of property. Passenger transport would be separated from freight transport in terms of legal and fiscal status, physical and financial assets, finance, management, personnel, wage and salary scales, employment contracts and, when indicated, in terms of location. Responsibility for passenger services would be assigned to the subsidizing authorities, central or local. It would operate as a public utility, under contract to the controlling authority. Control functions, including notably the commitment to prescribed services for given subsidies, may be performed by local authorities, or by regional transport executives on behalf, and under the rules and the supervision of, a central passenger transport authority. Models for such a mechanism of control may be sought in arrangements prevailing in European market economies with approximately similar population sizes.

Institutional Tasks

43. Only one of the Volán county units is specialized in passenger transport service and 85% of all Volán passenger-kilometers are provided by the 18 units that combine passenger with freight transport. Each of these is a county-wide organization with several branches or depots most of which are again equipped with both buses and trucks. Each possesses facilities, notably workshops, that are used in common by both types of service. Several of them have concentrated common services such as accounting, in separate satellite entities of various legal forms. The task of uncoupling passenger from freight business so as to form separate establishments is therefore considerable, similar in kind though not in scale to what is required for privatization, and unlikely to take less than one year. To make the task manageable it will be advisable to prepare and issue guidelines for the valuation of assets and for alternative ways of disposing over common facilities. Active assistance will have to be given by the Ministries of Transport and Finance and probably also the State Property Agency. Assistance may also be provided by the Volán Custodian whose appointment is suggested later in this note to assist with similar tasks associated with the transformation of Volán freight transport enterprises. Outside lenders and donors may consider assisting in the operation by funding capital improvements in the stock of buses and in station and terminal facilities.

(iii) Freight Haulage Enterprises

The Candidates for Reorganization

44. Of the total volume of tonne-kilometers of road haulage supplied by the Volán group in 1989, 16% was produced by Volán Tefu, the specialist road haulage enterprise operating in Budapest. Volán Tefu has now been transformed into a Public Limited (joint stock) Company with the stock held, for the time being, by the State Property Agency. A further member of the group, Volán Tomegarú, with a minor share in the group's tonne-kilometers but 21% of tonnage lifted, is essentially specialized in work for the construction industry. This enterprise, based in Budapest and with a staff of 2,300 and a fleet of 241 vehicles seems suitable for transformation. After auditing, some scaling down and possibly after regrouping with components of the former special (branch) transport enterprises, it may be formed into a Limited Liability Company, offered for sale and, pending sale, kept in the portfolio of the State Property Agency and its suggested agent, the Volán Custodian (see below).

45. Further specialist Volán enterprises, engaged in freight forwarding, packing, heavy lift services and computer technology and services, are modest in size and seem equally suitable for transformation into Limited Liability Companies on offer for sale.

46. Volán Union is not a commercial enterprise but a common interest representation of the Volán group members. It will find that the scope for its activities will change as the operating constituents of the Volán group are transformed, and if Hungary's road transport policy continues to support a competitive environment for haulage. Some of its more general services may be placed on a commercial basis, requiring a change in its legal status⁹, and should be made generally available. The immediate problem of restructuring relates therefore to the 19 county enterprises that provided in 1989, 84% of the group's tonne-kilometers.

Economic and Operational Considerations

47. In economic and operational terms, the county organization of the Volán branches, subsequently established as independent enterprises, seems more appropriate for passenger transport than for road haulage. Major inefficiencies, in the shape of a maldistribution of vehicles relative to tonne-mileage of sold output, were nevertheless avoided. Relative vehicle stocks, and relative volumes of services, are each reasonably well correlated with county population employed in industry (as distinct from other "material branches", such as agriculture, construction or trade). As Figures 6 and 7 indicate, the distribution of operating equipment across counties, in 1989, conformed quite closely to that of tonne-kilometers of service. This congruity of output with equipment holds also for the three Volán enterprises which appear from the diagrams, to have truck numbers and annual performance, for given industrial populations, above the county average. All three operate in counties bordering on Austria or Yugoslavia which are the two main destinations for Hungary's road-carried export tonnage. All the three enterprises were leaders in the international carriage by Volán group enterprises.¹⁰

⁹ Cf. Act VI 1988 on Economic Associations, Sections 103, 106.

¹⁰ Tisza Volan, in Csongrad County which borders on Yugoslavia and Romania, reported the second-largest non-Ruble revenue from international carriage among the Volan enterprises (after Volan Tefu). Zala Volan, in Zala County which borders on Austria and Yugoslavia, came third in the order of non-Ruble earnings. Vasi, in Vas county which also borders on Austria and Yugoslavia, increased its Ruble income from international carriage in 1989 at the highest rate and its non-Ruble income rose faster than the Volan average.

Figure 6

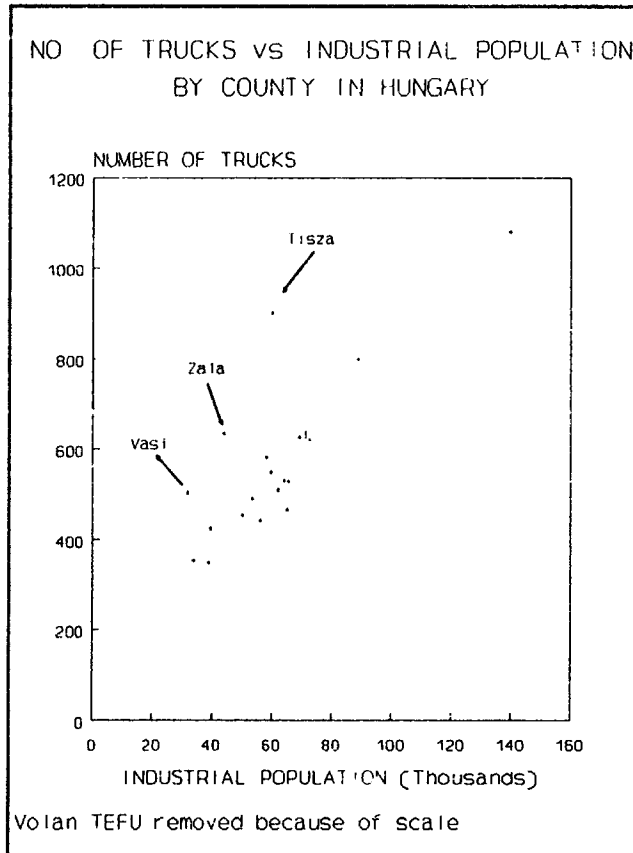
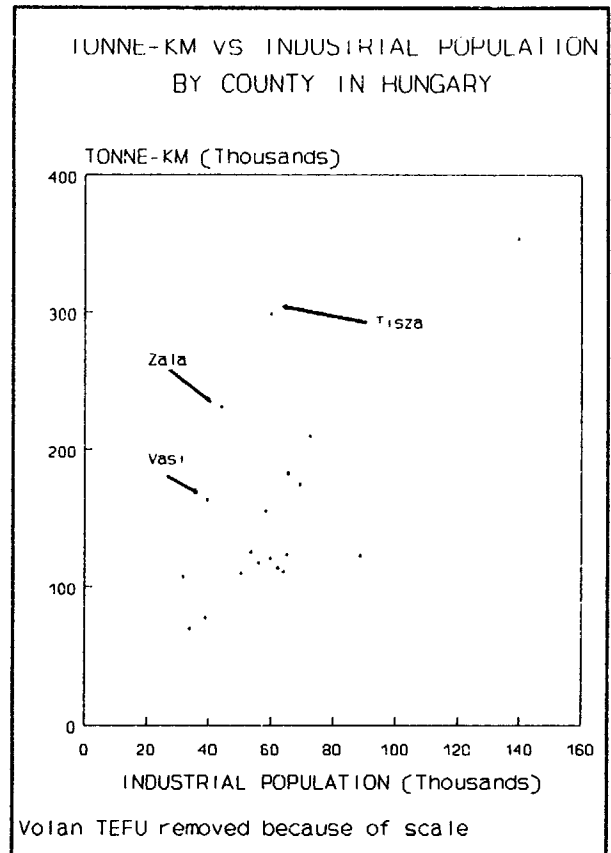


Figure 7



48. This test, however, refers only to the relative allocation of equipment to different counties; moreover, to the allocation of the most readily variable item of capital employed in the transport enterprises. What is relevant to the average level of efficiency and productivity throughout the group, in recent and foreseeable circumstances, is the large size of the individual enterprises, the mix of very dissimilar road freight activities and adoption of the concept of the county as the market area for domestic road haulage.

49. The size of the freight components of the Volán enterprises, in numbers of vehicles and of staff are unusually large by comparison with firms in the road haulage industries of Europe's market economies (Figures 4 and 5 above). The degree of integration of the enterprises, in terms of workshop facilities (shared generally with the passenger transport operations), stores and loading machinery, is equally unusual in countries where the market has been free to determine the shape and size of road haulage enterprise. The low average length of haul of their vehicles, even in recent years when private haulage was competing effectively for local business, is evidence of the multi-purpose nature of their haulage activities. As the managers of Volán enterprises recognize, the incursion of private competitors into some of their traditional markets signals inefficiencies that cannot normally be attributed to any one of the enterprise's work methods but are likely to be inherent in the overall system. None of the private enterprises that have established themselves in Hungary's road haulage sector combines passenger with freight transport, nor have they diversified their activities to anything like the same degree found in the Volán group. Counties, moreover, are unlikely to prove themselves

as viable market areas in a competitive transport system; the less likely as Hungary's large and highly integrated industrial enterprises undergo transformation and division, and as the customary long-term freight contracts with those enterprises located within the county cease to be available as a major source of regular Volán business. The past customary relations between large, state-owned client and large, state-owned supplier of transport services are unlikely to survive as Hungary's economy develops on new lines.

Options for Transformation: Common Conditions

50. The options for transformation that will be considered fall basically into two classes, distinguished by the degree of gradualism that is judged optimal.

51. Several conditions should be seen as common to both classes of option. First, passenger transport will be separated in the organizations from freight haulage. Second, the state, direct from its budget or through the State Development Institute, will not fund new investments, including the acquisition of vehicles, for untransformed Volán freight enterprises. Third, Volán freight entities, while remaining [untransformed] as state property, will remain under the obligation to pay to the state the dividend of 18% of post-tax profit. We stress these conditions for two reasons. First, they are necessary if the growth of the new truly private trucking companies is to be encouraged -- and it is these conditions which will provide the competitive pressure needed to force the evolution of the Volán units. Second, since many trucking assets are short-lived, absence of state-provided capital will perforce cause refinancing and increased private sector involvement in Volán units within a relatively short time of five to seven years.

The Option of One-Stage Reorganization

52. The first broad option to be considered aims essentially at one-stage reform. It would create a limited number of relatively large regional freight transport companies, from the freight transport-related estate of the present Volán group. The operational plan of the companies which determines their equipment, staffing and location, would be based on the best forecasts that can be made of market developments. Strictly local transport would therefore probably be relegated to a minor role or referred to other suppliers. Management would in the first instance be appointed by the authority initiating the transformation. Ancillary enterprises allotted to the freight entity in the course of separating passengers from road haulage -- workshops, agents' offices, stores and storage areas -- would be offered for sale or on lease to separate firms or individuals, unless they are expected to fit profitably into the freight haulage companies' own organization. The existing satellite enterprises of Volán units, such as those providing accounting, administrative or legal services, may be put up for sale, dissolved, let out on rent to their staff, or integrated, where that promises to be efficient, into the regional enterprise. The enterprises would be formed as Limited Liability Companies or as Public Limited Companies, with the stakes or shares vested in the first instance, in the State Property Agency which would then seek to sell them to private parties.

53. The merits of the one-stage option are principally tactical. By rebasing and regrouping Volán freight operations and the control of freight activity it may facilitate the separation of passenger from freight transport and the enforcement of the separation. Further, it will settle sooner rather than later the question of ownership and control of assets and enterprises and may thereby also minimize the dissipation of state property. Also, by aiming at the formation of large enterprises -- substantially larger than the present freight components of the Volán units -- this option may be thought to facilitate transformation into Public Limited (joint stock) Companies. In theory that form of organization allows ownership to be transferred to third parties more readily than is generally feasible with the parts or shares in Limited Liability Companies or Deposit Partnerships.

54. The disadvantages of one-stage solution are operational. The scheme requires decisions to be taken on the range of operations that the new companies would undertake and have to be equipped for in terms of assets, location, management and staff. Such judgements, if made in the next year or two, while the economy and the transport market remain in recession, are likely to be premature. The degree of continuity to be expected in the structure of Hungary's products, industrial organization and spatial distribution of activity, is low and the operating experience of Volán enterprises during the past two years may turn out to be a poor guide to what demands there will be in the longer run for road haulage services. A separate implication of this solution is that it is difficult to implement except by the creation of large enterprises (and the required consolidation would, in any event, be a very complex undertaking). Furthermore, the unusually large units created by this option would not be suited to market requirement and thus could be sold to the private sector only at a discounted price, if at all. While there has indeed been a tendency towards growth of firm size in the road haulage industries of Europe's market economies, this has been in response to market demands. Moreover, the representative firm sizes in those countries are still far lower than in the present Volán group configuration. There is no evidence for economies of scale in trucking; some activities, such as Less-than-Truckload transport and forwarding which many Volán units already perform among their many other lines of work, require an initial size beyond that of basic road haulage; but there are then also economies of specialization. When trucking companies have found large size to their commercial advantage, it has usually been the outcome of the system of regulations (restricting entry into the industry) under which they operate. A growth of size of road haulage enterprise in Western Europe has, however, also been associated with the accumulation by those firms of functions transferred to them by industrial firms: storage, stock control and distribution have thus been taken over by a new type of distribution company. These organizational developments cannot be engineered by forming transport companies for the performance of those functions for which there is not as yet a reliable industrial clientele. The possible clients are themselves in the throes of restructuring.

The Option of Market-Led Transformation

55. The alternative option is a stepwise solution. It presupposes the organizational, financial and managerial divorce of passenger transport from the freight component of Volán mixed operations enterprises, at the start of a roughly 4 year programme leading to privatization of road haulage. The separation would result in Volán freight haulage enterprises, emerging from each of the present units as separate, state-owned enterprises

56. Several Volán units have maintained profitable operations and adjusted themselves with success to market opportunities, even in generally adverse economic circumstances. In terms of the composition of their operations, their equipment and their market contacts, they appear robust and viable for independent commercial existence in the private economy. A limited number of these units may therefore be given precedence in assisted privatization. At the initiative of the founding body and the State Property Agency, possibly acting through a sub-agency (as suggested below), these enterprises should receive expert assistance in the accounting and legal preparations for privatization, and with marginal changes in their stocks of equipment. After being readied for privatization, the State Property Agency or its agent would actively seek private buyers for these units. A feasible target for assisted privatization might be 3 - 4 units in the first year of the program. The associated learning and demonstration effects may be counted as important benefits of the process.

57. Enterprises not selected for assisted privatization should continue to operate and to adapt themselves to the conditions of demand for road haulage in the country. Specifically, the managements should be free, (subject to conditions of financial discipline) to change location; seek markets and appoint or engage agents throughout the country and outside; sell or acquire, from own or borrowed resources, vehicles and equipment; dispose of activities, such as local

pick-up and delivery, which can better be performed by other enterprises; lease and let vehicles and facilities and to enter, on behalf of the state as owner, into management contracts for parts of the enterprise, with third parties, or accept such contracts.

58. The presumption underlying the proposal is that the market for transport services, if allowed to operate freely, will determine the operationally efficient range of activities and scale of profit seeking enterprises. The object of the proposal is to induce the formation of viable and flexible transport enterprises suitable for privatization. Managements might therefore be given an incentive for actively pursuing opportunities for privatization, and for the attraction of private participation, possibly in the form of contract termination payments in cases of unforced privatization (including privatization by management buy-out). Such incentive payments to management would obviously not be allowed in cases of enforced reorganization. This may be invoked when an enterprise fails to service its debt, and in two further sets of circumstances: when enterprises remain in state ownership at the end of the programme period, or when the assets of an enterprise according to its annual balance sheet have decreased by 20% below the lowest level in the preceding two years (as provided by Section 25(3) of Act XIII of 1989). In those cases, at the discretion of the founding authority or the State Property Agency, the enterprise may be taken under central control, reorganized, merged, put up for sale in whole or in parts, placed under new management or under management contract. Enterprises retained at that stage in state ownership might then be set financial targets (such as a target rate of return on the property balance assets, at a rate related to indicators of the economy's performance during the preceding 6 months). Overall, the restructuring would proceed in scheduled stages against a reasonable deadline -- 4 years, or so. At the end of this period, if any enterprises remain in the portfolio, they would either be sold (if they are viable) or subjected to direct intervention, with a view to forming them into units which have a prospect of disposal in the private market.

Financial Discipline, Accountability and Supervision

59. Either option requires the imposition of conditions to assure financial discipline, profit-conscious management and the freedom of management to operate competitively and to seek profits for the enterprise. Managers of the untransformed Volán enterprises might therefore hold their appointment from the Minister who would also approve their remuneration and issue guidelines on profit-related bonuses for management of untransformed enterprises. If the argument for a stepwise solution prevails, supervision would have to be exercised over the terms on which satellite companies or partnerships are formed by the Volán enterprises. Under either option, the preparations for the establishment of a property balance (see Act XIII of 1989, Common Rules, Section 5(1) (b)) should not be deferred until transformation is imminent, but should be started soon, on the basis of guidelines that the authorities could prepare with expert advice.

Form of Association

60. The choice between these two types of option is likely to depend crucially on the relative weight given to the perceived tactical and administrative advantages of the first, against the operational and economic merits proposed for the second, and the learning function that one expects from it. If it is accepted that the operational and economic considerations should prevail, then one may expect a regrouping of enterprises and activities and a smaller average scale of road haulage firm to emerge. Such a solution has implications for the choice of the organizational form of road haulage.

61. Joint stock companies are the appropriate form for large organizations and are thus uncommon in the road haulage industries of market economies. The form usually found reflects the preference for close control over the management of the organization, and that is more

readily compatible with the partnership or the Limited Liability forms of organization. State ownership (by the Property Agency) of all or part of the shares representing the estate of an enterprise has clear administrative advantages over ownership of Limited Liability Companies or stakes in them. But if the object is really privatization of the economy, then it may be found no more difficult to sell road haulage enterprise of medium scale in the form of a Limited Liability Company than shares in such an enterprise when formed into a joint-stock company. The organizationally more demanding requirements of a Public Limited Company under Hungary's law (as under that of other states) will themselves act as a disincentive to those interested in acquiring a majority share that would permit control of the management.

The Institutional Tasks

62. Either of the two options discussed, or the possible variants of either, require guidance and supervision by the authorities. The option of stepwise reorganization is the more demanding in this respect. It provides for assistance in the privatization and preparations for privatization, of a limited number of Volán units, to start early in the program. Expert help will therefore have to be found or made available and an effort in marketing the commercialized, selected units will be required. For the remainder of the Volán group, it envisages the continuing existence throughout the programme period of (a declining number of) individual Volán freight haulage enterprises, to adapt to the market, within limits set by the principle of preserving the state's property. There will therefore have to be supervision, enforcement of financial discipline, and some guidance on accounting, forms and requirements of privatization and on the most suitable forms of association. In cases of enforced reorganization and of subsequent transformation, the state's portfolio of entities and associations remaining in state ownership will require oversight. Most of these institutional tasks are of a financial character. The discharge of those tasks, as well as of tasks of a more transport-technical nature, will require expert assistance and may also present cases for outside capital infusions. The administrative complexity of the resulting tasks may argue for assigning the oversight of Volán freight haulage enterprises during the programme period, and of the portfolio of entities and assets remaining untransformed at the end of the programme, to a special agent, acting on behalf of the state or of the State Property Office. Experience with the organization and operations of state property agencies or trustee institutions is still limited, and there are few precedents for sub-agencies.¹¹ Consideration might be given to the appointment of a major bank as Volán Custodian, acting as the agent of the State Property Agency in supervising the financial and legal aspects of Volán entity activities and their transformation. The Custodian may seek expert help in the preparation of guidelines, the adaptation of accounting systems, the establishment of property balances, and in the search for, and negotiations with, prospective buyers of entities and assets. It might also mediate credit from third sources for buyers of entities or assets from the Volán estate, and negotiate outside loans for the renewal and modernization of individual Volán road haulage enterprises. Neither the one-stage option, nor the option for a stepwise solution can be efficiently implemented without some capital input.

¹¹ There exist some examples of very recent vintage. Among them is the Limited Liability Company founded by Trustee Agency (Treuhandanstalt) in Berlin, specifically for the privatization of trade in the former German Democratic Republic.

VI. Regulation of the Road Transport Industry

63. Various models of road freight transport regulation are available in the practice of different countries of Europe or North America. They differ primarily in the extent to which entry into road haulage for hire or reward is restricted. In Hungary, demands for a system of "concessions" to restrict competition (corresponding to the German system of Genehmigungen) are expressed by the managements of Volán enterprises as also by those of Hungarocamion, and of the present or transformed special (branch) road haulage combines. Hungary's government will, unavoidably, have to confront the question of the freedom of entry into road freight transport.

64. There is, moreover, a cost to delaying decisions on the rules and controls that will govern road haulage operations. Uncertainty about the use that can be made of assets is obviously bound to deter entry, investment and innovation, whether by nationals or foreigners. Restructuring and privatization of road haulage will be held up for as long as the government delays committing itself to a policy.

65. The present liberal system allows free access to all markets for road haulage and leaves the prices of the service free. It has permitted the rapid growth of small-scale and one-man trucking enterprises, affording employment to 26,000 persons in 1988. The number will have risen much since then. In all countries, road haulage has shown itself to be particularly suitable to small scale entrepreneurship, working successfully for their own account or as subcontractors to larger transport firms. Evidence of their viability is found in countries that restrict entry relatively stringently, such as Germany, just as much as in those, like Britain, Sweden or Ireland, that place no significant barriers on entry.¹²

66. Entry of individuals into the activity is socially desirable in that it offers productive employment and property ownership to the middle classes. It is economically efficient, not least because of the flexibility of the small operator and the gain in flexibility of the larger enterprise that contracts with him for individual jobs or limited periods. Hungary's transport market is responding to these opportunities. Volán enterprises are letting their vehicles to independents, among them former Volán staff. Manufacturing enterprises with some own-account road haulage integrate independent owner-drivers into their transport operations, finding them more reliable than the services, and harder working than the staff, on offer from the public haulage enterprises. Freight forwarders employ independents in international haulage.

67. Entry-restricting regulations vary in their rigor. They generally regulate entry separately into different segments of road haulage. Own-account operators are typically debarred from carrying for third parties, and are sometimes rationed in the number and capacity of their vehicles. Entry into public haulage may be restricted in terms of the number and capacity of vehicles, and the type of market for permitted working. Applicants for admission to professional haulage are usually required to prove need for their service as a condition of entry. (In Britain, the transformation, in 1953, of this requirement into a requirement on objectors to prove lack of need acted as a substantial measure of liberalization and led to the issue of many more licenses: the same change, and the same result, occurred in the United States in 1980). Entry regulations are often associated with price controls, either in the form of prescribed

¹² In Germany's long-distance haulage, 35 percent of all licensed enterprises operate with only one license -- one truck -- and 66 percent operate three or fewer. In the less rigorously regulated short-distance segment (up to 50 kilometers), 51 percent of all licensed haulers operated one single lorry in 1984, and 79 percent had three or fewer.

maximum or minimum rates, and with anti-monopoly provisions that are difficult to enforce. They tend to be cost raising.

68. The tendency of transport policy in many countries is towards greater liberality and freer competition. That tendency should also express itself in the proposals for a uniform road haulage regime for the European Economic Community countries which the Commission is still to submit (EEC Commission White Paper, 1985). A liberal regime which Hungary may find socially attractive and economically effective would be primarily limited to operator licensing. It requires operators of all vehicles to conform to legal requirements on the maintenance of vehicles and on drivers' hours (licensing requirements may be somewhat stricter for international traffic than for domestic carriage). Operators of larger vehicles need to convince the licensing authority that they are fit persons to hold a license, that satisfactory arrangements have been made for complying with road transport laws, and that financial resources and facilities are at their disposal to maintain the number of vehicles they wish to operate. For one-man enterprise, or owner-drivers, these requirements prevent heedless rush into the activity but are otherwise easy to satisfy. Other than operator licensing, we believe that Hungary's current policy of not regulating entry or rates in trucking is highly desirable and should be maintained intact.

69. The effects of maintaining Hungary's present competitive regime in the road transport of freight even in the current period of recession, are unlikely to be drastic. The impact of increasing competition on established operators will be buffered, first, by the relatively small size of the country's stock of trucks and, second, by the continuing drift of cargo from rail to road. The effects of restricting competition, on the other hand, are difficult to correct and are certain to be adverse in the long run.

70. If a competitive regime is allowed to prevail in Hungary's road haulage, there should be no reason for concern about surviving collaborative and cohesive practices in the Volán group. The risk of restrictive practices or collusion, if unsupported by the authorities, is not great while entry into the activity is left substantially free. Only if a restrictive system of concessions were to be instituted would there be a case for creating and wielding the various instruments of monopoly and restrictive practices controls.

VII. International Haulage

71. Hungary's economy is characterized by relatively high dependence on foreign trade. Exports of goods and nonfactor services in 1988 accounted for 38% of GDP¹³. In 1989, 27% of industrial production and one-quarter of agricultural production were exported. The impending changes in the terms of CMEA intra-trade are expected to work to Hungary's disadvantage. Exports to the non-ruble area, however, present the brightest aspect of recent economic performance.

72. Road transport is much more important in Hungary's exchanges with Western countries than with the ruble area, and the growth in the volumes traded with the West has therefore mitigated somewhat the impact of domestic recession on the road haulage industry. International haulage has increased its share in the revenues of professional road haulage enterprises; for several Volán enterprises, the share now lies between 30% and 50% of revenues from freight transport. As a consequence of this change in the structure of demand, the plans

¹³ For comparison, the share in Austria's GDP was 37%, 23% in Poland and 24% in Yugoslavia.

of road haulage enterprises, including the members of the Volán group, envisage increasing concentration on international haulage, whether as carriers or as freight forwarders.

73. International road haulage to and from the non-ruble area of Hungary's foreign trade was originally the monopoly of Hungarocamion, a unitary enterprise directly owned by the state. The enterprise employs over 5,000 people, 3,000 of them drivers. Its fleet of 1,800 vehicles contains the largest element of refrigerated trucks among Hungary's haulage enterprises, and much of it is adapted to the conditions of international haulage in Hungary's trade, with vehicles of a size and weight that are not technically suitable or commercially profitable in inland operations. The enterprise operates scheduled routes and has built up international connections, with a daughter company in Vienna and associations in Italy and Luxembourg. The expansion of Hungary's road-carried foreign trade with the non-ruble markets is reflected in Hungarocamion's performance over the 1980s; tonnes lifted and tonne-kilometers performed doubled between 1981 and 1989 while the Volán group, with its main business in internal transport, lost on both dimensions. In the late 1970s, Volán was given permission to participate in international haulage, a valuable extension of its range of operations since it secured a share of the hard currency income for use by the enterprise. Own-account transport in international trade was permitted in 1986. Private hauliers are now also free to work internationally and have made a successful entry.

74. With economic recession, competition in Hungary's international road freight transport has thus risen, for outbound hauls and especially for return hauls which became more difficult to secure as the structure of trade changed. Competition and the shrinkage of the domestic market has led the established, state-owned or former state-owned haulage enterprises to argue for government intervention, by way of a licensing system ("concession system") that would control entry and restrain competition.

75. The only instrument of regulation currently available to the government is provided by the system of permits, the entry or transit licenses conceded by the foreign countries for journeys to and from those countries. Since Hungary is outside the European Economic Community, and not a member of the European Conference of Ministers of Transport (ECMT), the multilateral licenses issued by those authorities are not available to her. Permits for haulage to or through a country are based on regular bilateral negotiations between governments. These bilateral permits are distributed to Hungarian hauliers by the Ministry of Transport.

76. The existence of such permits in the hands of the Ministry could, in principle, serve as an instrument for the comprehensive control of competition for international traffic between Hungarian hauliers. Competition could be controlled by rationing individual enterprises in the number and type of bilateral permits allotted to them. The Ministry could then ration out permits that it has in abundance as well as those that are scarce relative to the demand for road haulage across frontiers.

77. There is no evidence that the Ministry exercises such comprehensive control by withholding permits from adequate quotas. The issue raised by hauliers turns rather on the allocation of permits from restrictive quotas. The problem is common to the road haulage sectors of many countries, including those that allow free competition in domestic haulage. The system of bilateral permits owes its existence to the wish to protect national road haulage industries, combined in some cases with a desire to protect the railways. Competitive access to permits might be assured by auctioning for money which would appropriate for the state the rent that a permit confers, or the money that changes hands between hauliers who trade permits. The absence of examples suggests that national authorities may regard auctioning as a potential impediment at bilateral negotiations.

78. The alternative to auctioning for money is then to attempt to allocate scarce permits to those who will make the "best" use of them. The principle itself is ambiguous, leaves room for undesirable interferences, abuses and dispute and, in addition, is administratively burdensome. In Hungary, it was suggested in the 1980s that the principle should be to maximize hard currency income. Enterprises should therefore be ranked, for purposes of permit allocation, by a sort of Domestic Resource Cost computation applied to their operations (though without the full shadow pricing of DRC), similar to the Forint/US\$ index applied in foreign trade planning.

79. In the actual practice of other countries, allocations are based chiefly on past performance. Since forward planning by enterprises requires that at least some of the allocation should be assured for a period ahead, no case-by-case test of need is feasible across the entire pool of available permits. Periodic allocations to haulage operators, licensed or registered for international haulage, are therefore adjusted in the following period according to the utilization of the allocation in the preceding period. Permits left unused, or the shortfall below an allowed percentage of underutilization, are then deducted from the new allocation. Unlike auctioning, the method is backward-looking. It offers incentives for good performance but not for improving on poor performance, and it cannot by itself provide for newcomers. According to the policy followed in Britain, new applicants must first bring proof of energetic attempts at "self-help". Self-help may take the form of arranging international transport by piggybacking on the railway of the foreign country. Alternatively, under the "cooperation" agreements between certain countries, a permit, outside the national quota, may be obtained by arranging a backload for a haulier from the foreign country.

80. Hungary's interest lies in having as large an international market for her haulage industry as possible. Hungary's international haulage has shown itself to be remarkably successful in trade with the Western countries. In recent years, it has provided more than one-half of the vehicles operating in Hungary's foreign trade carried by road, carrying over one-half of the export tonnage and over two-thirds of the import tonnage.¹⁴ The industry retains the advantage of relatively low-wage cost. In all bilateral negotiations based on parity in the national quotas, irrespective of whether the past year's quota restricted Hungary's road hauliers or not, it would therefore be right to press for larger and larger quotas, relying on the national industry's competitive potential. Where cooperation agreements are not as yet in force, they should be actively promoted.

81. If the market orientation of Hungary's economic reforms is to express itself in her policy on road haulage, the resulting regime should allow substantially free access to the activity. Free access to international haulage operations, within limits set by the nationally available quotas of permits, would be most nearly assured by auctioning of the permits. Optimally, the auction should be accessible to everyone; as a second-best, all those registered or licensed for international road operations -- mainly hauliers and freight forwarders -- should be free to participate. Auctioning and free access to auctions need not be rejected on the grounds that international haulage is best carried on by large enterprises, or by specialist enterprises. Neither is the case in West Europe's market economies where small and large operators engage in international haulage and where most of them work in domestic haulage as well.

82. If auctioning is nevertheless rejected as impolitic, the method of distributing permits within a liberal system could be designed so as to approximate at least some of the characteristics of an auction system. The system should therefore be designed so as to forestall the emergence of artificial scarcity, and to permit new entities.

¹⁴ The shares in 1986 were: 57% of vehicles, 53% of export tonnage, and 67% of import tonnage.

83. A suitable scheme would divide the nationally available quota of permits for entering or transiting a particular country into two parts. One would consist of a pool of period permits, allocated to operators for use throughout a specified period. The other part would form a pool of spot permits, available for allocation in small batches, from case to case.¹⁵ To avoid artificial scarcity through underutilization of committed period permits, these allocations should be applied for, and given for, periods shorter than the period for which the national quota is effective (e.g., 6 months when the national quota runs for 12). At the end of each allocation period, enterprises would be free to apply for period permits for use in the following period. Those whose utilization of period permits in the preceding period had fallen significantly below the national average of permit utilization would not be entitled to a further allocation. In all other cases where not all of the allocated permits had been used within the preceding allocation period, a proportion of underutilized permits would be deducted from any allocation applied for in the following period.

84. Access to the spot pool would be free to any applicant who retains no unused period permits. Permits would be allotted, on a first-come basis, upon proof of confirmed jobs (or of confirmed jobs for a proportion of the number of permits applied for from the spot pool).

85. The most effective method of assuring efficient use of the national quota of permits would be the distribution of permits to the users of international transport. It may therefore seem appropriate to allocate a substantial proportion of the available period permits to Hungary's freight forwarders. Freight forwarders are currently employing the services of the large, state-owned professional haulage enterprises as well as private hauliers, including owner-operators. The number of fully licensed freight forwarders -- currently 5 firms -- could at the same time be raised to include more of the present 30 partially licensed firms.

VIII. Financing

86. Each of the options that can be considered for the restructuring of Volán and of Hungary's road transport in general will require a certain amount of finance for its implementation, including some capital for new investments. The regrouping of Volán road haulage entities which will result under the different options will entail some new investment in installations, while the trend towards specialization that is to be expected will ultimately require new vehicles. Privatization in its different forms would be held back by a lack of finance.

87. Two-level banking was formally introduced in 1987 but has not as yet resulted in the emergence of a set of competitive commercial banks capable of serving a wide variety of customers, differing in occupation and in the size and object of loan applications. Individual banks deal primarily with the branches and clients that were assigned to them, in their former role as channels of plan finance. The information and experience required for assessing the merits of particular applications aiming at activity in a particular industry or occupation is accordingly highly concentrated. Only a relatively small group of bank officials, essentially in one single bank, are familiar with the road transport industry. High concentration of information, in the possession of a limited number of bank personnel, creates a bias in favor of large clients and large transactions. Besides, banks may hesitate to finance new competition with their main traditional clients and debtors. This potential double bias should disappear in time. While it persists, it reinforces the lack of solvency in private hands that is regarded as

¹⁵ In practice, separate country pools would only have to be maintained, for those countries whose quota of permits is known to be restrictive.

a major obstacle to rapid privatization in Hungary. The new Entrepreneurship Fund, when fully developed, will lower the barrier but is unlikely to remove it.

88. Privatization on institutional credit is known to create macroeconomic hazards. But if those can be controlled there exists a case for supplementing bank financing by actively encouraging other proved methods of financing. Among them, it is leasing that has shown itself peculiarly suitable for transport industries.

89. In Hungary, a fully developed legal basis for leasing in all forms (mobile and immobile property) exists since 1980. Several leasing institutions exist and road haulage operates leased vehicles, primarily in international haulage.¹⁶ The plans of several of the larger Volán units include development of leasing as a new business activity.

90. The standard objects of leasing in Hungary are currently imported new vehicles or machines, on a multi-year contract at the expiration of which the object passes into the ownership of the lessee. In market economies, where the technique has had its most rapid expansion, leasing finances mobile as well as immobile property, new or used, on the basis of chattel mortgages. Transport vehicles of all kinds are particularly prominent objects of leasing.¹⁷

91. The most immediate additional role that leasing might play in the reorganization and privatization of Hungary's road haulage would be the acquisition, with a view to subsequent leasing (including leasing-back) of vehicles, machinery and other properties (including administrative and store buildings and workshops) from restructuring enterprises, including own-account operators. Transport-related technical skills for such operations are available in the country. Management techniques, and models of organization and of contracts may have to be imported. Advice may be sought from several of the national associations of leasing companies in West European countries.

92. The financial basis of leasing may be supplied by Hungary's own banks. Moreover, while doubts have been expressed about the willingness of foreign capital to engage in domestic road haulage in Hungary, there should be scope for foreign leasing companies, based on their own resources or on their banks, to extend their operations as intermediaries in the country.

IX. Transport Taxation and Road User Charges

93. Hungary taxes transport enterprises or operators on their profits or incomes. Sales of the service are subject to (Value Added Tax) VAT. Also, there are taxes on inputs into the production of road haulage which affect the cost of operations, by different techniques, directly.

94. Profit tax falls at equal rates on all economic associations (corporate businesses), including partnerships, while the 18 percent "dividend"--18 percent of post-tax profits--is levied equally on all state-owned enterprises. In market economies, partnerships are a common form

¹⁶ Vola Tefu leases from Volvo, with bank finance. Hungarocamion uses Austrian and Swedish leasing and operates 400 leased vehicles. The joint venture Unic Bank is active in leasing and a subsidiary of Hitel Bank is leasing machinery.

¹⁷ According to a recent estimate, 1.4 million road vehicles in Germany are leased. 43 percent are let by independent leasing companies, and the rest, by the manufacturers' leasing subsidiaries. (Handelsblatt, 16 October 1990). The majority of the units are presumably passenger vehicles.

of organization of road haulage, as of other small-scale activity, and therefore benefit from the "pass-through" rule under which partnerships are exempt from corporate profit tax. Partners are taxed on their incomes, and the business is saved the substantial cost and effort of satisfying the accounting and auditing (and publicity) requirements of corporate tax status. Hungary does not apply the principle. Personal income tax only applies to single private entrepreneurs.

95. The sale of transport services attracts VAT at the reduced rate of 15 percent which also applies to other services. Professional haulage, the only source of such sales, is therefore at a tax advantage over own-account haulage, which is integrated into enterprises whose sales are subject to VAT at the full rate of 25 percent. Since haulage is primarily an input into economic production or trade, it is not clear why it should be taxed at a rate different from other inputs.

96. Unlike the taxes on profits or sales, those on inputs into the production of road haulage affect the cost of operations. They are, therefore, capable of serving as vehicles for charging the cost of road use to the user. Such road user charges are normally classified with other taxes and levied like taxes but do in reality represent cost-based prices which should function to cover the cost that traffic occasions to the road through wear and tear, or to other vehicles through adding to congestion. If operators are not to use the country's infrastructure without reckoning the cost, they should be as aware of the cost to road and traffic that they cause by the nature and technique of their operation as they are of the cost of a tire or liter of fuel.

97. The available instruments for road user charging are relatively few and crude. We are not informed of the implicit tax in Hungary's road fuel prices. Vehicle taxes, however, are a major instrument for road user charges. In Hungary the vehicle tax rises with the unladen weight of the vehicle, but is levied at very different rates on different forms of business organization. The schedules differentiate between individuals, civil code partnerships and Economic Working Communities¹⁸, partnerships and other forms of business organization. There is, however, no case, either in terms of the efficient use of resources or of attaining social and distributional objectives, for varying prices of inputs into economic production according to the organizational form under which production is carried out.

98. The appropriate level of road user charges, its distribution over alternative instruments and its differentiation according to the way the roads are used, cannot be determined without investigating the traffic, its impact on the infrastructure and the cost of congestion in Hungary. Transport taxes have proved to be politically sensitive (as demonstrated by the case of the proposed highway levy of 1989 or the proposed increase in fuel prices in 1990). But some changes, leading to greater rationality in the use of national resources, should be easier to make than others. Enforceable regulations are no substitutes for pricing according to the cost of different actions to the economy. If Hungary adopts a transport regime of light regulation, there is a case for reviewing and rationalizing the taxation of the activity. In doing so, the 1988 Study of Road User Charges needs to be updated and implemented.

¹⁸

Civil Code Partnerships correspond to the German Gesellschaft des Bürgerlichen Rechts and are due, under the Act on Economic Associations, Arts 334 and 336, to be phased out. Economic Working Communities--GMKs--are associations of employees of state-owned enterprises, formed for working in the enterprise after normal working hours.

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