Pázmány Péter Catholic University
Faculty of Humanities
Doctoral School of History Science
History of Economics Workshop

Nagy Csaba:
Constraints and Hopes

The short history of Hungary's accession
To IMF and IBRD

Ph.D. dissertation

Theses

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I. Short summary of the planned research task

The present writing aims to present - from the point of view of economics, economic and political history - the process during which the external balance position of Hungary was fatally upset, and which resulted in the country's accession to IMF and World Bank. What kind of economic and political necessities led to the accumulation of debt, and to what degree was the Hungarian political leadership under pressure to act in an exigency situation? The exigency situation was due on the one hand to the inevitable nature of economic laws, on the other hand to the power ambitions of the Soviet Union. The focus of the writing is the fifteen-year endeavor to attain, with varying intensity but under ever stronger pressure, IMF and World Bank membership. These fifteen years can be divided into well-detachable parts both considering time and the changes of the political conditions. Following the chronological line of the different parts, we find out about the special framework of the economic policy of the late Kádár-era.

II. Sources

For every part of this writing, the most important and basic primary documents of my research were specialty materials, conceptions and proposals prepared by the Hungarian National Planning Office for the Economic Policy Department of the Central Committee, by the Ministry of Finance, and the Hungarian National Bank. These sources were at my disposal partly from the archives of the Ministry of Finance, and partly from the National Archives of Hungary.

It is only natural that the decisions in such an important question were made by top politicians. For this reason I analyzed in great detail the proposals of the Political Committee and the Central Committee, and the discussions of their most important sessions, always concentrating on the ones which are important for my research area. These materials can be found in groups 4 and 5, fond 288 in the National Archives of Hungary.

The inspection of the secondary sources was also indispensable for the comprehensive analysis of the topic. Books, articles, academic publications about the economic policy of the era, written partly by economists (including, but not exclusively: Katalin Botos, András Vigvári, János Kornai, István Szalkai), partly by historian (including, but not exclusively: Iván Berend T., Ignác Romsics, György Földes) were among my sources.

The writings and declarations of the period's economic policy secretaries of the CC in the 70's and 80's, which were usually published in books by Kossuth Publisher, constituted a great source in my research.

Specialists of the two institutions had performed a comprehensive examination, monitoring of the Hungarian economy before the country accessed IMF and IBRD in 1982. The results were published in so-called country-studies by both organizations. These studies have been extremely important throughout my studies, since their observations and judgments are free of the usual ’euphemisms’ that can be detected in the local publications, and many a time the official proposals (Ministry of Finance, Hungarian Central Bank, National Council, etc.) of the period. As such, they aided in objective opinion creating.

The economic policy secretaries, especially if they were members of the Party Committee as well, were perhaps the most important participants in the macroeconomic decision making processes, however besides them other members (leaders) of top organizations also had decisive impact on events. I was lucky enough to have had conversations with one of the most important participants of the period’s economic policy creation, István Hetényi. Professor Hetényi was first the vice president of the National Council, then financial minister, and in these positions he influenced, over a long period of time, Hungarian economic policy; for this reason his observations and comments proved extremely useful for my work.

III. Summary of scientific results

With an accelerated progress in world economy, and an increase in global interdependencies, economic activities in the 70’s started to become more and more international, expanding the frame of the national state; thus, a new era of world economy began at the beginning of the 70's. This relativization of the state borders also brought a negative effect: the national economies were less defended from external shocks.

In 1971 the so-called Bretton Woods system, which was created after the second world war, collapsed. The system was built on the hegemony of the USA, and meant certain stability in the international financial and economic processes, despite its indisputable faults. However, in the second part of the 60's there were changes that first eroded, then destroyed the prevailing architecture of world economy. The most important elements of change were the following:

- The Vietnam war of the USA ended in a severe balance of payments deficit.
- Resulting from this, trust in dollar as a key currency teetered.
- So-called euro markets were created, which got ever stronger, on which the leading currencies were moving in high volume, often with speculation behind their movement, resulting in serious pressure on exchange rates.

The above phenomena caused the dollar/gold exchangeability to cease in 1971, and it was also their result that the currency had to be devalued. '*On August 15, 1971 president Nixon was forced to change some regulations, which meant the death of the Bretton*

Woods monetary system. What were these about? First of all, they meant the total suspension for everybody of the obligation about dollar/gold exchangeability, for undetermined time period, not only de facto, but de jure as well.' (Gyöngyössy [1982], page 30.)

Beginning from this point currencies started floating, which led to instability of the balance of payment in many countries, and finally to the instability of the whole international monetary system.

Based on my research, I can share the widely-spread opinion in the specialty literature that Hungary had turned early on, from the 1968 reform and its financing plan, to the international markets. We can ascertain that the plan-like indebtedness had begun. (Vigvári [1990], page 14.)

In this situation was the world economy hit by the first oil price explosion. As a response given to the third Arabic-Israeli war, OPEC made a decision to drastically decrease oil exploitation, which doubled the price of crude oil in a couple of weeks. The increased oil price resulted in extraordinary incomes for the oil producing countries, which streamed their extra profits on the international monetary markets. Petrodollars created substantial liquidity abundance on them, which the banking groups placed out as loans, mostly in newly industrialized countries. '*In the seventies in Western Europe, Japan and Canada the volume of foreign loans offered by banks increased at an average of 26.75%. Contrary to this, the* *amount of domestic loans increased by only 12.75% yearly. External loan transactions became the engine of bank transactions, more and more.'* (Botos [1987], page148.)

These countries, the socialist countries being among them, could not resist the temptation of cheap money, and as a result their debt increased drastically. The debt of the developing countries was 34.3 billion dollars in 1965; by 1977 this sum had already reached 244 billions of dollars.

The paradigm change in economic theory that took place in the middle and at the end of the 70's also played an important role in deepening the crisis. The Keynesian economic policy was replaced by neoclassicism, which declared a lesser state role, all this happening primarily due to the work of Friedrich Hayek and Milton Friedman, two Nobel prize winning economists. The monetarist Friedman and his followers (the so-called Chicago school) proclaimed that the solution to the stagflation of the 70's and the anarchy in the world economy can be terminated by restricting the role of the state ('Free market is the best social policy').

Practical implementation of the theory began together with the reign of Margaret Thatcher and Ronald Reagan, at the turn of the 70's and 80's. In implementing the new economic policy the British conservatives played a pivotal role, but the most important world economic impact was brought about by the drastic change in the

USA policies. In fall 1979, after Paul Volcker was elected President of FED, a drastic restriction took place in American monetary policy: the interest rate was greatly increased, which attracted international liquidity abundance to the USA. The period of cheap money was over. Developing countries which were indebted in the 70's suddenly found themselves in a situation in which they were able to receive loans only with much worse conditions than before, or were simply unable to receive any. In August 1982 the Mexican Minister of Finance announced that his country was unable to fulfill its loan liability payments. With this the financial crisis had officially started.

It is only natural that the worldwide economic crisis reached the communist countries as well. The first perceptions of the signs of the crisis (back in the 60's) pushed almost all of these countries to decrease bureaucracy in leading their economy, and leave a bigger space to company independence. These experiments all failed after shorter or longer time periods, they softened up too much or had ceased to exist before they could have been applied. The reason was: resistance from political leaders. Naturally, big differences existed in the degree to which socialist countries had reformed and transformed their socialist economies. Within the socialist block Hungary, by introducing the New Economic Mechanism in 1968, and implementing it relatively consistently until 1972-73, reached probably the farthest point. This is true even if we consider the deficiencies of the reform concept. *'The elaborators of the*

Hungarian reform of 1968 did not account for the fact that the specific structure of the Hungarian economy constituted the basement of political stability, and trusted overly the functioning of the self-regulated market; this was the biggest failure of the reform. These processes undermined exactly the stability factor.' (Vigvári [2008], page 67.)

Agreeing entirely with the above statement but expanding its thread of thought, I would like to add that the reform process did not cease to exist solely because of the internal contradictions presented above. These contradictions were appropriate to give arguments for the leaders of the party who tended to follow a dogmatic way of thinking; these arguments fought the reform conception. According to Honvári, it was primarily due to these that the experiment to reform the economic system had failed. *'I think the Hungarian reform did not fail on the February 1972 Kádár-Brezhnev meeting, but rather on the biweekly held meetings of the Political Committee here, at home.'* (Honvári [2008] page 57.)

My research supports the fact that Soviet political circles had always questioned the economic reform because they thought that the country would inevitably orientate toward the West. In my opinion these two phenomena, internal and external together led to the questioning of most of the principles of the new economic system, and finally to its withdrawal.

There was another experience as well, which was about developing the functioning mechanism of Comecon. The Complex Program, which was accepted in 1971, had the same fate as other reform experiments in several countries, and it did not lead to an improvement of the economic relations among socialist countries.

The failure of the reforms meant that the countries of the Soviet block were entirely unprepared for the changes and negative tendencies of the world economy. *'The Hungarian half-reform played an important role in our exaggerated indebtedness. This was 'half' partly because politics did not allow it to go on its road that had been begun. '* (Botos [1990] page 76.)

Making use of the liquidity abundance on the international financial markets these countries were severely indebted. The majority of these loans in Hungary served a moderate improvement of the standard of living in the country, later its conservation, thus the developments that would have served debt repayment were all cancelled.

Research shows that the Ministry of Finance signaled to the political leadership as early as 1976, the start of the Vth five-year plan, that during the planning period substantial debt would be accumulated in case internal spending was not decreased. (Mol 288. f. 24/20. [1976])

Despite this, the Hungarian political leadership determined only at the end of the 70's to implement more serious restrictive measures, and by then the volume of debt was strangling. The delay was due to the fact that the regime considered the improvement in people's standard of living as a legitimating tool. János Kádár openly elaborated on this on one of his meetings with Brezhnev at the end of the 70's.

Accession to the IMF and IBRD had been a preoccupation for the Hungarian leadership ever since the end of the 60's. (Földes [1995] page 74.), (Honvári [2005] page 34.) At this time the question was seen merely as an option by which it would be possible for the country to get access to relatively cheap sources. The question of the accession had stayed on the agenda throughout the 70's (although it was dropped for shorter and longer time periods), and by the end of the decade it gradually became a necessity, parallel to the increasing indebtedness of the country, instead of a mere good option. The above mentioned proposal of the Ministry of Finance states: *'From our point of view a further problem will be that the free capitalist tools which are free to be used for further loans are increasingly accumulated in countries to which socialist ones do not have access (i.e. Saudi Arabia, Venezuela), and these can be acquired through international financial institutions only.'* (Mol 288. f. 24/20. [1976])

The Soviets had consistently dismissed accession due to their power politics, and supplied additional sources for Hungary in order to prevent it.

The sudden resource shortage at the beginning of the 80's, however, pressurized the Hungarian leadership as well. Internal consumption and payments of the debt were impossible to be fulfilled from the international financial institutions. The economic situation of the Soviet Union turned so weak that Hungary did not hope for their help either. Leading Hungarian economists had signaled beginning from the middle of the 70's that it had been impossible for the Soviet Union to cut itself from the processes and negative tendencies of the world economy. *'The dynamically increasing effect of the world economy does not only apply to small and medium size countries, but to such big economies as that of the USA or the Soviet Union.'* (Bognár [1976] page 47.)

Based on all this, and relying on my research sources, while also considering the economic, political and social determinisms, I can state that the Hungarian leadership did not have a choice by 1981: in order to survive as leaders and prevent state bankruptcy, the country had to join the international financial institutions.

Thus membership had by then become first a necessity (from good opportunity in the 60's), and by the 1982 accession, the last straw in order to prevent financial failure.

IV. Conclusion

The Hungarian economy was under pressure, in my view, to join the international institutions, owing to some political and economic policy determinisms. These determinisms, which were present in most other socialist countries as well, were the following:

- The socialist structure of the economy and the overwhelming bureaucratic coordination switched off the pressure for efficiency.
- The openness of the country to external trade and its relative capital shortage made Hungary extremely vulnerable to external shocks.
- The Hungarian external economy was functioning in a special cross-structure, namely the Hungarian industry and agriculture fulfilled a transfer role between the two main partner groups: Comecon countries, and the developed capitalist countries. This had further increased our vulnerability.
- The more powerful validation of market coordination proved impossible, due to political decisions.
- The national income and a substantial amount of our debt was spent on internal spending, because the system wanted to validate itself.

- The capital abundance of the 70's was replaced by resource shortage at the beginning of the 80's, while the price conditions of the Soviet raw materials and energy had also substantially worsened.
- Economic policy was late to answer the crisis, and did it in an unmatched way, again because it wanted to legitimize itself.

I would like to emphasize two facts that have become obvious during my research, and which haven't been considered by the specialty literature of the topic. One of these facts relates to the role of HNB and MF and their relations through the process of accession to the international monetary institutions. The decisions happened implicitly within the all-time party leadership; however the highest organ for specialist elaboration and implementation was not the Ministry of Finance, but the HNB. The materials in the subject that made it to the decision making forums of the party were mostly prepared in the HNB, rarely in common with the Ministry of Finance, and this is demonstrated by the fact that János Fekete, vice president of HNB had a pivotal role in preparing the accession process.

The other fact that comes to light from my primary resources is the dichotomy that could be easily detected between the organs responsible for economic policy and the leadership of the party through 5-6 years. Namely, the professional levels tried to pressure the political leadership into acclimatization to the changed worldwide economic situation as early as the beginning of the 70's, and they thought it possible through restricting internal consumption on the one hand, and on the other, by accessing the monetary twin organizations. The party refused to do this over a long time period and took the necessary steps (correction: 1979, accession: 1981-82) only when the situation became unsustainable. This delay naturally had a severe impact on Hungary's economy.

The socialist block resisted the financial crisis of the early 80's, however, the financial crisis and especially its return after a couple of years destabilized the political systems of these countries and there was no return from this crisis any more. Because of the interdependencies among Comecon countries those socialist countries that had not accumulated outstanding debts or had paid them back through serious efforts did also fail.

Although political analysts and the press treated the fall of the state socialist systems of Eastern European countries as an unexpected event, in reality what happened was the last act of a long agony, of an economic, political and social crisis.

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