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Hungary and the IMF: The Experience of a Cordial Discord

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by

László Csaba

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Introduction

In establishing the task and scope of this paper I set out from the following presumptions. The circumstances and facts about how Hungary has become one of the most indebted countries in the world on a per capita basis are discussed in detail in widely available and up-to-date source material (Lőrinc-Istvánffy, 1992; Oblath, 1993; and Riecke, 1993). Second, some of the most relevant professional and policy aspects of current Hungarian interactions with with the "Washington twins" are discussed in separate papers in this panel. Third, there is a body of quite relevant theoretical reflection on the general issues pertaining to the vices and virtues of applying stabilization policies to formerly planned economies while they are in transition to the market (Balcerowicz, 1993; Winiecki, 1993; Csaba, 1994, chapter 5). In what follows, I try to minimize the overlap with any of these. I also try to contribute to what may be the summary of the discussions conducted here, i.e., to the evaluation of how the Washington twins have fared in the troubled waters of systemic change in Central and Eastern Europe. In order to attain this, I shall focus exclusively on the Hungarian experience.

The bottom line of the argumentation is a search for an answer to the following question. Why is it that, despite the fact that, all Hungarian governments since our accession to the IMF and IBRD in 1982 have been explicitely cooperative with regard to the wishes of these institutions, that their leverage on systemic change has remained as limited as with any other country on Earth? In other words, why could't the IMF and the Bank bring about greater market-oriented changes in a country where nobody close to the commanding heights has ever challenged the "conventional wisdom" of these institutions, and where even in academic circles the "Fund-busters" constitute a miniscule and marginal minority?

What makes the question even more intriguing is the fact that Hungary has not had to face the problems typical of, say, Bolivia, Russia or Poland, i.e., the conflict between stabilization and market liberalization concerns have not come into the open. In many ways, at least in systemic terms, Hungary seems to have been predestined for the role of an exemplary pupil - still, she has surely

underperformed against the expectations. Fiscal reform, social security reform and banking reform have still a very long way to go. Although compared to the performance of her fellow-travellers, Hungarian performance may well be qualified as satisfactory, one cannot escape the temptation of ***applying a different standard*** to Hungary. In particular, a country which has had twenty-plus years of reform experience, including the implementation of commercial banking, bankruptcy legislation, VAT and PIT[1] reforms, and the launching of trade liberalization and reorientation before the collapse of communism, has clearly developed a certain edge in terms of institution-building. These circumstances, coupled with the professed cordial relationship with the two multilateral financial institutions, and the lack of political and philosophical differences over economic issues - so typical in the underdeveloped world - could well have led one to expect Hungary to accelerate rather than decelerate the pace of changes, once geopolitical constraints and ideological taboos suddenly evaporated in 1989/1990. While the list of domestic factors explaining these developments is infinitely long, one may still wonder why the Washington twins, especially the Fund, could not make better use of the leverage it certainly had over a country whose balance of payments was in a very shaky position between 1988 and 1991. The Fund and the Bank are, of course, no substitutes for a world government. However, ever since systemic transformation started, and especially since the Russian accession in 1992, these organizations have willy-nilly been taking up roles far exceeding their original mandates and the aspirations of the bulk of their staffs. They invested considerable amount of time, funds and expertise into understanding the formerly communist systems. Important theoretical and policy findings were arrived at (Bruno, 1992; Tanzi, 1993) explaining why standardized balance of payments adjustment recipes and other conventional considerations may not be directly applicable or helpful in mastering the task of economic transformation. Thus, the customary reference either to the "dogmatism" of the IMF or the "political narrow-mindedness" of the local élites may prove inadequate in explaining the Hungarian story.

1 PIT = personal income tax.

The Pre-Transformation Period

Since Hungary was not a founding member of the United Nations, the country could not "inherit" Bank and Fund membership from the pre-cold-war era. Understandably, ever since the first period of melting started in 1953, culminating in Hungarian UNO membership in 1955, there has been an undercurrent of political debate over joining the Washington twins. Several twists and turns delayed membership. First, the most logical step would have been to join immediately in 1955 the specialized UN organizations as well. This was indeed discussed in the government[1], but the return to power of the Stalinist boss Rákosi in July 1955, the crowding out of the reformist Imre Nagy of all political positions, and the return to pre-1953 economic policies made this step untimely. Following the crushing of the 1956 revolution, the Economic Commission convened by János Kádár - and composed mostly of avowedly non-Marxists - discussed the issue again, but this proved immaterial. First, the Hungarian case was still open with the UN, and Russia would have seen the new communist rulers' stepping in the footprint of Imre Nagy and his dangerously neutralist deliberations. Second, due to the internal political dynamics of consolidating communist rule, the propositions of the Economic Commission were considered so wide off the mark by the mandarines of the Central Committee that they decided not to put it on the agenda of any decision-making organ (Berend, 1983, p. 115).

The rule of János Kádár seems to have rested on a new compromise with Russia. The Soviet leadership - at least formally - seemed to back off its claim that there was just one correct way of running a society and economy, in exchange for unconditional loyality in foreign affairs. Though neither side completely followed the understanding, at the end of the day it did work. Later analyses of party archives (Horn, ed., 1989) shed some new light on this, proving that it was Kádár who rejected Khrushchev's troop withdrawal proposition in 1958 (which was offered to Romania as well). This meant that the above described deal was not only an arrangement imposed on the country from outside, but part and

1 Personal communication from J. Bognár, then Minister of Foreign Trade (1950-56).

parcel of the original self-interpretation of the person having ruled the country through 32 years. Thus, any attempt to make even small steps encountered fierce resistance for quite some time.

Not unlike the 1949-53 period, this time - maybe carried away by the ***sputnik***-shock of 1957 - economic target-setting was built on the fundamental misjudgment of both Soviet and domestic economic potential, as well as disrespect for all non-quantitative aspects of development. Similarly to the former, the attempt to realize an ideological dream ended in a catastrophe: instead of catching up with Austria by 1970, in 1963-1964, serious daily financing problems surfaced in a country whose external liabilities had been negligible. ***Reported*** growth stagnated, which meant for policymakers something worse than depression. This sood in contrast to the loudly preached expectations of growth acceleration.

Not surprisingly, in October 1964, a new reform committee was convened to discuss how to escape the dead alley. Due to the severity of the crisis, the debate was not constrained by the ideological straightjackets of the day (as documented in Szamuely, ed., 1986). The debates went much the same way as in 1957, but the outcome was different. The most radical variant was approved, along with a gradual implementation scheme. The year 1968 was chosen to implement the first, more timid version, with 1971-1972 targeted for the more radical market socialist variant. This decision was quite important for the next 25 years, since everybody knew that official approval was - or could have been - more far-reaching in terms of market reforms than the official dogma would ever have acknowledged.

Since this earthquake was brought about by Soviet and CMEA inability to deliver what was promised, further conflicts of interest within the CMEA intensified, with the Romanians vetoing integration consequently in 1964, the deliberation to go West proved legitimate again. Russian-German talks on what culminated in a ***Grundvertag*** in 1970, and the Helsinki Summit of 1975, provided the elbow room for Hungary to attempt to join the IMF again. Talks were successful, but the Hungarian leadership of the day wanted to play safe. They asked for formal approval from their masters. The answer was a flat ***n'iet*** (Bakó, 1990, pp. 226-7). Yet in the memory of other participants of the talks, the answer was not at all that clear. Kosygin stated: "It is your job, comrades. But..."

(and then followed the contemporary litany of complaints against the IMF as the extended arm of American imperialism). In the latter case, the Hungarian leadership did get the maximum of what it could ever have hoped for, still, its inherent constraints - referred to above - made it unable to make a decision. The timing was again poor following the Soviet invasion of Czechslovakia in the August of 1968.

The 1970s saw the replication of the Eastward-looking, import-substituting industrialization endeavor of 1949-1953 and 1958-1963, indicating how strong an ideological bias could be against fairly clear-cut economic realities. The result was much the same. By 1978 it proved to be obvious that either growth acceleration or more reliance on Comecon could bring about the required amount of bread and butter, which was written in the implicit social contract struck after 1956. In October 1977, the leadership decided to go Westward again. But they - again - wanted to play safe.

Though discussions on accession to the IMF were again fairly advanced, Hungarian officials sought Russian approval. To be more precise, they were trying to play the card of what was later baptized into "implicit subsidies." They told the Russians that Hungary would follow the example of the Romanians, who joined the IMF without advance notice to the Russians in 1971 (a step for which they were ***not*** reprimanded). Reference also was made to Polish membership. As a bargaining chip, the Hungarian leadership indicated that it would be willing to refrain from this step if the Soviet Union could find an extra couple of million tons of crude oil payable in soft currency. And it appeared a winning strategy. Comrade Brezhnev started his talk in the summer Crimean meeting: As is common knowledge, the IMF is an extended arm of American imperialism. Joining it would be an infringement of socialist brotherhood. A couple of million tons of oil could not be an issue among true allies.

And the Hungarian comrades were taking the promise of Brezhnev at face value, since such commitments had held before. The problem was that the world had changed entirely by then. As could be documented at the time (Csaba, 1980), there was absolutely no reason to believe that Russians would heed their promise, even in the best of circumstances. Thus, it both was and was not a surprise when, in October 1981, the Russians declared that it was their original

proposal of 1978 which held, i.e., all incremental oil supplies had to be paid for in hard currency.

This was a well-timed announcement on the side of the Russians. First, it angered Kádár, who has just been recognized as running a Hungary worthy of emulation at the 25th Party Congress if the CPSU in February 1981. He was deeply hurt as the withdrawn concession had been his personal victory over his "narrow-minded" economic advisers. Third, it was a time when the shadow of martial law in Poland - or of a Russian intervention - seemed to have been avoided by Jaruzelski's taking charge of both the Party and Government. Thus, neither the stick nor the carrot was in the hand of the Russians, and only 60 minutes after the Central Committee approved by a narrow majority Hungary's IMF accession, the plane of Mr. Fekete was taking off for Washington. He made it.

This was a typical Hungarian, last-minute rescue operation. Following the imposition of martial law in Poland, a lending blockade against the East Bloc was declared. This prompted the ***de facto*** Russian run International Bank of Economic Cooperation to withdraw 1.5 bn US dollars from the National Bank of Hungary to relend it to Mr. Jaruzelski, and to bridge Russian cash-flow problems. This would surely have knocked out the Hungarian economy, pushing it into rescheduling, had not the BIS, Manufacturers Hannover Trust and Margaret Thatcher extended their help. As the one-time vice governor of the National Bank Szalkai (1990, p. 195) noted, these exceptional forms of assistance would hardly have been conceivable, had not the Hungarian application for IMF membership already been submitted. Thanks to these operations, Hungary - which continued to pay her dues even in 1956 - could maintain her solvency.

It is hard to overemphasize the Copernican turn that eventual IMF membership and the connected rescue operations implied for Hungarian policymaking. This signalled an end to the "Russians-first" approach having molded the first 25 years of Kádár's rule. Ferenc Havasi, secretary of the CC in charge of the economy, noted in his speech to the Parliament: "As you know, at the beginning of this year, Hungary has run into exceptional difficulties in her international financial relations. First, we were turning to our allies. Unfortunately, they were all preoccupied with their own headaches. They were not in a position to help us... Then we were turning to our Western partners. As the Hungarian proverb says: it is in times of difficulty when you find out who

your real friend is. We were assisted and I can report to the Parliament with pride: the financial crisis has been overcome" (Havasi, 1982)[2].

But in what way? In theory, one could have visualised a radicalization of reforms, since the blueprint for a second economic reform (Bauer, 1984) already had been elaborated in expert commissions. From the introduction of two-tier banking to currency convertibility, from tax reform to bankruptcy legislation, more or less all the measures finally introduced in the time span of a decade were already around. Of course, this was under the watchful eyes of the Fund, which required a kind of market-oriented window-dressing. Nonetheless it was the analyses of inherent weaknesses of the malfunctioning of the Hungarian economy, conducted by endogenous research, which resulted in these findings. Many of the reformists of the day were of the opinion that "the extended arm of the imperialists" will give us a hand in convincing the political leadership of the uses of these measures. In fact, the result was disappointing.

I spent a relatively long time in explaining what a long-awaited fulfillment it was for the Hungarian leadership to attain full membership in the IMF. It is important to see the professional consensus behind these radical market-socialist measures, as well as the fact that Russian concerns became very relative with the step of accession itself. On top of this, the financial crisis of 1982 was so severe and immediate that it made sense to expect that IMF proposals concerning systemic change would have the ears of the decisionmakers, and, conversely the latter would feel more comfortable if they could make offers on their own, which were known to have the Fund's blessing.

But what really happened? With reference to the instability in and around Poland, each and every reform measure was rejected. As a temporary solution, the worst - and most primitive - version of the command economy was resorted to. Headed by the Economic Commission of the secretariat of Deputy Premier Marjai, a military style day-to-day management gained the upper hand. Regardless of the formal structures of economic and political decisionmaking, ***this informal chief of staff reigned***. Imports were administratively restricted, operative committees were set up to license inflows by the item, and export orders and

2 It is probably not a mere coincidence that the reference was printed in the narrowly circulated government daily newspaper, whereas the influential Party daily dropped this reference

obligatory contracts were utilized. Supply bottlenecks and other growing irregularities surfacing in intra-Comecon relations seemed to have justified this practice. This was so not only because it was consistent with everything which had become the actual norm of behavior in intra-Comecon relations by then, but also because it seemed practical in macroeconomic terms.

According to retroactive calculations conducted by the National Bank of Hungary, filtering out the several elements of misreporting in the contemporary statistics, the following findings were arrived at: the actual government deficit was 7.1 per cent of GDP in 1980, 5.1 per cent in 1981, 2.9 per cent in 1982, 2.5 per cent in 1983 and 0.5 per cent in 1984. As far as the actual - corrected - balance of payments was concerned, in 1973-1978 net debt grew by 5.3 bn dollars, whereas in 1979-1984 only by 408 mn, with 1983 and 1984 being the very rare surplus years in Hungarian history (Nyers Jr. et. al., Part II, p. 48. and Part III, p. 28).

At this point the story starts to resemble the ones recorded by developing countries. Since administrative measures bring quick results, a political leadership otherwise hesitant to support reforms, curtailing its discretionary power, finds an excuse for postponing overdue structural and institutional reforms by citing satisfactory macroeconomic performance. The Washington twins were internally divided in their views, but also restrained by their own statutes, which were developed for banking operations. If the quantitative performance criteria are - or at least look - alright, a banker can extend a friendly advice to his client, but not insist upon anything specific pertaining to the internal workings of the client's establishment. This rule applies ***a fortiori*** for governments. Thus, whatever one knows in theoretical economics about the temporary uses and many vices inherent in administrative guidance, there is very little leverage except persuasion that bankers can apply.

This was precisely the case in Hungary. The new 'new mechanism', applied, though never formally promulgated, seem to have worked. Macrocriteria were met. Reform deliberations were demonstrated, as committees never ceased producing documents, and from late 1982 they resumed activities with many prominent people involved. Guidelines for the next reforms were ready by mid-1983, party and state organs discussed them, and some of the ideas were aired in the press. However, a decision was not taken until April 1984, when an extremely

watered-down version of the projects was approved by the Party. In sum, the years 1982-1982 allowed the leadership to buy time, and relieved it of pressure.

There were several concrete reasons why this situation arose. First, there was very limited publicity of basic economic information within the country. The IMF could impose a certain degree of disclosure on the Hungarian authorities, but could not attain a breakthrough. Thus, the balance of the NBH or current account figures were made available in the English version of the quarterly report of the Bank, and later were printed in some major Western dailies, but this information could not be quoted inside the country, even in professional, narrowly circulated publications. Not only did legislators know little about the actual situation, but even governmental agencies, including the top leadership of the Planning Board, were uninformed. This proved to be a rather fundamental deficiency, since the forecasts of the five-year plan for 1986-1990 were elaborated without prior adequate knowledge of the state and of the prospect of its financing. As one of the active participants openly acknowledged (Zdeborosky, 1990) it was a small team hand-picked and controlled by then-Vice Governor Fekete which was running external finances in complete secrecy and without any external control. If and when any major decisions needed to be taken, Mr. Kádár and Mr. Fekete arranged it between four eyes, without caring much about the procedures.

These arrangements built an extremely effective ***filtering mechanism*** into the relations of Hungary with the IMF. For one, all relations with the IMF were channeled to the National Bank. This was paradoxical in more than one respect. For example according to the formal decisionmaking structures of the day, it should have been the Commission on Planning, composed of the chiefs of the Planning Board, the Minister of Finance, the NBH governor and some key ministers which had led these matters. This would have been appropriate if for no other reason than because this small economic cabinet had the authority to take any action pertaining to the country's entire macrostructure. Second, the National Bank of Hungary has traditionally been a typical agency pursuing its own particular interests. As could be demonstrated at the time (Csaba, 1986) it held a fairly ambiguous position in terms of market-oriented reforms. In general it had always been free market-oriented, but when it came to "planned currency management" or financial deregulation, it tended to act much more like a

sectoral organ. Third, the secrecy around the Bank and around external financing created an atmosphere in which any criticism, or indeed public discussion of any aspect of the activity of the Bank came close to high treason. I do not know of a single instance in which any leading personality of the Bank has ever acknowledged having done anything wrong (at least while in office). Fourth, as reflected in the contemporary analyses, while the standing and influence of the other actual center of power, Mr. Marjai's secretariat, was rapidly eroding, the power standing of the Bank was growing. Finally, since the external financing compartment of Mr. Fekete was hermetically sealed off from the rest of the Bank, a great amount of power was concentrated in the hands of a few, without any checks and balances or the control of publicity. This allowed for highly peculiar considerations not recognized by anybody to play a crucial role.

These circumstances may explain how the questionable self-interpretation of a small group could have prevailed over the deliberation of the mighty Washington agencies. This might also explain how the Fund and the Bank proved unable to forestall what retroactive analysts qualified as the gravest mistake of the National Bank's policy in four decades: its support for the growth acceleration policies of 1984-1985 (Csáki, 1994).

Those who have had the patience to follow the historical summary to this point will be less than surprised to see that the unchanged political and power structure did produce its last attempt to turn Eastwards and accelerate growth rather than to let the market in. What looks very trivial in retrospect was anything but that following 15 years of public reform thinking. In fact, it was the Planning Board headed by former Finance Minister Faluvégi that had become the bastion of resistance to the growth-accelerating propositions. The board was joined - in an uncoordinated fashion - by the IMF in rejecting a three-year standby agreement since the Hungarians were sticking to a policy of low prices through administrative controls.

Formally, there seems to have been no way to escape the policies advocated by the IMF and the domestic professionals: a restrictive stance complemented by accelerated institutional reforms which had been postponed by the fifth year in 1985. However, due to the filter mechanism described above, questions were raised in a completely different fashion. Systemic thinking was pushed to the background, and the more narrow financing considerations - and related prestige

considerations and success indicators - of the NBH came to the fore. According to the retrospective reflections of Szalkai (1990, p. 201), the dilemma for them looked like this: should we maintain that there were no external financing available, which had been untrue, or shall we tell the truth, knowing that it would be used for false economic target-setting? The less philosophical Mr. Fekete (1989) stated his case more bluntly. In his view, there was a leadership in the country which held full responsibility for setting targets. It was not his job to censor them, but rather to fetch all the money he could to secure financing. Well, knowing the informal imbalances in decisionmaking and in access to information, this view is less than acceptable. No major actions could be taken at the time without Mr. Fekete's approval.

And he did give it, against the wishes of most of the profession. As a leading official of lasting tenure and experience noted bluntly, "we were simply giving in" (Balassa, 1990, pp. 165-168). The IMF was unhappy, but private markets allowed for a stockpiling of currency reserves and provided considerable room for maneuvering by the Hungarian government of the day. The communist authorities could buy yet another two years of delayed reforms (1985 and 1986). One wonders whether this could all have happened had not it been for the filtering mechanism and the overall secrecy surrounding major decisions. These two interlinked factors were to blame for why internal pressure (of economists) and outside pressure (from the IMF) could not prevent a dangerous derailment, and a doubling of Hungary's external debt between 1984-1987.

By September 1987, conspicuous non-attainment of the targets earmarked by the five-year plan and the dramatic deterioration on the external front triggered the replacement of one of the longest severing Hungarian premiers, Mr. Lázár, by Mr. Grósz. The latter, coming from the quarters traditionally most hostile to reforms, surprised everybody by promulgating a three-year governmental program of export orientation and marketization. Besides domestic professional pressure, the IMF was instrumental in molding the decision, since bank reform and import liberalization were made conditions for the 1988 standby agreement (Brüll, 1993, p. 126).

This "infringement of national sovereignty" was particularly useful, since Hungary had to - indeed, was fortunate to - implement several of the institutional reforms other Central European nations started only years after their

transformation. Actually, tax reform, import liberalization, bankruptcy procedures, reliance on tight monetary policy, and the first nominally independent commercial banks were all issues where learning by doing could not be avoided. Thus, insistence of the IMF on an early start endowed Hungary with an important edge over the latecomers. Whatever the shortcomings that any of these arrangements might have been - and they were numerous indeed - a practice of three years is often more useful than a decade of speculation, especially if millions of agents are involved in a learning process and public choice is a non-trivial issue.

In 1989, the IMF again played a useful role. The administration - modestly labelling itself the government of experts - allowed for a huge surplus (ten times larger than planned) to emerge in Hungary's trade with the rouble area. Meanwhile, a parallel deficit of 1.4 bn dollars, nearly depleted completely the currency reserves of the country. In the midst of the improvisation of experts, the IMF suspended the standby agreement in May 15; in such conditions, the liberalization of imports could not be reversed (though it could well have been the most petty - and harmful - response by the Hungarian authorities).

Under the pressure of the growing number of analyses published domestically and abroad, Miklós Németh was forced to admit the regular misreporting conducted by the previous governments. The Hungarian public was first confronted with the actual severity of the situation. The IMF obliged the country to repay 150 mn SDR for this. Thus, the outgoing administration bequeathed an economy in which many of the institutions of the market were already present, with most public companies corporatized, and both entry and exit of firms secured, and the trade régime liberalized. Termination of Comecon, as well as the agreement on Russian troop withdrawal, were both accomplished. Meanwhile, when a new, democratically elected government took office in May 1990 the operative reserves of the country stood at the low of 300 mn dollars, covering only 10 days of imports.

Against this background, one wonders why the IMF could not push the Hungarian government more aggressively in the direction of the market between 1987 and 1990? At the end of the day, the reforms were long overdue and well elaborated by governmental agencies and expert commissions. The answer may be found if we peep into the recalculated general government deficit series

already quoted above. It shows the following deficit /GDP ratio: in 1986, 3.8 per cent; in 1987, 2.8 per cent; in 1988, 0.7 per cent; in 1989, 3.2 per cent and 1990, 0 per cent. In other words, we are back before our banker, which was in no position to impose any requirements on his client as long as that client's quantitative performance criteria were right.

The Post-Transformational Period

The year 1990 was full of expectations. Systemic change took place peacefully. It seemed that both geopolitical and internal structural resistance withered away. Representation of versed interests, so intimately intertwined with the old régime, had suffered a heavy blow. Unions struggled to survive, employers' organizations blossomed in large numbers, and political representation was decoupled from both ideological and regional interest articulation. The window of opportunity for sweeping reforms seemed to have been open. All political forces agreed[1] on the need for a market without adjective, and the need to turn toward the West. Various expert groups advising the new government were highlighting this singular opportunity and calling for radical changes. Fiscal reform figured high on the agenda.

The IMF was behaving in a seemingly uncooperative manner, as the new there-years standby agreement was signed only in February 1991. In the most unstable year of 1990, Hungary had to rely on private markets.

With the benefit of hindsight, the IMF was quite right in its restraint. The conservative parties having formed the first government shared an expansionist economic platform, which reflected electoral wishes rather than the realities of the country. Constraints imposed by external financing needed to be taken into account.

Formation of the government took much too long. Only four months after taking office did the government produce a document - the Program for National Renewal - but it was a collection of good intentions, not an operational policy document. Meanwhile, government ministers were quarrelling in public and acted single-handedly, following at least four different economic policy platforms. The Minister of Finance, in an interview, expressed puzzlement that no agreement has been reached with the IMF, though he himself conceded in the same interview that the three-years policy platform of the government still was in a preliminary stage (Rabár, 1990). In fact, he was the one who acted the most

1 Some spoke of a "social market" instead of a "free market" economy

unprofessionally and most single-handedly in his short period in office. Driven by his personal professional conviction, he declared a 100 bn Fts subsidy cut in a single stroke, which would have lead to a 65 per cent hike in fuel prices in a single day. This triggered the first and to date last massive social protest, with taxi drivers blockading the major bridges of Budapest for three days. In fact, Rabár put an end to the revolt again by himself, without the prior assent of the hospitalized Premier by making grave concessions. The good news, however, can by no means overshadow two basic shortcomings: a) he did not enjoy the support or formal endorsement of the entire government for his subsidy cuts; and b) this attempt was in open contradiction to the election promises of the largest governing party, the MDF, which had legitimated itself as an adherent of small and gradual changes, especially in the economic sphere.

When both shock therapist Rabár and his opponent, supply sider Matolcsy, resigned in November 1990, a three-year economic program (cf. ***Figyelő***, vol. 34 Nos. 49 and 50) could finally be adopted. Without going into details, suffice it to say that this was a slightly edited version of the similar document of 1989, the major thrust of which was to pass over functioning losses of the system onto the population, without touching any of the fundamentally ill points. A few of the many key issues not addressed by this "policy guideline" included banking reform and the handling of inherited bad debt, fiscal reforms, means of privatization, anti-inflationary policies, the social safety net, and ways of financing the pet project of the administration, the 1996 World Exposition. In sum, this was basically a single year document, with vague if any propositions for longer periods of time.

In the meantime, a new finance minister emerged on the scene. Mihály Kupa was known domestically and at the IMF for being the father of PIT reform, who had the courage to explain this most unpopular way of paying public dues in a televised series week after week. He was an avowed adherent of urgent fiscal reform. Furthermore, both the new Hungarian democracy and its first Prime Minister seemed to have been in pretty bad shape. Altogether the IMF had good reasons to apply its famous ***educational exercises*** in unexpectedly signing a ***three-year standby agreement*** in February 1991.

The collapse of Comecon was a much feared event both in terms of public finance and its implications for the balance of payments. A deficit of 1.2 bn

dollars was approved as a target for that year, and out of the 1.1 bn standby facility 500 mn could be drawn in 1991 alone. In addition a special facility bridging the losses from CMEA's collapse in the order of 348 mn SDR was agreed to, of which 226 mn SDR could be drawn in 1991. Further, the budget deficit was exempted from performance criteria (Brüll, 1993, p. 127). Obviously, both the impact of the Gulf War on global oil markets and the impact of the collapse of CMEA were misjudged, to the benefit of Hungary. In fact, the years 1990-1991 ended with a combined balance of payments surplus of 394 mn dollars. The fiscal balance ended in equilibrium in 1990, and a reasonable 5 per cent deficit in 1991.

It is important to emphasize that as in all previous cases, it was expectations rather than actual performance ("hard facts") which shaped IMF policies ***vis-á-vis*** Hungary. Judging by the merit of the documents listed above, Hungary was obviously unfit for support. Meanwhile, the IMF had two expectations, which proved to be wrong. 1. It believed in the mechanistic approaches dramatizing the impact of Comecon disintegration on the Central European economies. In such circumstances, the flexibility of adjustment in the microsphere was clearly underestimated. 2. The IMF also overestimated the reform deliberation/commitment of the Hungarian government. At that time, the Kupa Program (Stabilization....1991) seemed to have made a step in the right direction in declaring the legislative aspect, i.e. institutional change, as its major thrust, and in putting the quantitative estimates into its supplement. But in many ways, Kupa too lacked support within the government and the governing parties. In fact, none of the major elements of legislation were submitted to the Parliament by the governing factions, which enjoyed a comfortable majority. By the end of 1991, Kupa lost the support of the Prime Minister, who entrusted a minister without portfolio and vice chairman of the MDF, Dr. Tamás Szabó, to convene the Working Group on Economic Policy. In this forum ideas diametrically opposed to those of Kupa received official blessing: from populist privatization schemes to an overall policy of growth acceleration. But Dr. Szabó was not the only member of the government pushing a line incongruous with the policy of institutional reform and fiscal restraint. When the consultations on the State Budget for 1993 ended with the Hungarian side proposing a 250 bn Fts deficit, or double of the figure targeted by the IMF, the latter suspended the three-year standby agreement in July 1992.

This seemed short-sighted and bad mannered. After all, despite its many weaknesses, the Hungarian government ***did*** legislate some very radical reform measures unmatched even by those preaching shock therapy. For one, the 1986 bankruptcy legislation was severed, producing over 16.000 cases between April 1992 and December 1993. The Law on Accounting and the Law on Financial Institutions approximated Hungarian practices to those in the European Union, thus uncovering much of the financial strain inevitable under restructuring and recession. Private enterprise boomed. And unemployment climbed quickly up to double digit levels in 1992. It was at this structure that the IMF discontinued lending.

With the benefit of hindsight, the IMF was quite right in sending this signal, serving the same educational purpose as signing the agreement did. By mid-1992, it has become clear that the government had lost control over fiscal process, and fiscal expansion was threatening to derail many of the favorable developments which were then under way. There was surely an inadequate awareness of the problems. In an article written just about this time, the new governor of the National Bank emphasized that financing needs of the state could be covered from domestic sources. He contrasted this situation with practices of preceding decades (Bod, 1992, p. 8), suggesting that it was a lasting trend that could be reckoned with for a longer time. Already in 1993 - and to an even greater degree 1994 - domestic savings were falling behind the financing needs of general government spending - not least because of the Bank's continued - and temporarily successful - attempt to depress interest rates. As late as April 1993, the National Bank was still publicly contemplating tying the forint to the DM, though sings of export weakness were quite conspicuous by then. In the middle of July 1993, financial organs still disputed the repeated claims of the Ministry of International Economic Relations that there might be a collapse of export performance (Kádár, 1993). This collapse actually materialized soon enough as the value of exports declined from 10.7 bn dollars in 1992 to 8.9 bn dollars in 1993. At the same time the trade account deficit rose to 3.6 bn and the current account deficit to 3.4 bn.

Fiscal reform also became a controversial field. Despite many promises, virtually nothing had been done to date. The Fiscal Act is a collection of procedural norms only. The Committee on Rationalizing State Finances was

convened, but has not even started working except for two encounters where members made introductions and got to know each other.

Seeing the danger, Kupa tried a ***salto mortale*** - and fell. In September 1992, he made very radical promises to the IMF to cut back fiscal spending - without any backing in the government, and even less backing among the coalition MPs. The figures approved by Parliament had no relation to the ones presented to the IMF. Kupa remained alone, alienated, misused - and was sent to retirement in an act balancing the ouster of the populist rightist wing of the MDF in February 1993 (cf. also Lengyel, 1993).

His successor, Iván Szabó had earned a name as a friend of large industrial programs, not one as a monetarist, in his former position as minister of industry and trade. Szabó actually proved much less of a disaster than feared by many, since his amended version of the Kupa Budget for 1993 could indeed be delivered. Also, for the first time, a draft budget was submitted to Parliament and approved before the calendar year of 1994 started. The figures and the structure of spending in that budget, however, left much to be desired: the targeted 12 per cent general government deficit speaks for itself.

One wonders what made Hungarian government officials believe throughout 1993 that they could get away with meeting merely some of the elementary formal requirements of the IMF agreement while dodging most of the substance of fiscal and social security reforms. As late as mid-July, anonymous sources informed the most influential economic weekly that although the government could not agree with the IMF in June on cuts to the new social security directorates it still saw an agreement the basis of an the amended state Budget as realistic (cf. ***Figyelő***, vol. 37. No. 28). Later, in the autumn, the then-secretary of state reiterated much the same story as the one which lead to the downfall of Kupa a year before. He argued that requirements and financing targets agreed to with the IMF and ones derived from legislation passed by the Hungarian Parliament on the initiatives of the governing parties - such as the laws on civil servants, social security, retirement age, support for health care and bank consolidation - were mutually exclusive (Nagy, 1993). Still, the hope for a "new deal" was cherished - in a truly childish manner.

With the time passing and elections approaching, a certain sobering took place. This lead to the first open confrontation between the Hungarian authorities and the IMF. Explaining the economic policies and the Budget for 1994, the minister of finance stated clearly, and with reference to the election defeat of Polish radical reformers, that growth and social consensus were more important than fiscal cuts and anti-inflationary concerns (Szabó, 1994). After 40 years of socialist dogmatism, we do not need antisocialist, free marketeer dogmatism he asserted, implying the IMF.

But what was the issue if, as was the case, the Hungarian government held back from launching new governmental programs, did not begin a spending spree, and followed a generally pragmatist overall line? In part, the structural deficit inevitable in transforming economies (Bruno, 1992) surfaced. This may explain less than a half of the general government deficit figure referred to above. The other half may be explained by delays in social security and fiscal reforms, and the related explosion of the domestic debt-servicing burden of the Treasury, as well as the costly reorganization underway in industry and banking.

As far as social security reform is concerned, it was not a new finding in and for the Hungarian economy. At the time the Antall government took office, a leading figure of the central bank called it an issue that had been delayed by about a decade (Riecke 1991). As documented in detail in this reference, as well as in Kopits (1993), by the late 1980s, a fairly detailed and far-reaching reform project had been elaborated with the technical assistance of the Fund. This would have separated entitlement services from those which had to be paid for. Privatization of many public establishments figured high on the agenda. In reality, with the accession to power of the "conservative" government, these proposals were rejected.

A confused idea which orginated with the Free Democrats, and was later taken over and cultivated by the governing Christian Democrats, prevailed. This rejected the concept of focusing on the financing of services. Instead, it sought to endow social security directorates with wealth and enable them to conduct economic activity as a large bank or pension fund would in the USA. However, due to Hungary's level of financial intermediation, demographic structure, and extremely lavish retirement, sickness and unemployment schemes, this idea had absolutely no relation to Hungarian realities. Furthermore, at times when the

average yield of public assets was between 2-3 per cent, even in the best of circumstances social security directorates could not earn enough to be able to finance ongoing schemes. Actually, these organs were endowed with less than 10 bn Ft of assets instead of the decreed 300 bn by mid-1994. But this was good news, since they were already making sizeable losses on this, disproving the belief (dogma) that it is the state which is always the worst entrepreneur.

Meanwhile, the Ministry of Public Welfare (sic!) sabotaged any major reforms. In a survey, conducted by the independent Hungarian-International Blue Ribbon Commission, the following tasks of social security reform were identified (KSZB, 1993): social services should be targeted to the poorest rather than be extended on citizens' rights. Except for basic services, health care should be made payable. Tuition fees should be introduced in higher education and combined with a British-style credit system. The system of unemployment benefits needs reforming, since two-sevenths of the unemployed receive 85-100 per cent of their previous wage, and a further two-thirds over 70 per cent; thus the incentive seek new employment is minimal. Rents should be approximated to levels covering at least maintenance. Special programs to deal with the problems of certain underprivileged groups, especially Gypsies and drug addicts, need to be created.

All of this sounds more or less like a replication of the 1988 propositions. Meanwhile, the Ministry of Public Welfare was proud of its' defending the poor' by undermining any change.

As far as fiscal reforms are concerned, the current IMF resident representative in Hungary, Kopits (1993), argued that it is the lack of transparency, insufficient controls, and the duplication of task which daunt Hungarian public finances. First attempts to produce a consolidated general government balance were made only quite late (Borbély and Neményi, 1993) and even then without taking due account of the need to apply international standards in accounting individual items. Therefore, several duplications - of the external debt and many other items - artificially inflated the annual debt-servicing requirement of the Treasury, surpassing the size of the overall total deficit in 1994 (Oblath and Valentinyi, 1993).

It is important to note that these overdue technical corrections do not take account of some further factors which aggravated the situation. A large number of new offices were created. New entitlements - such as restitution and compensations of various sorts and early retirement schemes - were created. The Act on Civil Servants envisioned transfers absolutely out of line with the economic performance of Hungary in 1990-1994. In particular, when 20 per cent of the GDP is lost, it is not the time to raise wages across the board in the public sector. Last, but not least, territorial decentralization created 3.200 new municipalities, with obvious financing needs for the longer run. As many of the vested interests were defended and new entitlements created in the sphere of social security, and with the new legitimacy and revoutionary euphoria gone, it will be increasingly difficult to get the elementary cuts through. Owing to the type of legitimacy earned by the first coalition government and to the type of political self-interpretation practised in the first Hungarian Parliament, it not only has been the traditional left, but also most of the middle of the road and center-right which has declared a crusade against the type of reforms discussed above, with the extreme right employing social demagoguery. This means that most precious years (1990-1994) have been wasted. It will be both more costly and politically more intricate to institute the cuts when the pressure comes to a head in 1995 at the latest.

Third, the Government of Hungary has chosen forms of reorganization of banks and companies where political, employment and strategic considerations play a much larger role than the resident of the IBRD sees as understandable (Rogerson, 1994). This is not a fully independent development, but intimately related to the economic policy turn of late 1991 discussed above. Hard pushed by the disciplinary force of the IMF, private financial markets, social resistance and the dramatized fears of the implications of collapse of the Comecon, the coalition government in 1990 and the first half of 1991 managed to distance itself from the economic platforms of its constituent parties and apply a fair degree of common sense.

With the immediate danger gone, and with the radical populist voices in the governing parties, especially in the MDF, gathering momentum in the August of 1991 and of 1992 again, policymaking became more forthcoming to what it perceived as "social" needs (and what was basically its own election rhetoric and

the feedback from its handful of faithful). Whatever our political tastes and priorities are, the fact remains that the educational operation of the IMF's three-year standby program failed. Commitment of the Hungarian Government to market principles was much less than was assumed, while its vulnerability to various pressure groups much larger than recognized. Therefore, the story increasingly resembles a typical Third World scenario, with the Fund and Bank preaching macroeconomic common sense, and the national authorities making their customary references to their special situation and the need to behave in a socially sensitive manner.

It is an important feature of continuity that the government in general has refrained from publicly contesting the wisdom of the Washington twins either in general or in particular cases. However, its way of thinking was clearly reflected in its hysteric outburst against the National Bank when it dared to increase its prime rate in September 1993 at a time when the Treasury was still dreaming of depressing the real rate of interest and avoiding the burden of debt servicing, without any technical, institutional or structural fiscal reform. A couple of days later, the professional number one of the Bank, First Vice Governor Tarafás, an internationally esteemed, long-serving non-partisan official, who could have been a model of a civil servant in any democracy, was relieved of his post by the then-acting Prime Minister without explanation. Since Tarafás was only 48, and Mr. Boross was just about to run for the chairmanship of the largest government party against populist-rightist contenders, the message seems fairly straightforward. Likewise, another professional, known for his strong skills and opposition to ***dirigiste*** industrial policies, Péter Balázs, was relieved of his post as secretary of state for industry just at the time his boss became a frontrunner of the Christian Democrats, the staunches adherents of statist policies in Hungarian legislation. In sum, 'social sensitiveness' and dislike for IMF-type policies were emerging hand in hand.

But these developments are not only due to the inevitable politickling connected with the 1994 election campaign. Since late 1991, i.e. ever since the "we survived it" sigh was uttered, an overall softening up of general economic policies could be observed. First, monetary policy became expansive for the period of October 1991 to September 1993, before it returned to the neutral stance of 1989-1990. In the summer of 1992, the fiscal explosion started. In 1992

and in 1993, costly government-run reorganization programs were launched and several new transfer entitlements legislated. Tough bankruptcy legislation was eased in June 1993, leading to a three-times decrease in new cases initiated since then. Meanwhile, the stock of mutual non-payments among companies nearly doubled, from 110 bn to 190 bn according to the Bank's statistics (as reported in ***Magyar Hírlap,*** 18 June 1994). And - as one could only have expected - calls for protecting the domestic market and backtracking on the "inadvertent" opening started to gain the ears of decisionmakers. In 1994, one could witness the first time since 1988 that the degree of liberalization in Hungary decreased - even though by just 2 per cent.

The bottom line is that a replication of all that has been surveyed during the years 1985-1987 could be observed. While the government of the day was responding to politico-ideological and power aspirations, rather than to economic challenges, the central bank of the country was diligently hoarding hard currency reserves. This stockpiling did pay off insofar as direct clashes with the Fund and the Bank could be averted, with reference to the satisfactory level of reserves. Having raised over 4.5 bn dollars in fresh money in 1993, the NBH earned the borrower of the year title from ***Euromoney*** magazine. And indeed, comments by the chief money manager, Hárshegyi (1994), were directly supportive of the claims of Finance Minister Szabó quoted above: Hungary can survive 1994 not only without resorting to the IMF facility, but even under a worst case scenario, where not a penny of fresh money is injected into the country. Again, quite like in 1985-1987, narrower banking considerations and success indicators directly contradicted broader economic policy and especially systemic priorities. Successes and the predominance of the former lead to distortion in the latter. In times of real need, when grave mistakes were just being made, the IMF could - and did - send its warning signals, make its position clear, and try and persuade the authorities. But it could not "impose" anything upon an unwilling partner. In many ways, it is a typical story which could take place in any corner of the globe, but it still is a peculiar story in many respects.

If there remains a ***difference between the two periods,*** it is the domestic scene in Hungary. The filter mechanism of the early period was not around. On the other hand, no central economic policymaking could emerge in Hungary. Formally, the Hungarian party conducting talks with the Fund and the economic

cabinet are representative and could take action. In reality, none of these were in a position to transmit the understandings into actual policy measures. The economic cabinet remained a formal organ, not least since Mr. Antall consistently resisted the creation of a top government agency overseeing the entire economy. When he passed away, the election campaign already was on, with cabinet ministers paying their prime political (party) roles. With the new government composed from widely divergent forces of a single large Socialist party this state of affairs is likely to continue. By the time the Fund will have regained its leverage over the Hungarian Government, the latter will have shown early signs of being worn down by being in office and yet unable to come up to popular expectations, most particularly with regard to improving living standards. Thus, the situation from 1995 will probably be a re-run of 1989-1991, with domestic weaknesses preventing it from performing up to the expectations of the Washington twins. The latter will probably get some of their measures through to gain a degree of fiscal equilibrium, but will surely fall short of seeing the implementation of those wide-ranging measures that they like to see "good pupils" adopt. But, herewith we are back to the much too familiar scenario of the developing country members of the Fund and the Bank.

Concluding Remarks

The aspirations of this paper are much more modest than those of a general or detailed overview. In summarizing the pre- and post- transformational experience of Hungary, a fair degree of continuity could be spotted, which is remarkable in itself, given the widely divergent philosophy and target-setting of the respective régimes. Going through the details, the recurring conflicts between systemic and narrower banking considerations could be identified. Inherent limits of the IMF and the World Bank, not being global governments, could be established. They were lacking the means to discourage governments from adopting populist measures and socially motivated growth-promoting policies at times when systemic and other broader conditions for the sustainability of growth were clearly unavailable. The repetition of the story also is indicative of the fact how little the Fund and the Bank let themselves and their working be influenced by the pecular transformatory considerations. This is a value-free descriptive statement.

Thus, reasons for the discord between the IMF and the Hungarian Government of the day were quite similar to those in other countries, including the always belated resort to the advice of the agency. Reasons for the cordiality of relations are several. First, nobody who has ever come close to governance seriously played with the idea of rescheduling or moratorium, even at times when countries from Mexico to Bulgaria were not slow in resorting to this tactic. Those who publicly aired such ideas every now and then were keeping these for themselves any time they were close to having a say in actual decisionmaking, from Mr. Torgyán to Mr. Pozsgay and the dramatist Csurka.

Second, Hungary has never had a government during its IMF-membership which would have declared an all-out combat on the principles of market economy on which the Fund is built. This is quite unlike in many member-states, probably Russia included. Third, the Fund has always treated Hungary with care and assistance. At times of real difficulty, such in 1982 and 1990, a hand was

specialists. Meanwhile, governments never blamed the Fund for their own policies or for the need to take stock of the exigencies. The Fund never aspired to make policies instead of the Hungarian authorities, whereas the latter never contested the philosophy or "the final wisdom" of Fund proposals. Still they often declared these untimely or dodged their substance out of fear of social resistance.

One wonders wether or not ***the Fund and the Bank could have delivered more in terms of market reforms.*** And, indeed, when it first became possible to discuss the vices and virtues of Hungary's Fund membership, the criticism was immediately made (Csikós-Nagy, 1990, esp. pp. 257-8) that the Fund maintained one-sided insistence on financial equilibrium considerations and neglected restructuring. Our reading of the events has not supported this claim, reiterated by several other authors since. We can join Szalkai (1991, esp. pp. 178-180) in seeing the standby program and radical measures to implement institutional reform as mutually supportive in each of the cases.

The only exception was 1982-1984, but then an unprecedented improvement in fiscal and external balances took place. Moreover, the requirement of even-handedness would hardly have allowed the Fund to apply more pressure on Hungary, where radical reforms were already endorsed by governmental expert committees, than on, say, Romania under Ceausescu, which was a similar member, or on Dr. Husák's Czechoslovakia. Similarly to other countries, the Fund gathered bad experiences with medium-term standby agreements in Hungary.

While being constantly dissatisfied with what the government of the day delivered - and rightly so - the IMF never lost its sense of reality. Resisting the constantly changing tides of sympathy in the international press, the Washington professionals never forgot the Hungarian edge in systemic reform. In many ways, Hungary was a training ground for them to study strains and difficulties which surfaced sooner or later in the other countries. Bankruptcy legislation, the problem of bad debts in banking reform, the insufficiency of subsidy cuts to attain fiscal equilibrium, and revenue losses due to privatization made a sizable imprint on IMF thinking. These topics could be studied in and on Hungary first among the transforming countries.

Consequently, it is hardly by chance that it was the then-resident of the IMF to Hungary who concluded this about transformation: there is no cookbook to go by (Szapáry, 1993). He too drew attention to the large number of unexpected behavioral characteristics of both firms and households which made actual transformation quite unlike the early model vision. Last, but not least, he and Koptis (1993) underlined the large number of factors making fiscal and social security reform much lengthier an operation than most of us would have thought a couple of years ago. When one-fifth of GDP is lost and living standards have not improved over a decade, it is hard to initiate drastic cuts, provided sustainability also is a consideration of the policies conducted. And in the end, it is the trio of ***sincerity, criticism and empathy*** which are the foundations of any lasting and cordial relationship.

Is there a general lesson from the limited results of the IMF - Hungarian encounter? I can suggest only some preliminary findings. First, the radical nature of a reform ***project*** did no prove to be a terribly sound success indicator, since sustain ability matters more when stabilization is mastered and institutional reforms come to the fore. Second, being a watchdog of balance of payments disequilibria, the Fund is ill-fitted to enforce ***structural*** reforms. When Fund assistance is needed, immediate - often administrative - steps to improvement is attained and reserves are built up, only enlightenment and persuasion remains: the Fund has no leverage on an unwilling government. Last, combining the above two, one might be reminded of a political triviality often forgotten by technical economists and system designers.

In order to enable institutional reforms to last - preferably beyond a single election cycle - one needs to build up a ***constituency*** in favor of these reforms, primarily ***within the country*** concerned. Unless there is a degree of consensus, the stability of policies required by the nature of the exercise cannot be maintained long enough to become effective. Poland and Russia already show the importance of lastingly cultivating such backing for reform efforts. Membership in the Bank and the Fund can hardly substitute other conditions of a sustainable and committed reform policy: rather, they can only complement them.

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