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The crisis of the happiest barracks

Hungary on the way to indebtedness

Abstract

This paper presents the contents of my presentation at the Communist Parties in the Soviet Bloc in 1980-1985. Corrosion of the system conference, held in Prague in October 2023. The aim of the conference was to present the crisis phenomena that affected the socialist states of Central and Eastern Europe. In my presentation, I therefore reviewed the external and internal factors that brought Hungary to the brink of insolvency by the end of the 1970s. The country was days away from bankruptcy in the early 1980s because of its heavy debt in Western currencies. Therefore, the only possible way left for its leadership to keep the country solvent was to join the IMF and the World Bank. Accession to international financial organisations had already been mooted after the Second World War but was not pursued due to the Communist takeover. From the late 1970s, as economic difficulties worsened, accession negotiations were launched, leading to our eventual admission to both organisations in 1982. This was because the decline of the Soviet Union's power had given the domestic political leadership some room to open up to the West. The Soviets were then no longer able to offer their “allies” any meaningful assistance to successfully deal with their economic problems. In my presentation, I showed the path to accession.

Hungary was seen by many among the socialist bloc as an exceptional place, where it was better to live due to the higher standard of living. It also seemed to Hungarian society that living conditions had improved somewhat after the 1956 revolution was repressed. János Kádár who came into force, came to the conclusion after 1956, that society can't be oppressed and exploited to the extreme. Therefore, one of the pillars of the legitimacy of the new system was to raise the living standards of the population. This was so important to the leadership that everything was subordinated to this policy after 56 until 1982. Kádár was aware that the "support" of the system would only be maintained as long as the population was concerned with the acquisition of wealth and not with politics. The era from the 60s until the 80s can be defined as the Time of the Hungarian Petty-bourgeoisie.¹ The increased consumption demand has led to a year-on-year trade deficit with the West. To balance this deficit the country took Western loans which were cheap at the time, and this led to the gradual growth of debt.

By the 1970s, the world economy was in recession because of the dramatic rise in oil prices, and Hungary and the other countries of the socialist bloc could not escape this. In a changed economic environment, debt levels reached a critical level by 1978. To avoid bankruptcy, by the end of 1981, a political decision was taken to join the IMF and the World Bank. Regarding the joining of international financial organizations, it was important for Kádár and the Hungarian leadership to obtain the "green light" from the Soviets. After 1978, the previously halted economic reforms were restarted, which also contributed to some consolidation in Hungary by 1985. In the following, I will describe how Hungary survived the crisis of the first half of the 1980s.

One of the local jokes of the 80s in Budapest was the following: "How long are we going to continue to build socialism? As long as the West gives us loans."² This anecdote clearly reflects the situation in Hungary in the 80s. The Kádár regime itself was born of indebtedness, as after the revolution was oppressed, the country could only be revitalized with the help of China, the Soviet Union, and other socialist countries. Kádár succeeded in solidifying his power by consolidating the economy and then came the socialist transformation of agriculture, which was completed by 1961. By this time, 66.9 percent of the country's arable land became state-owned.³ After collectivization, there was a shortage of basic agricultural products, which forced the country to rely on Western exports. Therefore, as a correction of the previous policy, private farming, the so-called backyard farming, was allowed within certain limits. The essence of this

¹ Gerő 1999, 57.

² Katona 1994, 218.

³ Pető-Szakács 1985, 445. table 115.

system can be explained simply as the following: the peasants could rent land from the farmers' cooperative and sell the produce on the market or to the state. Thanks to backyard farming Hungarian agriculture could be stabilized, which can be seen as the predecessor of the second economy of the 80s. The backyard farming and cooperative system in agriculture contributed to the development of a specific Hungarian socialist model, which was later to be put into practice in the Soviet Union, China, and other socialist countries.⁴

The decade following the start of the new economic mechanism in 1968 could be called the "golden age of socialism"⁵, as living conditions in Hungary improved noticeably during this period. In my opinion, this was not unique, but was due to the global development of the 1960s, which also drew in the countries on the eastern side of the Iron Curtain. This global golden age was brought to an end by the oil price explosion of 1973, which severely shook the capitalist countries. The socialist countries, because of cheap Soviet raw materials, did not react in time and continued to support wasteful industries. This led to an economic and political crisis in the countries of the Soviet Union's sphere of interest by the 1980s.

Hungary embarked on a path of indebtedness in the early 1960s.⁶ It was at this time that the first Western loans were taken out to finance investment and rising living standards, as well as to offset the ever-looming trade deficit. By 1978, this had led to the leadership of the Hungarian Socialist Workers' Party having to face up to the worsening situation. Kádár realized that under these circumstances he would have to give up the policy of supporting living standards for a while. As his power was legitimized by the presence of the Soviet army and a policy of living standards, his position was shaken by the austerity measures in the second half of the 1980s.

The Hungarian public debt at the end of 1978 amounted to 213 billion forints net, of which 192 billion was incurred after 1975.⁷ This is when the idea of joining the IMF and the World Bank was raised again. Hungary had already wanted to join the two international organizations earlier, in 1967, because of the growing public debt and the impending economic reform. External and internal pressures eventually led to the failure of this first attempt to join. The question of joining was then taken off the agenda for a while, as the new economic mechanism improved the country's external trade indicators and the Soviet Union was still able to provide support at that time.⁸ The question of joining was raised again in 1973, when, without

⁴ Berend T. 1988, 370.

⁵ Stark 2018, 269–274.

⁶ Földes 1994, 34.

⁷ Földes 1994, 194.

⁸ Honvári 2005, 82–102.

loans, the country would no longer have been able to maintain the increase in national income without cutting consumption. They also perceived the changed international environment, the focus on raw materials, energy, and infrastructure investments grew, which in turn required significant resources. At the same time, Hungarian domestic politics was undergoing a process of reconstruction, and due to Soviet pressure Kádár removed the reformers from power. Over the next five years, public debt increased steadily by an average of 1 billion forints per year. However, in 1978 there was a sudden increase of more than 3 billion. The reasons for this were a drastic deterioration in the trade exchange ratio and exchange rate losses. These factors led to a situation where the only way to finance the country's debt was to borrow more.⁹ The situation was discussed at the June meeting of the Political Committee. Quote follows: "for the 1976-80 period, we projected that our net debt would increase by 2.2 billion dollars, with a gradual reduction in the pace of our indebtedness, to reach 4.2 billion dollars by the end of 1980. In contrast, our net debts already exceed this level. By the end of the fifth Five-Year Plan, our debt will be about 6 billion dollars more than our plans."¹⁰ It was also at this time that the idea of joining the IMF and the World Bank was raised again, as a solution to preserve the country's solvency. Kádár and the others decided to send a letter to Moscow outlining the country's problems, thus justifying the importance of joining, but leaving a loophole in case the Soviets were displeased and would ask them to withdraw. By the end of the year, however, it became clear that the Soviets were no longer able to provide any meaningful assistance to their "allies".

The crisis in the Soviet Union is best illustrated by the events in Poland in 1981. After Jaruzelski imposed martial law due to Soviet pressure, he asked for help to calm society. Moscow, of course, said yes to the request and agreed to deliver thirty thousand tons of meat. However, it soon became clear that they were not able to produce the requested quantity. It is said that the following scene happened at the Soviet Communist Party's Political Committee meeting. Quote follows: Brezhnev: "Well, comrades, what about the meat for Poland?" To which Gorbachev, who was responsible for agriculture, replied: "Comrade Brezhnev, we have sent out the directive to all regional and city party leaders, and they are working with extraordinary enthusiasm to carry out the request." To which Brezhnev said: "Splendid. Very good. But what about the meat? Is the meat ready?" To which Gorbachev said: "No, not yet."¹¹ This went on for a while, until finally, with great difficulty, sixteen thousand tons of meat were

⁹ Torda 2007, 92.

¹⁰ MNL OL (288.f.5/748.ö.e.) 1978. June 13, Political Committee meeting

¹¹ Bukovsky 2011, 41.

sent to Poland. Can you imagine that a country that could launch a nuclear strike anywhere in the world could not produce thirty thousand tons of meat?

In 1979, with the intervention in Afghanistan and the new boom in oil prices, the socialist countries faced a major financial disaster. In Hungary, creditors have started to withdraw their capital from the National Bank of Hungary, bringing the possibility of insolvency close. Therefore, joining international financial organizations became a priority, and foreign policy was subordinated to it. Kádár was most concerned about the impact of the possible joining on Hungarian-Soviet relations and whether the country's sovereignty would be violated. One of the biggest deterrents was the possibility of Soviet raw material supplies being halted, without which the Hungarian economy would have collapsed.

Kádár's 1981 trip to Crimea played an important role in the decision to join. During the meetings, it became clear to the First Secretary that he could not expect any help from the Soviet Union.¹² After the meeting, Brezhnev sent a letter to Zhivkov, Husak, Honecker, and Kádár, informing them that the Soviet Union was unable to deliver the energy resources agreed in the plan coordinations. This meant that between 1982 and 1985, Hungary would receive 2.2 million tons of oil, almost 10 percent less than the target.¹³ This was a problem because, after processing some of the Soviet oil, the products were sold in the West. As economic conditions deteriorated further, it was decided to "accelerate" the joining. In October 1981, the necessary decisions were made at the meetings of the Political Committee and the Central Committee to allow János Fekete, the Vice-President of the National Bank of Hungary, to present Hungary's application for admission in Washington on the 4th of November.¹⁴ The Soviets were informed the day before the application was submitted. Kádár informed the friendly countries in a letter on the 23rd of November, explaining why the country's joining was necessary, but making it clear that there would be no change in policy. Quote follows: „It is about this and nothing else. We have no illusions, we do not want to increase our debts to the West, and we have not changed our policy or our economic policy in any respect. We have also informed the leaders of the said international financial organizations – it may even be pointless to emphasize this to you –, that even if our application is accepted, we will act as a socialist country, as a member of the Warsaw Pact, and The Council for Mutual Economic Assistance.”¹⁵

¹² Földes 2015b, 577–588.

¹³ Földes 2015a, 326.

¹⁴ Torda 2007, 96.

¹⁵ An informative letter from János Kádár to Erich Honecker, Gustav Husak and Todor Zhivkov on the initiative to join the World Bank and the International Monetary Fund. MNL OL (288.f.5/841.ő.e.) 1981. November 24, 181–204.

The decision to join has proved to be the right one, as the Polish crisis that unfolded in December has shaken the country's financial situation to its core. In the spring of 1982, the situation became so critical that the country was days away from insolvency, or so to say bankruptcy. On the 8th of March, for example, the 85 million dollars in outstanding payments was offset by only 15 million dollars in export income, and the value of unpaid imports was a further 225 million dollars. On the 17th of May, The National Bank of Hungary had to make a payment of 100 million dollars, at which point the foreign exchange reserve fell below 200 million dollars, and an import bill of 320 million dollars was still to be settled.¹⁶ The situation was discussed at a meeting of the Political Committee on the 14th of April in 1982, which did not give cause for much optimism. "Our international situation has become critical in recent months: borrowing options are tight, gold and foreign exchange reserves are virtually exhausted."¹⁷ An analysis of the circumstances at the time led to the following conclusion: "Total gold and foreign exchange reserves fell from 2.2 billion dollars on the 1st of January of 1981 to 570 million dollars at the end of the first quarter of 1982. But only 100 million dollars of this is available for use at any time, which - even with a balanced flow of goods - only covers 2-3 days' worth of payments."¹⁸

While the country's representatives were peddling daily to obtain credit to maintain financial solvency, the joining processes were running smoothly in the background. In March 1982, the IMF's Admissions Committee accepted the report of the expert group that had visited Budapest, giving the green light to Hungary's application for admission. Subsequently, the constitutional procedures necessary for the harmonization of the law were started. The Presidential Council of the People's Republic and the Council of Ministers took part in these preparatory works, and in their decisions, they made a number of important decisions, including decisions related to persons. János Fekete, Vice-President of The National Bank of Hungary who was also appointed Governor of the IMF in Hungary, was tasked with signing the statutes, and Miklós Pulai, deputy chairman of the National Planning Office, was appointed Governor of the World Bank.¹⁹ On the recommendation of the IMF Board, the members of the IMF voted in favor of Hungary's admission. Thus, on the 6th of May 1982, Hungary became a member of the International Monetary Fund.

¹⁶ Földes 1994, 186.

¹⁷ The international financial situation of Hungary. MNL OL () 1982. April 14, 121–128.

¹⁸ The international financial situation of Hungary. MNL OL () 1982. April 14, 121–128.

¹⁹ Torda 2007, 97.

Nevertheless, the Hungarian side did not feel triumphant about the event, because the ongoing credit crisis has pushed most indebted countries, including Hungary, off their feet. The country's solvency was then saved by a loan from the Bank for International Settlements (BIS) and a consortium of US banks. The news of the country's admission to the international financial institutions greatly helped the stabilization of the financial situation. In order to obtain the loan linked to the membership, the country was also required to pay the IMF membership fee of which 100 million dollars had to be deposited in cash. The problem was the cash payment, as the country did not have that amount available. But how did Hungary get the sufficient amount of money?

We can find interesting information in the memoirs of Ferenc Havasi, the member of the Political Committee. Quote follows: “We got from those who we were on bad terms. We wondered where to turn for money now. Like if somebody has died and we could not bury him. Or like if a child were born and we couldn’t get clothes for him. We’ve paid our 80 percent of our entry fee in forints, but still, about 100 million dollars were needed to join. We’ve asked for money from the Chinese. They gave us 100 million. We were under great pressure to break trade and economic ties with China. Because that's when the Sino-Vietnamese war was going on. These 100 million dollars were thanks to the bankers, because János Fekete and the others had personal connections in China. They have found this Chinese partnership.”²⁰ In my opinion, the Chinese financial aid was due to the fact that Deng Xiaoping wanted to modernize China after he came to power. This has led Chinese economists to travel to the socialist countries of Central and Eastern Europe to study their economies. After careful analysis, they concluded that the Hungarian economic governance model was the one that best suited them. Formal inter-state relations were out of the question because of the Soviets' policy towards China. However, relationships could be built at informal levels. The foreign affairs records of the Chinese economists' 1979 trip to Hungary bear witness to this.²¹ On this basis, I believe that a relationship has indeed been established between Hungarian and Chinese financial circles, which has made it possible to obtain the necessary funds.

After joining, in the summer of 1982, the first loans were available, which helped the country avoid financial bankruptcy, but the IMF imposed tough conditions on their disbursement. Apart from the depreciation of the forint, the most painful was the almost 4 percent reduction in the real income of the population. Of the measures introduced between

²⁰ Bozza–Farkas 1990, 46.

²¹ Vámos 2020, 621–629, 639–641.

1980 and 1983, I consider the most important to be the supporting of small forms of enterprise and the authorization of new ones. The importance of the second economy was acknowledged at the February meeting of the Hungarian Socialist Workers' Party (MSZMP) Central Committee in 1980 and based on it, thousands of new small commercial and industrial enterprises were created in the first half of the 1980s. By 1985, nearly thirty thousand company or individual economic working groups had been set up. The number of artisans was 140 thousand, not much lower than the 170 thousand number in 1948.²² Despite this, macroeconomic indicators have still not improved, as the government has had little scope for debt reduction due to subsidies to loss-making companies and further deterioration in export indicators. Joining the IMF has restored creditor confidence, but the interest rate on the debt has risen from 5.4% to 15.1%.²³ As a result, interest repayments on previously borrowed loans have become an increasing burden on the economy. With the restriction of imports and the exchange rate gains, by 1984 it was possible to stop the increase in public debt. In 1985, at the time of the Party congress, the national debt was no higher than in 1982. Even so, the debt could not be reduced, and the economy could not be put on a long-term path of growth. With investment restrained, consumption continued to expand, albeit modestly, and the country gradually used up its reserves. After 1985, poor economic decisions led to a financial imbalance, and the country was forced to take on more and more loans. Therefore, by the time of the regime change, the country was practically bankrupt.

Hungary, considered by many to be the "happiest barracks" in the first half of the 1980s, was close to bankruptcy. Joining the IMF and the World Bank has helped stabilize, albeit temporarily, the country's financial situation. The scale of the problem is illustrated by the fact that the experts involved in the negotiations regarding the joining were awarded a state prize at the end of 1982.

From this fragile balance, Kádár, by then sick and isolated, concluded that the country had overcome its difficulties and could return to a policy of supporting the rise in living standards. This was important for him because he feared a decline in support for the system due to the austerity measures that had been taken, in which he was right. Therefore, at the 13th Party Congress in 1985, a resolution was adopted to accelerate the economy, which soon had disastrous consequences.

²² Domonkos 2021, 104–105.

²³ Domonkos 2021, 106.

By 1986 the financial equilibrium had collapsed, the Hungarian economy was in crisis, and as a consequence, after a long period of time, there were personnel changes among the leaders. Károly Grósz, who was appointed the head of the Council of Ministers by Kádár, announced a new program of economic and social development to deal with the situation. This came too late because the Hungarian economy could no longer be put back in order under the existing conditions. Before the fall of Kádár, the reforms necessary for the introduction of a market economy were started. In parallel with the economic crisis and the personnel changes in the party, the democratic opposition groups have also strengthened. In the samizdats that were published, they wrote about news and issues that were not given publicity and openly criticized the system. In 1987 the Social Contract program was published, in which for the first time it was written that "Kádár needs to go".

We must therefore dispel the myth that Hungary had an economic basis for relative prosperity. It can be seen that the process of indebtedness that began in the 60s was driven not only by investment but also by rising living standards. As the world economy deteriorated, the country's financial situation became critical in the early 1980s. Can we say that bad decisions by the leadership have led the country into a debt trap? In a sense, yes, because they made the decision to use loans to achieve the goals set out in the plans. Although, with cheap credit available, this might have seemed like a good option at the time. Did they have any other choice? Not really. The logic of the Cold War confrontation meant that foreign investment or technology transfers were out of the question. The modern industries that were the basis of the West's economic growth in the 1980s were almost non-existent in the socialist countries. So, they tried to do some kind of modernization with the help of loans, but without much success. As a closing note, I would like to quote Vladimir Bukovsky: "...Most importantly, if they happened to come to power in their own country, it was a real nightmare for the Soviet Union, because they exported the same dysfunctional economic system along with communism."²⁴

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²⁴ Bukovsky 2011, 40.

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