

The 20th anniversary of Hungary's joining the International Monetary Fund

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by Mr Jacques de Larosière

It is for me a great honor and a personal pleasure to recall, in this prestigious and historic hall, my memories of Hungary's accession to the IMF in 1982.

I was, at the time, Managing Director of the Fund and I remember vividly the unfolding of events that lead to Hungary's membership.

Hungary had knocked at the door of the Fund on several occasions. In October 1946 -after the last minute decision by the Soviet Union at the end of 1945 not to ratify the Bretton Woods agreement, -the government of Hungary nonetheless expressed interest. However, given the circumstances and the increasing weight of Stalinism in Central Europe, the matter was not pursued.

Twenty years later, in 1966, there was a new discrete attempt. Hungary was initiating, at that time, a process of economic reforms : somewhat adapting central planning to demand, moving towards a unified exchange rate at a market level.... In this context, some Hungarian officials -and notably Mr. Janos Fekete, who was, then, in charge of foreign exchange matters at the Central Bank -"viewed Fund membership as an essential part of the reform process"¹.

Mr. Fekete regularly attended the governors meetings of the Bank for International Settlements (BIS) in Basel. Indeed, the Central Bank of Hungary has been a shareholder of the BIS since its foundation in 1930. On the occasion of one of those meetings, M. Fekete approached Joseph Gold, the Fund's General Counsel, to get information on the possible reaction to an application from Hungary. But, given the international political context, the feed-back was negative.

¹ "Silent Revolution" by James Boughton, IMF - 2001, p. 981.

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Fifteen years later, in 1981, things had changed. This time, the application process was successful and conducted swiftly.

To understand how things developed, a few remarks are called for.

Firstly, contacts between the Fund and Hungary had never been interrupted. Discrete conversations took place between Alan Whittome -who was the head of the European Department at the Fund- and a few Hungarian officials. Those talks maintained an ongoing relationship between the two parties and, especially after 1979-80, showed that Budapest was considering the matter seriously.

Secondly, the financial situation in Hungary and of its international environment was calling for change.

Hungary had continued, over the 70's to take steps towards economic reform. By 1980, domestic prices of most traded goods were determined by world market conditions. But the absence of external balance of payments support and insufficient adjustment, had gradually lead to a sizeable increase in foreign debt owed to international banks.

This situation become critical with the second oil shock of 1979-80. The higher oil prices worsened Hungary's balance of payments deficit and the hike in world interest rates compounded its debt service problem. "By the end of 1980, Hungary had more than \$ 10 billion in external debt, which was becoming more and more expensive to service"².

As we have often witnessed over the past years under such circumstances, "contagious effects" tend to appear. In 1981, Poland, then Romania, began to arouse concerns among creditors. Banks tried to reduce their exposure as quick as possible. The crisis soon reached Hungary and by March 1982, the country was virtually cut off from external financing.

What is remarkable -I should say admirable- was the absolute determination of Hungary not to default. Therefore the decision was taken in Budapest in the fall of 1981, under the leadership of Mr. Kadar -Mr. Lazar was then Prime Minister, Mr. Marjai deputy Prime Minister and Mr. Timar President of the Central Bank- to apply for Fund membership.

² Ibidem, p. 982.

How was that crucial decision taken given the traditional strong opposition of the Soviet Union towards COMECON countries IMF membership ? How did the government manage to put its neighbors in front of the "fait accompli" ? This is for historians and those in Hungary who in effect participated in the decision making process to tell

But what I recall is that in the fall of 1981, I was informed of Hungary's intention to apply.

I remember vividly the situation. I first talked to a few important shareholders and notably to the US Secretary of the Treasury, Mr. Donald Regan. He asked me if I thought Hungary could really abide by the Fund's rules. I said that I had no doubt they could. I stressed the importance of the Hungarian initiative. I argued that this country had made significant strides towards opening up it's economy and that it should receive support in times of stress, as long as IMF conditions were met. In my view, the acceptance of membership followed by a Fund program could only facilitate the integration of Hungary in the international financial system. My interlocutor listened carefully and said : "Mr. Managing Director, I will rely on your judgment, but I will take you on your word".

You know how events unfolded. Things went briskly. Preemptive devaluation and unification of the exchange rate preceded the formal application which was handed to the Fund in November 1981. Then an IMF team lead by Patrick de Fontenay went immediately to Budapest to collect the necessary data and to determine the adequate quota. Mr. Fekete, in the meanwhile, arranged two bridge loans with the BIS³. The IMF Board accepted the management's recommendation in April 1982. After the Board of Governors completed its voting by mail, the deputy Prime Minister, Jozsef Marjai, went to Washington for the signing by Hungary of the Articles of Agreement (May 6, 1982). Hungary joined the constituency lead by the Belgian Director, Mr. Jacques de Groote. At the time, the only Hungarian staff member in the Fund was Mr. George Szapary, presently Vice President of the National Bank of Hungary.

Since then, the history of the relationship between Hungary and the Fund has been rich in events. Lessons have been learned, in particular in the field of data transparency and compliance with Fund's rules. Several programs supported by Fund resources were negotiated. A compensatory financing (CFF) drawing of SDR 72 million and a first stand-by of SDR 475 million were approved in

³ Mr. Leutwiler, President of the BIS, called me on the phone in Washington. He asked me if I was reasonably sure that Hungary would obtain membership and a Fund program. I answered that I fully expected Hungary to qualify for IMF credits within a few months (see J. Boughton, p. 325). These bridge loans were instrumental in keeping Hungary current on its external debt obligations.

December 1982. Another stand-by arrangement (SDR 425 million) was signed in January 1984. A third one was concluded in May 1988 (SDR 265 million). In the 90's, several programs were agreed (an SDR 159 million stand-by in March 1990, an SDR 1,1 BN extended arrangement in February 1991, an SDR 340 million stand-by in September 1993 and an SDR 264 million stand-by in March 1996).

In total, seven programs over the last two decades. Today, Hungary has no outstanding liabilities vis-a-vis the Fund as it has repayed all its drawings. Since January 1996, the government has accepted the obligations of Article VIII of the IMF Articles of Agreement.

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What does this history tell us ?

- First that Hungary was the first of the European Centrally planned economies to begin opening up and to move towards a more market oriented economy ;

- Secondly, Hungary also suffered from external shocks and turbulences, all the more so because it had opened up and had incurred sizeable -and excessive- external debt. Therefore the Fund's conditionality and support were the logical outcomes ;

- Thirdly, Hungary has always taken most seriously its external commitments. The idea of a default or of a restructuring never crossed the minds of the officials in charge. Their bold initiative to join the Fund is a clear manifestation of this attitude. This scrupulous contractual compliance has enormously contributed to the credibility of Hungary in the markets, and helps to explain the remarkably low spreads on Hungarian foreign debt ;

- Fourthly, fiscal and monetary discipline as well as structural reforms have been conducted hand in hand. Over time this process -which was not easy (there were "ups and downs")- has allowed Hungary to become an open economy, almost entirely private, with a modern legal and regulatory framework, a strong banking system and a competitive market driven environment. I remember, Mr. Chairman Horn, the importance of the stabilization program of 1995-98. This is why Hungary is now placed at the fore front of the central European countries candidates to the European Union.

As a former Managing Director of the IMF, and a faithful admirer and friend of Hungary, I believe that the past twenty years of relationship between Hungary and the Fund have played an important role in the remarkable achievements of this country.

I am honored to have been part of that history.