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## Reform in Exchange for Credit? Hungary and the International Financial Institutions in the 1980s

### Reformy w zamian za pożyczkę? Węgry i międzynarodowe instytucje finansowe w latach osiemdziesiątych XX w.

**ABSTRACT:** Between January 1984 and May 1988, Hungary did not apply for an International Monetary Fund (IMF) loan, but continued to cooperate with the World Bank, which financed industrial restructuring and infrastructure development projects. In 1985–1986, with the assistance of the World Bank, a plan of measures (the so called “Matrix”) covering eleven areas was drawn up, which in many respects served as a guide to the economic reforms of the following years. The bankruptcy law, personal income tax, the reorganisation of the banking system, and the increase in working capital attraction were increasingly pointing outwards from the socialist system. This article shows the role of international financial institutions in shaping these reforms, and the tailoring of the proposed measures to Hungary and their impact on the Hungarian economy.

**KEYWORDS:** Hungary, economic reforms, International Monetary Fund (IMF), World Bank, transition in Central and Eastern Europe

**STRESZCZENIE:** Między styczniem 1984 a majem 1988 r. Węgry nie ubiegały się o pożyczki z Międzynarodowego Funduszu Walutowego (IMF), lecz kontynuowały współpracę z Bankiem Światowym, który finansował projekty przebudowy przemyśle i rozwoju infrastruktury. W latach 1985–1986 z pomocą Banku Światowego został przygotowany plan działania („Matrix”, „Arkusz”), obejmujący jedenaście płaszczyzn, który pod wieloma względami wyznaczył kierunek reform gospodarczych

w następnych latach. Prawo upadłościowe, podatek dochodowy, reorganizacja systemu bankowego i wzrost kapitału obrotowego coraz bardziej wskazywały na odejście od systemu socjalistycznego. Artykuł pokazuje rolę międzynarodowych instytucji finansowych w kształtowaniu tych reform i dopasowaniu proponowanych środków do sytuacji na Węgrzech, jak i ich wpływu na węgierską gospodarkę.

**SŁOWA KLUCZOWE:** Węgry, reformy gospodarcze, Międzynarodowy Fundusz Walutowy (IMF), Bank Światowy, transformacja w Europie Środkowo-Wschodniej

## Introduction

I hope very much that the program outlined in your letter will be successfully implemented as it would provide a sound basis for the Bank support it during 1986–90. As we consider the program of industrial restructuring to be a cornerstone of the Bank's medium-term program of assistance to Hungary in the coming years, it is our intention to make available for industrial restructuring about one half of the total resources the Bank expects to provide Hungary during the period 1986–90. We expect to do this through further industrial restructuring loans, designed along the lines of the first loan, in each of the Bank's fiscal years 1987–90, assuming successful implementation of each successive operation and provided the momentum of reform is sustained.

So wrote the World Bank Vice President Willi Adolf Wapenhans to the Hungarian Deputy Prime Minister József Marjai in May 1986.<sup>1</sup>

Wapenhans' words illustrate the ambivalent attitude of the international financial institutions at the time – they tried to be at once helpful and cooperative, while at the same time they had to show the necessary rigour and consistency towards the indebted country. Hungary also pursued a dual policy: it undertook unavoidable reforms and austerity measures in order to secure funding but often delayed their actual implementation for concern about the social consequences. Noteworthy, even during the crisis years of the 1980s, Hungarian society lived better than their Polish or East German

<sup>1</sup> National Archives of Hungary (hereinafter MNL OL), XXIX-L-1-ccc, Documents of the International Development Institutions of the National Bank of Hungary, box 60, Letter of W.A. Wapenhans, World Bank Vice President, to József Marjai, Deputy Prime Minister, 28 May 1986.

counterparts, so no substantial protests, let alone strikes, took place until 1989. The expansion of small businesses and private sector opportunities improved supplies of goods and provided supplementary income alongside stagnant or declining state wages.<sup>2</sup> At the same time, according to László Csaba, by 1982–1983 it was widely believed in economist circles in Hungary that “the system not only does not work, but is also beyond repair,” therefore radical market reforms were proposed – necessarily preserving the one-party system. The economic growth between 1984 and 1987, financed by further foreign loans, quickly slowed down, and as a result, the “socialist, third-way, state-oriented” economic ideas finally became obsolete in Hungary.<sup>3</sup>

There is broad consensus in the literature of the field that the expansion of external convertible debt in the 1980s and its mismanagement undermined the legitimacy of the Socialist systems in Central and Eastern Europe and contributed significantly to their economic collapse.<sup>4</sup> However, the assessment of the role played by international financial organizations in crisis management is widely debated. According to a left-wing narrative embedded in Immanuel Wallerstein’s world-system theory, neoliberal ideas had already become dominant under the Kádár regime, and thus, after the fall of Communism, the countries of the region simply “dissolved” into global capitalism, and the International Monetary Fund (IMF) did not even have to impose its shock therapy, as the local neoliberal elites implemented it themselves.<sup>5</sup> According

<sup>2</sup> L. Csaba, “Was Market Socialism Ever a Viable Alternative Development Model?” in *The Oxford Handbook of Post-Socialist Economies*, ed. A.V. Gevorkyan, Oxford: Oxford University Press, 2024. <https://doi.org/10.1093/oxfordhb/9780197621509.013.6>.

<sup>3</sup> L. Csaba, *Válság, gazdaság, világ. Adalék Közép-Európa három évtizedes gazdaságtörténetéhez, 1988–2018*, Budapest: Central European University, Magyar Tudományos Akadémia, 2018, p. 57.

<sup>4</sup> F. Romero, “Socialism between détente and globalisation,” in *European Socialist Regimes’ Fateful Engagement with the West: National Strategies in the Long 1970s*, ed. A. Romano and F. Romero, London: Routledge, 2021, pp. 11–30; É. Forestier-Peyrat, K. Ironside, “The Communist World of Public Debt (1917–1991): The Failure of a Countermodel?” in *A World of Public Debts: Palgrave Studies in the History of Finance*, ed. N. Barreyre and N. Delalande, Cham: Palgrave Macmillan, 2020 (); F. Bartel, *The Triumph of Broken Promises: The End of the Cold War and the Rise of Neoliberalism*, Cambridge, MA: Harvard University Press, 2022.

<sup>5</sup> A. Antal, *Chicago a Dimitrov téren. Neoliberalizmus és a Kádár-rendszer*, Budapest: Napvilág, 2021; T. Gerócs, A. Pinkasz, “The Interdependence of Socialist Hungary’s External and Internal Balances: The Bridge Model and the Consolidation of the Kádár Era,” in *State Socialism in Eastern Europe: Marx, Engels, and Marxisms*, ed. E. Bartha, T. Krausz, and B. Mezei, Cham: Palgrave Macmillan, 2023 (DOI: [https://doi.org/10.1007/978-3-031-22504-8\\_2](https://doi.org/10.1007/978-3-031-22504-8_2)); A. Fabry, “The origins of neoliberalism in late ‘socialist’ Hungary: The case of the Financial Research Institute and ‘Turnabout and Reform,’” *Capital & Class* 1 (2017), pp. 77–107, DOI: <https://doi.org/10.1177/0309816817692125> – in complete agreement with Johanna Bockman’s argument, see J. Bockman, *Markets in the Name of Socialism: The Left-Wing Origins of Neoliberalism*, Stanford, Ca: Stanford University Press, 2011.

to this interpretation, the IMF's prescriptions were only capable of deepening the crisis in the semi-periphery.<sup>6</sup>

Also, a widely held view is that the so-called 'Washington Consensus' was one of the main reasons for the perceived failure of the post-1989 transition. Moreover, many believe that the harmful influence of international financial organizations was behind Hungary's economic crisis and its heavy indebtedness in the 1980s. Instead, in fact, as György Szakolczai and István Benczes highlighted, the ten points of the 'Washington Consensus' have been taken out of their original context and widely misinterpreted in recent decades.<sup>7</sup> Szakolczai and Benczes stress that the points made by John Williams at the November 1989 conference were specific to Latin America and not made with the intention and need for a general ideological application.<sup>8</sup> The coincidence of the November 1989 conference and the acceleration of the collapse of the Socialist regimes gave the possibility to interpret the policy agenda for Latin America as a guiding program for the transformation of Central and Eastern Europe in the following years. In retrospect, however, the various measures listed in these points are of little relevance to the reforms of the 1980s in Hungary. Even though some of their elements and objectives appeared in the reform proposals and loan requirements formulated by the IMF and the World Bank after 1982, they did not yet put then the Hungarian economic policy on a neoliberal path. In 1996, László Csaba analyzed the controversial relationship between international financial institutions and Hungary in the period 1982–1995. In his concluding remarks, Csaba expressed scepticism about the ability of the Washington organizations to influence contemporary Hungarian economic policies.<sup>9</sup>

As will be demonstrated below, while liberalization measures were taken in the early 1980s (improving the framework for the private sector, decentralizing corporate governance, etc.), economic governance, especially foreign trade, was strictly centralised, dirigiste (top-down), so to speak. Thanks to

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<sup>6</sup> M.Á. Éber, "A centrum hitele: A magyar állam külső eladósodásának történetéről," *Fordulat* 21 (2014), pp. 64–86.

<sup>7</sup> See in detail Gy. Szakolczai, "A washingtoni konszenzus és ami utána következik," *Külgazdaság* 10 (2005), pp. 26–46; I. Benczes, "A washingtoni konszenzus és a nemzetközi pénzügyi szervezetek," *Köz-Gazdaság* 3 (2016), pp.107–123.

<sup>8</sup> On misuse of the term also see P.-P. Kuczynski, "Setting the Stage," in *After the Washington Consensus: Restarting Growth and Reform in Latin America*, ed. P.-P. Kuczynski and J. Williamson, Washington, D.C.: Peterson Institute for International Economics Press, 2003, p. 24.

<sup>9</sup> L. Csaba, "Hungary and the IMF: the Experience of a Cordial Discord," in *Die Rolle der Internationalen Finanzorganisationen in Mittel- und Osteuropa*, ed. R. Schönfeld, München: Peter Lang, 1996, p. 224.

the tight restrictive policy and the protective umbrella of the IMF–World Bank, Hungary’s economic situation had been stabilised by 1984, prompting the political leadership to focus again on economic growth and consumption expansion. Disputes with the IMF escalated to the point where no new stand-by arrangement was signed. Thanks to flawed economic policies, the country’s debt almost doubled between 1985 and 1987, and with the situation turning serious again, Budapest returned to the IMF as a last resort.

It is important to underline that many reform ideas and measures were formulated and started to be prepared well before Hungary’s accession to the IMF. One of the examples was the reintroduction of a two-tier banking system, which had been on the agenda since 1979, but was only incorporated into the reform program in 1985 under World Bank pressure. This article argues that the Hungarian reformers could not have succeeded without external support, and that the only way to pressure the Communist party’s conservative forces to take the necessary steps was through international financial institutions, or even the governments that provided (or organised) the loans. In doing so, these foreign actors did to some extent influence Hungarian domestic politics (some consciously, some less intentionally). Nevertheless, the financial and economic reforms, and structural adjustment programmes that were initiated then, indeed improved the efficiency of the Hungarian economy. However, comprehensive budget reform, radical liberalisation of foreign trade and real factory closures and cutbacks did not take place until 1988–1989.

The most thorough research of the history of Hungarian debt was carried out by Attila Mong in his 2012 book, and he conducted research not only in Hungarian public archives but also the IMF archives in Washington D.C.<sup>10</sup> The aim of this article is to explore further the actions of Hungarian institutional actors and individuals, their motivations, and the perception of the measures taken by international financial organizations. However, this study does not deal with discourses outside of the official public sphere, in which economic issues, especially the problem of debt, were rarely mentioned. Instead, they focused much more on the future of socialism itself and the possibility of reforming it.<sup>11</sup>

<sup>10</sup> A. Mong, *Kádár hitele. A magyar államadósság története 1956–1990*, Budapest: Libri könyvkiadó, 2012. In recent years, the IMF Archives have digitized numerous sources from the 1980s and made them available on its website. See <https://www.imf.org/en/about/archives>.

<sup>11</sup> See J.M. Rainer, *Újratervezés. Szocializmus Magyarországon a 20. században*, Budapest: Osiris, 2023. In Rainer’s book on reforms, the title of the relevant chapter is also telling: “The disappearance of socialism from (re)planning” (*ibid.*, pp. 209–242).

It would also go beyond the scope of this study to discuss the social consequences of the economic crisis of the 1980s.<sup>12</sup>

The study of previously not researched details was made possible by the examination of new groups of sources: records of Deputy Prime Minister József Marjai, and private papers of the Hungarian Ambassador in Bonn István Horváth, and with intensive use of the records of the National Bank of Hungary. The argument of this paper unfolds in four parts. First, it briefly outlines the relations between Hungary and the international financial institutions up to 1982 and then describes the circumstances of the Hungary's accession to the IMF. The third part discusses the World Bank projects and the reform agenda developed with its assistance. Finally, the study analyzes the turbulent period between 1985 and 1989, when Hungary's convertible public debt doubled.

## Relations with the International Financial Institutions Before the 1982 Accession

When the IMF was established in December 1945, Czechoslovakia and Poland joined as founding members from Central and Eastern Europe.<sup>13</sup> The Soviet Union decided at the last moment not to sign the treaty.<sup>14</sup> From the beginning of 1946, occupied Hungary was plagued by increasingly brutal hyperinflation, so one of the most important tasks of the government led by Ferenc Nagy was to stabilize the national currency. In the economic terms of peace proposal drawn up in June 1946 (and approved by the government), the aim of stabilization was stated as follows: "Hungary wishes to achieve currency stabilization as soon as possible, particularly in order to enable it to participate in the international financial cooperation decided upon in the Bretton Woods Agreement."<sup>15</sup> According to János Honvári, the government submitted its application to join the

<sup>12</sup> On these issues see B. Tomka, *Austerities and Aspirations: A Comparative History of Growth, Consumption, and Quality of Life in East Central Europe since 1945*, Budapest: Central European University Press, 2020 (<http://www.jstor.org/stable/10.7829/j.ctv16f6cv5>).

<sup>13</sup> List of the IMF members in order of date of entry: <https://www.imf.org/external/np/sec/memdir/mem-date.htm>; Czechoslovakia ceased its membership in 1954, and was only readmitted as a member of the Fund in 1990. Poland withdrew from membership in 1950 and was readmitted as a member of the Fund in 1986.

<sup>14</sup> J.M. Boughton, *Silent Revolution: The International Monetary Fund, 1979–1989*, Washington, D.C.: International Monetary Fund, 2001, p. 981.

<sup>15</sup> "A magyar kormány gazdasági békejavaslatai. 1945. június 15. [The economic peace proposals of the Hungarian government. 15 VI 1945]," in *Nagy Ferenc első kormányának minisztertanácsi jegyzőkönyvei A. kötet 1946. február 5. – 1946. július 19.*, ed. L. Szűcs, Budapest: Magyar Országos Levéltár, 2003, p. 851.

IMF and the World Bank in the course of the year.<sup>16</sup> James M. Boughton states merely that in October 1946, Hungary “expressed interest in initiating discussions with the Fund.” However, with the dramatic advance of the Communists, the idea became unrealistic by 1948, and following signals from the US State Department, the Hungarian government withdrew its request.<sup>17</sup> Relations were subsequently discontinued for almost two decades.

Between 1962 and 1965, the need for foreign loans tripled as convertible revenues failed to keep pace with the payment obligations. In a memorandum at the end of 1965, Finance Minister Mátyás Timár first raised the possibility of expanding international financial relations since the Hungarian balance of payments deficit was becoming extremely tense. Thus, in the spring of 1966, the IMF and the World Bank came into the picture, and accession to these organizations was considered politically feasible by the Ministry of Finance and the National Bank of Hungary (NBH).<sup>18</sup>

From the end of spring 1966 onwards, negotiations began to soften, and financial diplomacy sought to approach the main IMF member countries. At the end of 1966, János Fekete, Managing Director of the NBH, also visited Washington, negotiating with the IMF’s European Director about the possibility of Hungarian accession.<sup>19</sup> It is important to note, however, that the US government had consistently refused to support such an initiative.<sup>20</sup> The Soviet Union did not approve of Hungary’s and other socialist countries’ negotiations with international financial institutions. Budapest eventually suspended its talks with the IMF because it had managed to solve its financial problems with Soviet help in 1967–1968 (loan roll-over, excess supplies, investment contribution waivers).<sup>21</sup> Following the military intervention in Czechoslovakia in August 1968, Hungary’s accession to the IMF was completely off the agenda. However, despite the Soviet ban, attempts to establish contacts continued.<sup>22</sup> In the 1970s, János Fekete met more or less regularly Alan Whittome, Director of the IMF’s European Department, in Basel, Budapest or Washington – attempting to maintain constant communication.<sup>23</sup>

<sup>16</sup> J. Honvári, “Magyarország IMF-csatlakozásának előtörténete,” *Valóság* 10 (2005), p. 88.

<sup>17</sup> J.M. Boughton, *Silent Revolution*, p. 981.

<sup>18</sup> A. Mong, *Kádár hitele*, pp. 100–103.

<sup>19</sup> J. Honvári, “Magyarország IMF-csatlakozásának előtörténete,” pp. 88–96.

<sup>20</sup> J.M. Boughton, *Silent Revolution*, p. 982.

<sup>21</sup> J. Honvári, “Magyarország IMF-csatlakozásának előtörténete,” pp. 97–98.

<sup>22</sup> A. Mong, *Kádár hitele*, p. 124.

<sup>23</sup> J.M. Boughton, *Silent Revolution*, p. 982.

According to an unpublished analysis by Ede Bakó, Managing Director of the NBH, in the five years after launching the reform Hungary raised US\$ 1.5 billion in medium- and long-term convertible loans, increased its foreign exchange reserves to US\$ 1.2 billion, and the previous commodity financing loans were gradually replaced by syndicated loans. Additionally, Hungary was the first socialist country to issue bonds in the Western markets in 1971.<sup>24</sup> After the oil-price “explosion” of 1973, the state budget was the buffer that alleviated the price shocks of the world economy for the internal actors. The trade balance and the public budget deficit increased significantly in the following years.<sup>25</sup>

External financing for expanding consumption and investment was easy to find on international financial markets, and the national bank quickly broadened its international links to ensure that it could provide the required credit as smoothly as possible. However, as Ede Bakó pointed out afterwards, only 6% of total investment was spent in export-enhancing development. In the second half of the 1970s, the NBH set up a new information system to keep foreign creditors regularly informed. Bakó explained in flowery language that these information reports must paint the most beautiful picture imaginable of the Hungarian economy and economic policy, “with due regard for our security interests, with all information that points to the balanced conduct of Hungarian economic policy, or at least to the intention of such a course.”<sup>26</sup> In reality, however, this meant that the NBH published manipulated, or to use a finer word, ‘embellished’ cosmeticised data on the Hungarian public deficit and later on the level of public debt. A 1993 national bank data revision shows that after 1974 it was not uncommon for the actual public deficit to be ten times higher than the publicly published figure. As a percentage of GDP, the deficit ranged from 9.5% in 1975 to 5.7%–7.8% from 1976 to 1978.<sup>27</sup>

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<sup>24</sup> MNL OL, XXIX-L-1-e, Records of the Secretariat of the National Bank of Hungary, box 321. Ede Bakó: “A külső egyensúly alakulása 1968-tól napjainkig. A nemzetközi tőkemozgásokkal kapcsolatos gazdaságpolitikák értékelése 2000-ig kitekintve [The evolution of the external balance from 1968 to the present. An assessment of economic policies related to international capital movements, looking out to 2000],” no date – supposedly 1987.

<sup>25</sup> See in detail P. Germuska, “Failed Eastern integration and a partly successful opening up to the West: the economic re-orientation of Hungary during the 1970s,” *European Review of History* 2 (2014), pp. 271–291.

<sup>26</sup> MNL OL, XXIX-L-1-e, box 321. Ede Bakó: “A külső egyensúly alakulása 1968-tól napjainkig.”

<sup>27</sup> I.Ny. Baárné, et al, *Külső eladósodás és adósságkezelés Magyarországon*, Budapest: MNB Inf. Főoszt., 1993, p. 59.

The party leadership wanted to maintain the expansion of domestic consumption and accumulation despite heavy price losses and deficits. However, the voluntarist policy soon reached its limits. At the end of 1977, NBH First Deputy President Miklós Pulai presented a report to the bank's board, which openly stated that the external debt would reach the financially collapse-prone level of US\$ 8 billion by the end of 1978. In June 1978, Ferenc Havasi, the secretary for economic policy of the state party, shocked the Hungarian Socialist Workers' Party (MSZMP) Political Committee (PC) with dramatic figures on the expected bankruptcy, which succeeded in triggering a reassessment of the situation. In February 1979, the Politburo was confronted with the fact that by the end of the previous year, convertible debt had reached US\$ 9.4 billion, of which US\$ 4.3 billion was short-term debt. Instead of severe austerity, the MSZMP PC opted to join the international financial institutions, to take out new loans. János Kádár sought the Soviets' permission from Leonid I. Brezhnev at their meeting on 6 March 1979, but the Soviet party general secretary did not approve the move. Thus, the Hungarian Politburo did not dare to enter negotiations, but price increases and the first restrictive measures became inevitable.<sup>28</sup>

Boughton stresses that by the end of the decade, Moscow was unable to provide further aid to the bloc's countries, and after the invasion of Afghanistan, the Soviet economy became even more overstretched. The recent rise in the price of oil and the rapid increase in world interest rates from the US made it even more difficult for Hungary to refinance its external debt.<sup>29</sup>

## The Ultimate Lender – Joining the IMF

The unfolding international financial crisis hit Hungary hard. From the beginning of 1981, Hungary again approached the IMF with spectacular gestures, and Whittome spent the second half of May in Budapest. By July, correspondence was already exchanged concerning the data to be provided. Everyone was just waiting for the green light. After Kádár had unsuccessfully tried to persuade Brezhnev during the meeting on the Crimean Peninsula in July that the Soviets should grant Hungary another loan and should not cut their oil supplies in the coming years, the Hungarian party leader made his

<sup>28</sup> A. Mong, *Kádár hitele*, pp. 161–162, 166–167.

<sup>29</sup> J.M. Boughton, *Silent Revolution*, p. 982.

decision. The Politburo approved Hungary's application to join the IMF on 15 September 1981.<sup>30</sup>

Ede Bakó, Managing Director of the NBH, when taking stock of the tasks of the accession negotiations, set out the following cornerstones as a basis for the principle and strategy: 1. Accession must not affect Hungary's obligations towards other socialist countries, and must not entail any obligation to provide information that would allow insight into the internal affairs of the socialist countries; 2. The Hungarian economic policy and economic governance system must be accepted by the two international organizations, and the Hungarian political and social system must be recognized as unchangeable; 3. In the negotiations, information should be handled in a closed system within the domestic administration; 4. The fact of accession should also be duly emphasized to Hungary's traditional creditors.<sup>31</sup> In his note of 19 November, NBH Deputy President János Fekete also stressed the need for particular caution when sharing information, such as the data needed for the IMF quota calculation (e.g. total current account income and expenditure back to 1964), the shares of foreign exchange reserves (gold and convertible currencies), the convertible gross debt stock and its maturity composition. He also wanted to keep this information "in a closed system." Moreover, work was to begin on the development of projects that could be offered to the World Bank, and on a comprehensive report on Hungarian development policy.<sup>32</sup>

As part of the closed information management, the central bank presumably also "cosmeticized" the actual debt figures. (The prime minister was forced to publicly confess this fact in the autumn of 1989; see below.) According to the official history of the NBH published in 2004, the debt figure, 'embellished' over the years, was US\$ 2.1 billion less than the factual figure on 31 December 1980; and this difference was not carried over to the official central bank accounts even after IMF accession.<sup>33</sup>

<sup>30</sup> A. Mong, *Kádár hitele*, pp. 183–186.

<sup>31</sup> MNL OL, XIX-A-2-af, Deputy Prime Minister, box 178. Ma-004/219/81. Javaslat a Nemzetközi Valutaalappal és a Nemzetközi Újjáépítési és Fejlesztési Bankkal való csatlakozási tárgyalások irányelveire. [Proposal for guidelines for accession negotiations with the International Monetary Fund and the International Bank for Reconstruction and Development], November 1981.

<sup>32</sup> MNL OL, XIX-A-2-af, box 178. Ma-004/219/81. Feljegyzés Marjai József elvtárs részére: Javaslatok a csatlakozási tárgyalások közvetlen teendőinek lebonyolítására. 1981. november 19. [Memorandum to comrade József Marjai: Proposals for the immediate conduct of accession negotiations. 19 XI 1981].

<sup>33</sup> J. Botos and K. Botos, *A Magyar Nemzeti Bank története III. A jegybank útja rendszerváltozástól rendszerváltozásig*, Budapest: Presscon Publishing, 2004, p. 464. According to other sources, the difference was closer to 3 billion; I. Tömpe, *Az elitek árulása*, Budapest: Noran Libro Kiadó, 2015, p. 290.

Negotiations with the IMF were encouraging and effective, but maintaining day-to-day liquidity was a major challenge, especially following the declaration of martial law in Poland. At the most critical moment, in April 1982, Hungary received two loans of US\$ 100 million from West German banks. In 1982, Hungary received a total of US\$ 500 million in loans from the Bank for International Settlements (BIS), which was seeking to avoid a financial collapse of a major debtor amid a credit crisis that was terrorizing the world. At the same time, the BIS expected IMF entry to take place as soon as possible. Deputy Prime Minister József Marjai was finally able to sign the Act of Accession in Washington D.C. on 6 May 1982.<sup>34</sup>

Marjai spent two weeks in the US capital and was welcomed by Secretary of State Alexander Haig on May 10. The head of US diplomacy made it clear at the meeting that Washington greatly appreciated Hungary's commitment to reform: "The President's policy is one of differentiation and we continue to conduct political and economic relations based on our assessment of each individual country. Accordingly, we supported Hungary's entry to the IMF [...]"<sup>35</sup>

By the summer of 1982, however, the treasury was so empty that the People's Republic of China contributed US\$ 100 million to pay the Hungarian IMF quota (the quota was 375 million SDR, which was then equivalent to US\$ 435 million, of which 21.7 percent had to be paid in convertible currency – the rest in Hungarian forint). As conditions for the first stand-by loan, however, the IMF imposed tough conditions: devaluation of the Hungarian forint (HUF), increase in interest rates, price increases, reduction in price subsidies, reduction in real income of the population – by 4% in real terms. Following Budapest's announcement on 13 July of a 7% devaluation of the forint and other tough measures, by early August it was clear that Hungary would be able to access the first US\$ 260 million three-year credit line. Attila Mong in his book argued that a double game unfolded between the IMF and Hungary from the summer of 1982; the IMF tried to remain firm and consistent, while taking care not to overstretch and cause political failure in Budapest, while the Hungarians knew that they had little room for maneuver and that the country would go bankrupt without IMF help, but they could keep the IMF negotiators at bay politically in order to obtain certain concessions. At the

<sup>34</sup> A. Mong, *Kádár hitele*, pp. 190–206.

<sup>35</sup> Document No. 319. Memorandum of Conversation in *Foreign Relations of the United States, 1981–1988*, vol. 10: *Eastern Europe*, ed. M.J. Taylor, Washington D.C.: US Department of State, 2023.

end of the tug-of-war, Budapest managed to get the politically unpalatable measures left out of the Hungarian letter of intent.<sup>36</sup>

At the same time, in the autumn of 1982, a reform package had to be drawn up to meet the expectations of the creditors. According to the decision of the MSZMP PC of 28 September 1982, a Consultative Board was set up under the leadership of Ferenc Havasi, the economic secretary of the state-party, in which we find Rezső Nyers, the ‘father’ of the 1968 reform (who was then a research fellow in the Institute of Economics of the Hungarian Academy of Sciences). Miklós Németh (the later prime minister) was the secretary of the committee, and several reform economists were involved in its work. At the same time, the limits of possible change seemed to have been predetermined by János Kádár’s words at the Politburo meeting when he harshly warned everyone not to dare to think about far-reaching reforms.<sup>37</sup>

By September 1983, the Consultative Board had prepared a detailed set of proposals for the necessary measures. At the MSZMP PC meeting on 13 September 1983, most of the members supported the draft, but Kádár, who was the last to speak, quickly dashed all hopes. “Let us not come up with some distorted new invention, gunpowder smoke and God knows what else, and make our own work in the socialist relation politically difficult,” argued the First Secretary in his special style.<sup>38</sup> What happened clearly showed that once the imminent threat of bankruptcy had passed, the party leadership did not feel the same urge to change.

The lively negotiations with the West German banks in the autumn of 1983 were clearly aimed at widening the space for maneuver. In the most critical weeks, the Deutsche Bundesbank, with the help of the BIS, provided life-saving assistance to Hungary. At the same time, the National Bank of Hungary and the Hungarian Foreign Trade Bank borrowed nearly 3.2 billion Deutsche Mark (DM) from 22 different banks in the Federal Republic of Germany (FRG). To ensure that the loans were properly renewed, a delegation of Hungarian bankers held talks with two dozen banks in West Germany in the second half of October 1983, ranging from the Bayerische Vereinsbank to the Hamburgische Sparkasse and the Dresdener Bank. A particular result was that the smaller banks again showed a willingness to lend but were essentially

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<sup>36</sup> A. Mong, *Kádár hitele*, pp. 207–211.

<sup>37</sup> T. Huszár, “Kádár János az 1980-as években,” *Múltunk* 1 (2003), pp. 24–27.

<sup>38</sup> A. Mong, *Kádár hitele*, pp. 223–224.

thinking in terms of short-term (within 12 months) commercial loans. Several banks also indicated that they had reached their lending limit by including loans from Hungarian companies in their claims in Hungary.<sup>39</sup>

## Cooperation with the World Bank – the ‘Matrix’

In the context of the credit crisis, the World Bank’s activities in Hungary received much less attention, although it also committed a significant amount of money (more than one and half billion US\$), with much stronger conditionality. The Hungarian portfolio had a high share of industrial programs, as industry was also at the forefront of development policy at the time. The one-tier banking system left the NBH not only with the task of liaising but also of on-lending. The National Planning Office played a key role in defining and coordinating development objectives. The NBH then made credit available to project implementers through its sectoral departments. The World Bank projects were used for rationalizing energy production and infrastructure development (transport and telecommunications).<sup>40</sup>

It is noteworthy, that there was a collusion between certain reformer groups and the World Bank. One of Pulai’s former colleagues, András Horvai (who was a staff member of the NBH and then of the World Bank from 1993), pointed out that the World Bank’s Governor in Hungary:

[...] recognized from the very beginning that the World Bank could help the Hungarian economy to revitalize and restructure not only through its lending and technical expertise, but also through the international experience and professional qualifications of its staff, which could provide important technical support for domestic reforms. It has also recognised how the World Bank can be used to help in the political backroom battles at home.<sup>41</sup>

This interplay was much needed since relations with the IMF became increasingly strained in 1984. János Kádár and the Politburo wanted to show a new perspective instead of austerity. They did not want to let go of state

<sup>39</sup> MNL OL, XIX-A-2-af, box 198. Feljegyzés a Bundesbankkal fennálló kapcsolatainkról [A note on our relations with the Bundesbank], 7 October 1983. Di.203/1/hf/ca; Ütijeletés: 1983. október 15–29-ig az NSZK-ban tett üzleti banklátogatásokról [Travel report on business visits in banks in the FRG between 15 and 29 October 1983], n.d.

<sup>40</sup> K. Antalóczy, É. Kinczer, “Magyarország és a Világbank kapcsolatai,” *Európa Fórum* 4 (1995), pp. 52–59.

<sup>41</sup> Memories of András Horvai, in *Pulai Miklós – A reformer, az érdekképviselő, az ember*, ed. T. Halm, Budapest: Magyar Közgazdasági Társaság, 2021, p. 144.

control of economy, they did not want to embark on tough reforms, while the NBH made it clear that no more than US\$ 1.0–1.2 billion a year could be borrowed, public spending and unproductive investment would have to be reduced, and subsidies cut. In the run-up to the 1985 party congress, Kádár again spoke of the “unbroken continuation of socialist construction” at the November 1984 meeting of the MSZMP Central Committee (CC). The IMF followed developments in Budapest with growing concern, and by the end of the year it was clear that there was little chance of an agreement being reached.<sup>42</sup> The ambivalence of Hungarian intentions, the lack of a clear intention to move forward, was expressed by Helen B. Junz (IMF Senior Advisor in the European Department) in a letter to József Marjai in September 1984:

We fully support the intent of the proposed reform measures and agree with the judgment that a more efficient and rational use of resources cannot be achieved without further reform of the economic management system. [...] However, in discussing the shape and content of the actual measures, we have found that almost each major step toward liberalization of the economic management system is being accompanied by measures that reintroduce a significant degree of control or distort the basis on which the rational decisions can be made. The need for reform stems from the realization that both material and human resources are being used wastefully, and that overregulation of the system has contributed to this waste. Accordingly, the intent is to allow economic agents a greater degree of freedom in the allocation of resources.<sup>43</sup>

Junz rightly pointed out in her letter a key issue for change – giving economic actors more freedom to allocate and to operate. Now, this was precisely what frightened János Kádár and his inner circle; it would have meant giving up an important segment of their power, and it was no coincidence that they did not want to go too far.

However, despite warnings from IMF experts and domestic reformers about the need for further decisive reforms, in March 1985 the 13th Congress of the MSZMP enthusiastically voted for Kádár’s acceleration program, aiming at increasing the performance of the national economy, creating and

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<sup>42</sup> A. Mong, *Kádár hitele*, pp. 238–247.

<sup>43</sup> MNL OL, XIX-A-2-af, box 179, Helen B. Junz to Mr. J. Marjai, Deputy Chairman of the Council of Ministers: Assessment of discussions on economic reform program for 1985 and beyond, 9 September 1984. The letter is written in English.

consolidating economic equilibrium, and gradually improving living standards and living conditions.<sup>44</sup>

However, at the end of December, Deputy Prime Minister Marjai had to call a crisis meeting because the current account balance at the end of November showed a deficit of US\$ 802 million, against a planned surplus of US\$ 300 million. Mátyás Timár and János Fekete, the top executives of the National Bank of Hungary present at the meeting, considered the 1 billion balance sheet deterioration unacceptable to international financial institutions. Marjai, as Chairman of the Economic Committee, finally decided that a deficit of “slightly below US\$ 500 million” should be presented to the IMF. He also drew particular attention to the problem that, contrary to earlier intentions, “the gap between actual and published data is still widening in 1985.”<sup>45</sup> The financial markets and the IMF watched the events in Hungary with bated breath, but the warnings, which were made in numerous forms, including several personal conversations, were not heeded.

Perhaps the only success story of 1985 was the formulation of the so-called ‘Matrix’ with the World Bank experts.<sup>46</sup> In the summer of 1984, Marjai held talks with World Bank representatives on the development of a new type of credit line, which was started by experts from both sides. However, the Deputy Prime Minister only learned of the first results from a protocol signed by the Ministry of Industry and the World Bank in May 1985. Later, the World Bank’s Deputy President sent a detailed proposal for the further development of the Hungarian economic governance system based on this protocol. The Deputy Prime Minister held a special meeting in October 1985 to ask the heads of the National Bank, the Planning Office and the Ministry of Finance to explain the Matrix. He concentrated on leaving the Hungarian leadership sufficient room for manoeuvre, as he stressed:

It must be expected that there will inevitably be a discrepancy between some of our outwardly declared measures and commitments and the actual practice that can be implemented. [...] If we commit to something, we need to see how we are going to do

<sup>44</sup> L. Borhi, *Dealing with Dictators: The United States, Hungary, and East Central Europe, 1942–1989*, Bloomington, Indianapolis: Indiana University Press, 2016, pp. 370–371.

<sup>45</sup> MNL OL, XIX-A-2-af, box 182, 004461/NGKT/1985, Emlékeztető a Marjai elvtársnál 1985. december 27-én tartott megbeszélésről [Reminder of the meeting with Comrade Marjai on 27 December 1985].

<sup>46</sup> The agenda is thus called because it presented the planned measures in a table format, like a matrix.

it. We must prevent ourselves from facing difficulties down the line if we do not have the foresight to do so on the part of the World Bank.<sup>47</sup>

Marjai demanded that internal negotiating protocols be respected beyond this; he also called for a relaxation of commitments on the three most sensitive issues (import competition, corporate operating rules, and price, wage and tax issues). He focused on how to soften as much as possible the World Bank's vision of the conditions for the expected loan disbursement and how they intended to monitor the fulfilment of the conditions.

Between 22 October and 12 November 1985, a team of World Bank experts met in Budapest, where a consensus was reached at expert level on the cornerstones of the 11-point 'Matrix.' The 'Matrix' was accompanied by an industrial policy letter of intent setting out the conditions for the restructuring program. On 28 November, Marjai considered the two documents acceptable.<sup>48</sup>

It is difficult to underestimate the importance of the 'Matrix,' which, unlike many other initiatives, consistently set out the key objectives and the government actions needed to achieve them, albeit in a rather sketchy form. This economic reform programme covered eleven main themes: enterprise creation, enterprise liquidation, foreign trade, price policy, tax policy, wage differentiation and labor mobility, capital markets, banking system, corporate governance, working capital attraction and technology transfer, and technical development policy. Among the measures envisaged were the creation of a bond market in 1985, the possibility of enterprise liquidation in 1986–1987, the introduction of a personal income tax and a two-tier banking system in 1987.<sup>49</sup>

The 'Matrix' served as a guideline for both parties in the times to come. The plan of measures and economic conditions for the first industrial restructuring program were finally adopted by the Economic Committee

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<sup>47</sup> MNL OL, XIX-A-2-af, box 182, Ma-004/336/85, Emlékeztető a Marjai elvtársnál 1985. október 17-én tartott megbeszélésről: Az ipari szerkezetátalakításhoz kapcsolódó Világbanki hitel közgazdasági feltételeiről folytatandó szakértői tárgyalások irányelvei [Memorandum of the meeting with Comrade Marjai on 15 October 1985: Guidelines for expert negotiations on the economic terms of a World Bank loan for industrial restructuring].

<sup>48</sup> MNL OL, XIX-A-2-af, box 182, Ma-004/336-2/85, Emlékeztető a Marjai elvtársnál 1985. november 28-án tartott megbeszélésről: Az ipari szerkezetátalakításhoz kapcsolódó Világbanki hitel közgazdasági feltételeiről folytatott szakértői tárgyalások [Memorandum of the meeting with Comrade Marjai on 28 November 1985: Expert negotiations on the economic terms of a World Bank loan for industrial restructuring].

<sup>49</sup> MNL OL, XXIX-L-1-bbb, box 2, pp. 136–151, Gazdasági reformprogram 1986–1990 [An economic reform program for 1986–1990], 26 June 1985.

on 15 December 1986. The decision provided for an annual review of the action plan.<sup>50</sup>

## Stop-and-go Approach: Bargaining with the IMF

Meanwhile, the acceleration programme decided at the 1985 party congress had disastrous consequences. In 1986, the convertible current account deficit doubled from the previous year to US\$ 1.49 billion. At the same time, a huge surplus accumulated in terms of roubles – 545 million transferable roubles in 1985 and 304 million in 1986. The NBH repeatedly drew the attention of the government and the party leadership to the fact that Hungarian production enterprises were transforming convertible loans into rouble receivables and meaningless accounts receivable through their exports to the East, thus further worsening the overall situation of the domestic economy.<sup>51</sup> A lesser panic, however, was caused in Budapest by a July 1986 publication of the BIS, entitled *The maturity structure of international bank loans*, which showed US\$ 234 million more short-term borrowed loans in Hungary than the NBH had previously published. The central bank's International Financial Policy Department explained the situation to Deputy Prime Minister Marjai in a 7-page report. According to this, at the end of May 1986 there was a total of US\$ 2.5 billion more Hungarian government debt in internal records than in public books, including one and a half billion in short-term loans. The latter was easier to conceal, but with the ever-closer cooperation between international financial organizations (BIS, IMF, World Bank etc.) and improved data gathering, it was becoming harder to cheat. The International Financial Policy Department saw the only solution as exaggerating Hungarian short-term receivables (outstanding debts, i.e. loans granted by Hungary) – so that the net debt would still appear less.<sup>52</sup>

<sup>50</sup> MNL OL, XIX-A-2-af, box 184, A Gazdasági Bizottság 10194/1986. számú határozata – A Világbanki finanszírozású első ipari szerkezetátalakítási program végrehajtását szolgáló intézkedések. 1986. december 15. [Decision of the Economic Committee No 10194/1986 – Measures for the implementation of the first industrial restructuring program financed by the World Bank. 15 December 1986].

<sup>51</sup> J. Botos and K. Botos, *A Magyar Nemzeti Bank története III*, pp. 486–487.

<sup>52</sup> MNL OL, XIX-A-2-af, box 184, Ma-004/95-6 Jelentés a Nemzetközi Fizetések Bankja (BIS) 1985. végi adósságadatai és a hivatalos Magyar adósságstatisztika összehasonlításáról. 1986. augusztus 1. [Report on the comparison between the Bank for International Settlements (BIS) debt data at the end of 1985 and the official Hungarian debt statistics. 1 August 1986].

The disorganized and almost paralyzing indecisiveness of the Hungarian economic leadership is sadly illustrated by the words of Helen B. Junz, who was welcomed for a short time by Deputy Prime Minister Marjai after the IMF delegation's meeting in Budapest on 21 October 1986. According to a memo from Marjai's staff, Junz told Marjai:

Her recent stay in Hungary has been particularly depressing for her. She experienced confusion in all areas, uncertainty and confusion in thinking [of the Hungarian leaders]. [...] For her, there was a strikingly wide variation in what her Hungarian partners told her. The two extremes: we have time to take stronger steps, there is no reason to hurry; or the situation is catastrophic, hopeless. Their Hungarian counterparts would constantly cite the political risks of their actions. They do not see or do not acknowledge that the political risk of delaying action is already too high.<sup>53</sup>

Her suggestions have always been met with the response that they agree with what needs to be done, but not now, not in the same way, and not as hard. She tried to reassure Marjai that she was trying to put together a report on her trip to Budapest that would not damage Hungary's image with the IMF Executive Board, but she added: "The difficulty is that you can't get too far from reality."<sup>54</sup>

From the early 1980s, Hungarian-West German relations expanded dynamically and as mentioned above, the private banks of the FRG were among the most important lenders to Hungary by the first half of the 1980s. The Social Democratic and later the Christian-Democratic governments also appreciated the Hungarian reform efforts. At the same time, in the spring of 1986, leading bankers (Dresdener Bank, Commerzbank, Deutsche Bank) meeting with the Hungarian Ambassador in Bonn, István Horváth, criticized the over-distribution of resources in Hungary, the weaknesses of economic governance and the tolerance of uneconomic production.<sup>55</sup> In December 1986, Ferenc Havasi, secretary for economic policy of the MSZMP CC, presented the Hungarian reform efforts to Bavarian Prime Minister Franz Josef Strauss and stressed that the focus of economic policy was now on restructuring the economy and

<sup>53</sup> MNL OL, XIX-A-2-af, box 184, Ma-004/95-11, Emlékeztető a Marjai elvtársnál 1986. X. 21-én a Nemzetközi Valutaalap küldöttségével tartott megbeszélésről. [Memorandum of the meeting with the International Monetary Fund delegation at Comrade Marjai on 21 October 1986].

<sup>54</sup> Ibid.

<sup>55</sup> István Horváth: Jelentés Horn Gyulának vezető személyiségekkel folytatott megbeszélésekről [Report to Gyula Horn on meetings with leading figures], 24 April 1986, in I. Horváth and I. Heltai, *A magyar-német játszma. Emlékezés és dokumentumok*, Budapest: Corvina Kiadó, 2015, pp. 143–147.

that, in addition to borrowing, they planned to attract foreign capital. Strauss expressed support for Hungary's efforts. In response to a question, Havasi said that a loan of DM 1 billion (like the one the German Democratic Republic had received) would be a great help to Hungary. Strauss saw no obstacle to the loan.<sup>56</sup> The agreement was indeed reached by October 1987, with Strauss's effective assistance, and Hungary received the DM 1 billion loan it had been seeking from the West German banks.<sup>57</sup>

The German loan also became particularly important because by the summer of 1987 the Japanese loans, which had been abundantly available, had disappeared. The Hungarian government was also compelled to contact the IMF again. In April 1987, the IMF delegation appreciated the government's steps (introduction of the two-tier banking system, 8% devaluation of the forint, planned introduction of personal income tax, etc.), but the Hungarian budget was still spending huge sums to support loss-making enterprises. Mátyás Timár, NHB President, again stressed the importance of political stability – i.e. he would have tried to delay the introduction of these measures without disputing the need for them. János Kádár seemed to accept the inevitability of the changes at the Politburo meeting in June 1987, but there was a lengthy debate about the name of the measures.<sup>58</sup>

The new government, led by Károly Grósz and formed on 25 June, also announced gradual changes, although it admitted that the debt was rising and that the targets set by party Congress had not been met in the previous two years. The IMF representatives, on their visit to Budapest in October 1987, rejected any gradualism and blamed the Hungarian leadership for the gap between intentions and actual implementation. In November, the Hungarian government also received a three-year outline reform program from Washington D.C., and a Hungarian letter of intent to apply for a one-year stand-by loan was prepared by February 1988. The loan agreement, finally signed in May 1988, provided for a loan of SDR 265 million (US\$ 350 million) – on

<sup>56</sup> Miklós Németh: Feljegyzés Strauss bajor miniszterelnök úrral történt megbeszélésről [Minutes of the meeting with Bavarian Prime Minister Strauss], 5 December 1986, in I. Horváth and I. Heltai, *A magyar–német játszma*, pp. 177–178.

<sup>57</sup> A. Schmidt-Schweizer, T. Dömötörfi, "A magyar-nyugatnémet kapcsolatok dinamikus időszaka: a diplomáciai kapcsolatok felvételétől a határnyitáig, 1973–1989," *Külgügyi Szemle* 4 (2014), p. 33.

<sup>58</sup> F. Bartel, "The power of omission. The IMF and the Democratic Transitions in Poland and Hungary," in *New Perspectives on the End of the Cold War: Unexpected Transformations?*, ed. B. Blumenau, J.M. Hanhimäki, and B. Zanchetta, London, New York: Routledge, 2018, pp. 203–206. The NBH preferred yen loans in previous years because their interest rates were significantly lower compared to dollar loans.

rather harsh terms. Loan disbursement had barely started, and Budapest was already trying to soften the program, citing rising inflation. Kádár was finally replaced at the party congress in May, but Grósz, who took over as party secretary-general, had little space for maneuver. The IMF was sympathetic to the accelerating changes but was careful to maintain a balance; it knew that if it acted too harshly, it could stall the whole process of transformation in Eastern Europe.<sup>59</sup>

In a delicate domestic and foreign policy situation, the Hungarian government had to do everything in its power to maintain solvency. The Strauss loan of October 1987 had a positive effect on the mood of West German private lenders, and thanks to this, refinancing was secured; during 1988, DM 600 million of Hungarian bonds were subscribed in the FRG (with a maturity of 6-7 years), and a further DM 400 million of syndicated and other loans were secured – with an average maturity of 5 years. Frigyes Hárshgyi, NBH representative in Frankfurt am Main, however, in a letter to the Hungarian Ambassador in Bonn in October 1988, recalled that the perception of the changes in Hungary remained positive, but the credibility of the economic policy was fragile. As Hárshgyi stated, “the economic changes announced can only have a positive effect on our creditworthiness if they actually take place.” With Hungarian debt notoriously reaching US\$ 16.5 billion, any policy statement had to reflect a determination to maintain Hungary’s financial solvency at all costs.<sup>60</sup>

Miklós Németh, who took over as head of government in November 1988, introduced strong market economy measures, but inflation exceeding 15%, a balance of payments deficit reaching approximately US\$ 800 million, the deteriorating situation of enterprises and the huge budget deficit, posed extraordinary challenges. The conditions of the stand-by loan were so far from being fulfilled that the IMF Executive Board postponed the disbursement of the last tranche of the loan of US\$ 60–70 million in May 1989.<sup>61</sup>

Hungarian diplomats worked actively to secure US support for domestic financial consolidation and reforms. Compared to this, during his visit to Budapest in March 1989, the chairman of the US House of Representatives

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<sup>59</sup> A. Mong, *Kádár hitele*, pp. 270–272, 279–283.

<sup>60</sup> MNL OL, P 2379 Former Ambassador István Horváth to Bonn private papers, box 2, t. 9, Hárshgyi Frigyes, az MNB Frankfurt am Main-i képviselőjének levele Horváth István nagykövetnek: Az NSZK-ban 1988 folyamán felvett hiteleink és adósi megítélésünk [Letter of Frigyes Hárshgyi, NBH representative in Frankfurt am Main to István Horváth ambassador: Our borrowings in the FRG during 1988 and our debt rating], 5 October 1988.

<sup>61</sup> A. Mong, *Kádár hitele*, pp. 284–286.

Budget Committee expressed concern about Hungary's foreign trade surplus. It soon became clear that Washington was treating Hungary (and Poland) separately from other socialist states but did not wish to provide any serious financial support.<sup>62</sup>

The Bush administration was seemingly surprised by the dynamics of change in Central and Eastern Europe, forcing the White House to take action in April and May 1989. In a speech delivered in Hamtramck (Michigan), on April 17, George Bush promised to review his policy toward the region and assured that the West would not abandon Eastern Europe. In subsequent presidential speeches, he promised some debt rescheduling, investment guarantees, and support for the IMF and the World Bank.<sup>63</sup>

During his visit to Budapest on 11–13 July 1989, Bush addressed economic issues in a speech at the Karl Marx University of Economics. Among other things, he said:

First [...] I will propose at the [G7] Paris economic summit concerted Western action for Poland and Hungary, to back your reforms with economic and technical assistance from the summit partners. Of course, our efforts for Hungary will be targeted to your needs. And second, I will ask the United States Congress to authorize a \$25 million fund as a source of new capital to invigorate the Hungarian private sector.<sup>64</sup>

But the G7 summit in Paris on July 15 didn't achieve any real results for Hungary. The joint declaration on East-West relations pushed for Poland and the IMF to quickly conclude their talks, and Budapest had to be satisfied with the G7 states coordinating their support for reforms.<sup>65</sup>

Amid the uncertainties of the transformation, the help of the Federal Government of the FRG was of paramount importance when it supplemented the 1987 credit line with another DM 500 million in June 1989. In addition, the

<sup>62</sup> L. Borhi, *Dealing with Dictators*, p. 394.

<sup>63</sup> T.S. Blanton, "U.S. Policy and the Revolutions of 1989," in *Masterpieces of History: The Peaceful End of the Cold War in Europe, 1989*, ed. S. Savranskaya, T.S. Blanton, and V.M. Zubok, Budapest: Central European University Press, 2010, p. 72.

<sup>64</sup> Remarks to Students and Faculty at Karl Marx University in Budapest, 12 July 1989; <https://www.presidency.ucsb.edu/documents/remarks-students-and-faculty-karl-marx-university-budapest>. For a detailed analysis of George Bush's visit to Budapest in the summer of 1989, see: J.E. Kávássy, *Nyugati szélben: Adalékok a magyar-amerikai kapcsolatok 1989-es történetéhez; gondolatok a kelet-európai és a magyar rendszerváltáshoz*, Lakitelek: Antológia Kiadó, 2015, pp. 9–68.

<sup>65</sup> Declaration on East-West Relations, Paris, 15 July 1989. <https://g7.utoronto.ca/summit/1989paris/east.html>.

Land of Bavaria and the Land of Baden-Württemberg indicated their willingness to guarantee a further DM 500 million loan. In a letter to US President George Bush, Chancellor Helmut Kohl justified the move by saying, “We hope that the additional financial assistance to Hungary at this critical time will contribute to a consistent pursuit of political reforms and economic opening towards the West.” Moreover, in October 1989, a month after the release of the East German refugees who had been crowded into Hungary, Kohl wrote to Németh to inform him that Hungary could count on a total of DM 1 billion in loans from West Germany, including federal and state loans.<sup>66</sup>

The emerging opposition parties had fairly limited information about the country’s actual level of debt, even though everyone was aware of the seriousness of the situation. Nevertheless, suspending debt repayments was not considered a viable alternative.<sup>67</sup> According to the September 1989 theses of the Hungarian Democratic Forum’s economic program, the center-right party wanted not only to deal with the internal and external financial crisis, but also to launch a modernization program. The draft program emphasized that Hungary was at least as dependent on Western banks and the International Monetary Fund as it was on Eastern European markets and the Soviet Union.<sup>68</sup>

It shocked both new political movements and public opinion when the true extent of Hungary’s debt finally came to light. According to Németh’s memoirs, the difference of about US\$ 3 billion (between the declared and the actual debt) in 1981 had been reduced only US\$ 300 million by 1989. By November, the head of government considered the time had come to make public the earlier manipulations. To do this, he first wanted to inform key partners in confidence. Németh first shared the details with the President of the European Commission, Jacques Delors, and the French Foreign Minister, Roland Dumas, who held the rotating presidency of the European Communities, during their visit to Budapest on 17 November. Delors undertook to inform the IMF management and Dumas the French government. British

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<sup>66</sup> A. Schmidt-Schweizer, T. Dömötörfi, “A magyar-nyugatnémet kapcsolatok dinamikus időszaka,” pp. 37–38.

<sup>67</sup> See Document 52. Draft economic and social policy program of the Hungarian Democratic Forum. 8 January 1989 in *Dokumentumok a Magyar Demokrata Fórum korai történetéből, 1987–1989. Válogatás a lakiteleki Rendszerváltó Archívumból*, ed. A.L. Riba and N. Szekér, Lakitelek: Antológia Kiadó, 2017, p. 163.

<sup>68</sup> Document 104. Theses of the economic program of the Hungarian Democratic Forum. 15 September 1989 in *Dokumentumok a Magyar Demokrata Fórum korai történetéből*, p. 321.

Prime Minister Margaret Thatcher and West German Chancellor Helmut Kohl were personally informed by Németh.<sup>69</sup>

According to Boughton, in October 1989, Gerard Bélanger (Division Chief in the European Department), who arrived in Budapest for a routine consultation, was invited to lunch by Ferenc Bartha, the president of the central bank, and told that the Hungarian government and the NBH had “systematically and deliberately” provided false data since accession. Bartha then telephoned Michel Camdessus, Managing Director of the IMF, to inform him of the fraud. He also asked the IMF’s team of experts to contribute to the revision of the data and to start preparing a new stand-by arrangement. Boughton stressed that, “If the data had been reported correctly at the time, Hungary would not have been eligible to make several of the drawings that it had made under each of the stand-by arrangements of the 1980s.” Moreover, Hungary had to repay the misused loans before a new agreement could be prepared.<sup>70</sup>

The Prime Minister made the public announcement in Parliament on 21 November. In his dramatic speech, revealing the crisis openly, he said the following about the debt:

[...] the Government is now in a position to finally give Parliament, our public, and our foreign partners a credible picture of the country’s financial situation. After a thorough review, methodological clarifications and a full accounting of all additional financial operations, carried out with the sincere intention of revealing the truth, the total gross debt will reach or slightly exceed US\$ 20 billion by the end of this year.<sup>71</sup>

The IMF moved on from the incident relatively quickly, because the situation in Hungary had indeed become critical. Despite Foreign Minister Gyula Horn’s attempts to convince Donald Kursch, the deputy chief of mission at the US Embassy in Budapest, of Hungary’s difficulties during their meeting

<sup>69</sup> A. Oplátka, *Németh Miklós – “Mert ez az ország érdeke,”* Budapest: Helikon, 2014, pp. 122, 285–287.

<sup>70</sup> J.M. Boughton, *Silent Revolution*, pp. 985–986. Boughton stressed: “Hungary was not the first member to be out of compliance with that decision, but this case was by far the most extensive and widespread, and it was the first in which the Board declined to grant a waiver for the required early repayment of affected credits; *ibid.* p. 986.

<sup>71</sup> Az Országgyűlés 65. ülése. 1989. november 21-én [The 65th session of Parliament on 21 November 1989] in *Az 1985. évi június hó 28-ára összehívott Országgyűlés naplója. Hiteles kiadás. V. kötet. 65–83. ülés. (1989.XI.21.–1990.III.14.)*, Budapest, 1998, p. 5386.

on 8 December, Washington recommended full acceptance of the IMF's conditions.<sup>72</sup>

In December 1989, an exceptionally austere budget was submitted to Parliament, perhaps helped by the fact that Chancellor Kohl praised the Hungarian transformation and wished it courage to continue, at a session of Parliament on 18 December. Hungary was finally saved from default by a new IMF stand-by loan, signed on the eve of free elections.<sup>73</sup>

On the government's instructions, an ad hoc committee led by Rezső Nyers and Miklós Pulai was set up in the spring of 1988 to work out the details of the transition to a market economy. The body, renamed the Economic Reform Committee in 1989, directed the work of 11 sub-committees, in which 100–150 banking experts, and those from ministries, academia and universities worked on the preparation of legislation, plans and programs. On 10 December 1989, the Economic Reform Committee submitted its 150-page report and proposal for reform of the economic system, entitled *Economic Policy Turnaround – Market Economy*. The summary by Nyers and Pulai criticized the Németh government's concepts and actions in relation to the opening of world markets, property reform and the management of the economic situation. It is therefore perhaps no coincidence that the Prime Minister did not propose to submit the document for substantive discussion at the Council of Ministers' meeting of 4 January 1990. The main difference in approach between the committee and the government was that the latter considered it possible to continue economic liberalization even in a crisis situation.<sup>74</sup> So, at the dawn of the regime change, there was no agreement between the former key personalities of the reforms and the government on the details of the transition – its timing, and the role of the international financial institutions. Understandably, after the free elections in spring 1990, these debates intensified and positions have continued to polarise to this day.

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<sup>72</sup> L. Borhi, *Dealing with Dictators*, pp. 410, 522.

<sup>73</sup> A. Mong, *Kádár hitele*, pp. 287–290.

<sup>74</sup> MNL OL, XIX-A-83-a, Proposals and decisions of the Council of Ministers, 967-6/a-1990, Gazdasági Reformbizottság: Jelentés a Minisztertanács részére. Javaslát a gazdasági rendszer reformjára. 1989. december 10. [Economic Reform Committee: Report to the Council of Ministers. Proposal for reform of the economic system. Economic policy turnaround – market economy. 10 December 1989]; 967. jegyzőkönyv a Minisztertanács 1990. évi január hó 4-i üléséről [Minutes of the meeting of the Council of Ministers held on 4 January 1990].

## Conclusions

Hungarian society paid a heavy price for failing to adapt to the new world economic environment; by 1989, the Hungarian economy was characterised by a deteriorating infrastructure, a rampant black market economy, a lack of capital and technological backwardness. Although the MSZMP leadership temporarily spared the population from the shocks of the world market, in the long run it paid for its mistakes with the economic collapse of the system. The debt trap of the 1970s and 1980s also determined the room for maneuver of the governments in the following two decades. According to the 1993 calculations of the National Bank of Hungary, only US\$ 1 billion of surplus resources effectively entered the Hungarian economy in the whole period 1973–1989 – with US\$ 11 billion of cumulative interest expenditure. Looking at the two sub-periods, the picture is even more dramatic; while actual resource inflows between 1973 and 1978 were US\$ 3 billion, resource outflows in the period 1979–1989 were US\$ 2 billion – even taking into account the US\$ 250 million working capital received in 1987–1989.<sup>75</sup>

In agreement with Jochen Lorentzen, the cooperation with international financial institutions in the 1980s can be divided into three phases. There was a partnership under two IMF programs between 1982 and 1985 and between 1988 and 1991. In the first case, the overriding goal was to restore solvency. The second program featured strong recommendations for reform policies. The third period was essentially an intermediate, transitional phase, during which technical consultations with the IMF continued even in the absence of an agreement.<sup>76</sup> As we have seen above, interaction with the World Bank was the most effective and visible in these two years.

Naturally, the IMF's solution for crisis management offered to Hungary was not particularly tailor-made, as the international financial institutions themselves were learning how to deal with the socialist system countries. At the same time, these proposed measures were not radically different from what the country would have had to do without the IMF; reducing the myriads of subsidies, increasing the efficiency of industry and the economy as a whole, cutting energy consumption, balancing the budget, and reducing the foreign trade deficit. As

<sup>75</sup> I.Ny. Baárné, et al, *Külső eladósodás és adósságkezelés Magyarországon*, pp. 56–57.

<sup>76</sup> J. Lorentzen, *Opening up Hungary to the World Market External Constraints and Opportunities*, Basingstoke: Palgrave Macmillan, 1995, pp. 27–34.

we have seen, the attempts of the Hungarian reformers were repeatedly blocked by the resistance of the conservative wing of the MSZMP, but above all by the János Kádár's own unwillingness to change. In this sense, the pressure from the IMF, the World Bank or the West German government sought to continue and deepen the reform, which would have served to further improve the Hungarian economy. It is important to emphasise that the defining reform agenda of the 1980s, the 1986 'Matrix' was indeed jointly compiled by Hungarian reformers and World Bank experts, who made it a handbook for preparing for a market economy. In my view, the relationship between Hungary and the international financial institutions until 1989 was characterized by cooperation based on mutual will, rather than the tortuous implementation of an external dictate.

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