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“When people take out a loan, they get advance for consumption for which they will create the financial cover in the future. When certain societies or the whole global population over-consume ecosystem goods, they get advance for consumption of natural resources for which the cover has not yet been created by the planet.

There is an evident correlation between unsustainability and our credit-based banking system. The credit system provides the financial cover of overconsumption. If we look at irresponsible over-crediting and responsible crediting from a sustainability point of view, the only difference is that the first one penetrates into the future even more than the second. They are the same in the sense that they are both based on overconsumption. They only differ in their extent.

Dr Iván Gyulai

“The salient feature of the current financial crisis is that it was not caused by some external shock like OPEC raising the price of oil or a particular country or financial institution defaulting. The crisis was generated by the financial system itself. This fact that the defect was inherent in the system contradicts the prevailing theory, which holds that financial markets tend toward equilibrium and that deviations from the equilibrium either occur in a random manner or are caused by some sudden external event to which markets have difficulty adjusting. The severity and amplitude of the crisis provides convincing evidence that there is something fundamentally wrong with this prevailing theory and with the approach to market regulation that has gone with it.”

George Soros


Hungary became a member of the International Monetary Fund (IMF) on 6 May 1982. Hungary was the second member of the World Bank Group, and a member of the whole Bretton Woods system from the Council for Mutual Economic Assistance (CMEA) countries after Romania.

In Hungary Over the past few decades –apart from the political and public hype after 2010 – the IMF received public attention only when Hungary was the recipient of loans from the institution. Otherwise the Hungarian general public paid only fairly minimal attention to the IMF and few studies dealt with it.

It is worth noting that Hungary planned to join the IMF as early as 1967. At that time, the Political Committee – the main decision-making body of the Communist Party and therefore of the country – gave their permission to start informal negotiations with the IMF. In the words of György Fekete, then Vice-President responsible for International Affairs of the Central Bank of Hungary: “In October 1967 as a leader of a small group, confidential negotiations were held with the competent leaders of IMF, and in fact, everything was ready for the country to join (the IMF). It was planned to ask for a standby loan from the IMF and for investment loans from the World Bank. The government backed out at the last moment – as I found out later – because of Soviet intervention.”

Fifteen years later, when Hungary joined the IMF and the World Bank Group, it immediately received several loans. Interestingly, the circumstances were similar to the loan Hungary went on to receive in 2008. During the economic crisis at the beginning of the 1980s, Hungary faced serious short-term (convertible) foreign exchange shortages. This is in spite of the fact that, at the beginning of 1982, it was revealed that the Hungarian account deficit was slightly positive in 1981, for the first time in many years.

In the autumn of 1981, the Central Bank of Hungary revealed that it needed to borrow $600 million as a short-term bridging loan, but this was impossible due to the global financial problems at that time. The only way to secure this loan was from the Bank for International Settlements (BIS). The BIS lent $600 million after an informal guarantee from the IMF Managing Director Jacques de Larosière that Hungary would soon join the IMF and possibly receive a standby loan from them. This $600 million was a syndicated loan by national banks, which received international attention because of its amount and the uniqueness of the arrangement.

In fact, seven months after Hungary joined the IMF, the country received a $475 million special drawing rights (SDR) stand-by loan, which was 125 per cent of the country’s IMF quota at that time. Hungary used it to pay back the BIS loan. One week later, Hungary signed another loan agreement, this time with a $72 million SDR liquidity line arrangement, which was used immediately for current expenditures and debt payback.

2.1 Debt crisis

During the years before the 2008 crisis, external funding was the catalyst for the Central and Eastern

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3 György Csáky (2013), IMF and the Hungarian regime change, XII. Century
European (CEE) economies. Growth was due mainly to foreign financial flows/loans. Hungary was a forerunner in this process, setting a record in the debt rate, with the ‘little’ problem, namely that Hungary achieved the lowest overall economic growth in that period in the region.\(^6\)

Hungary also held three records regarding its economic indicators in the new EU Member States, which may explain why the crisis was so serious:

- Hungary had (and still has) the largest external debt as a percentage of Gross Domestic Product (GDP) among the CEE countries.
- Hungary’s aggregate economic growth was at its lowest in the years before the crisis (2002–2008), therefore the large indebtedness was not linked to growth.
- Hungary had the lowest appreciation of its currency against the Euro (real, adjusted with inflation) in the period 2004–2011. Therefore the real appreciation has not reduced the burdens associated with the external indebtedness.

In addition to these three economic factors, Hungary was a leader in another area – the indebtedness of the state, commercial banks, households and municipalities.

However, alongside the public debt, private debt was even more significant, as Figure 3 shows.


\(^5\) The currency value of the SDR is determined by summing the values in U.S. dollars, based on market exchange rates, of a basket of major currencies (the U.S. dollar, Euro, Japanese yen, and pound sterling). The SDR currency value is calculated daily (except on IMF holidays or whenever the IMF is closed for business) and the valuation basket is reviewed and adjusted every five years.

Until 2002, the vast majority of financial flows were working capital coming to Hungary. Until then, funds were invested in buying shares or greenfield investments. This was radically changed after 2003 and debt type sources became dominant. The inflow of foreign direct investment (FDI) was subdued. The country’s net external debt increased significantly by 2008, and was close to the total of FDI investments. In contrast, the external debt ratio was much lower in other CEE countries. In Poland, before the crisis, it reached nearly 15 per cent of GDP, while in Slovakia it was around 0 per cent, and in the Czech Republic debt claims were higher than obligations.

Another important aspect of the years before the crisis is the balance of payments. According to Eurostat, during the period 2004–2008 the balance of payments for Hungary was €35 billion in deficit. The majority of this amount was transferred to the old EU Member States. During this period, Hungary received €5 billion from EU Structural and Cohesion Funds.

Meanwhile the high Central Bank base rate also forced borrowers to take out foreign loans. Although the primary responsibility of the Central Bank of Hungary is to curb inflation through the base rate, according to Hungarian legislation, it has to take financial stability

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7 See Eurostat – Statistics Explained:
into account. Therefore, due to the growing debt financing needs, the Bank kept the base rate high enough for a long time to attract foreign investors’ confidence and funds. Instead of the more expensive Hungarian Forint (HUF) financing, companies and the general public were increasingly indebted in foreign currency.

This process made Hungary extremely vulnerable. It was only a matter of weeks before the country followed the bankruptcy of Iceland. This was also the general opinion of the foreign investors at the end of 2008.

2.2 Public behaviour before the crisis

Although real wages increased by 144 per cent between 1998 and 2008, households spent one-third more than they could afford. In fact, consumption did not decrease drastically after the 2006 restrictions imposed by the Gyurcsány government, while household revenues fell. On the one hand, this was partly due to the extent of the black and grey economy; on the other hand, the households covered the part of the expenditure from loans. Before the crisis, more than 50 per cent of the population was not able to save money, while 16 per cent had already spent their savings.

Household debt tripled between 2004 and 2008: at the end of 2008 the amount of loans was 30 per cent bigger than deposits in the banks. Hungarian households were deeper in debt compared to the rest of the world and compared to neighbouring CEE countries. However, these funds/loans did not turn into any meaningful economic growth.

Although a large proportion of the household loans were for house purchase and construction, according to a Central Statistical Office survey, family spending on TVs, phones, computers etc. increased by 128 per cent between 2000 and 2007. The size of general purpose loans increased by HUF 388 billion to HUF 2041 billion\(^8\) between 2005 and 2008, of which HUF 2006 billion was denominated in foreign currency, according to data of the Central Bank of Hungary.

While we could blame households for their irresponsible behaviour regarding over-consumption, we have to highlight the fact that the GDP growth since 1989 was always higher than the growth of wages in Hungary. The benefits of economic development has not been distributed evenly across society.

2.3 The bank sector before the crisis

As previously mentioned, households in Hungary were greatly indebted before the crisis, which was also the responsibility of the banks. It was not just the households...
but also the whole private sector loan portfolio that doubled from 2004–2008.9

“In early 2008, I remember we went to Vienna for training. There, the regional leader of the bank said that we had plenty of money, we just had to place it somewhere. And if we did not have enough funds at the parent bank, we could take from the interbank market. Lending money in Hungary was not a problem,” said one banker from an Austrian based bank to hvg.hu about the lending before the crisis.

The growing amount of borrowed money came from the foreign parent banks, but this was no longer just the Austrian, German and Italian people’s investments. It also included other loans taken from interbank markets. Therefore, short-term loans were converted into 20–30 year loans. At the beginning of the crisis it caused a particular problem because there was not enough money for such long-term loans or the loans that were available were very expensive.

The profitability of the Hungarian banking system was outstanding, not only in the region, but throughout Europe from 1998–2008. Hungarian banking sector profitability exceeded 50 per cent, or, in many cases, 100 per cent of the parent bank’s country performance. Officially, 30–40 per cent of the profits were remitted home and the rest was put out as new loans.

The Hungarian and Western European banking systems are not just different in terms of profitability, the composition of the profit is also different. In the Western European banking system, the main sources of income are not related to the income from interest. In contrast, the main source of income of the Hungarian banking system is linked to high interest margins and high interest income from it. Therefore, the effectiveness and impact of the financial operations of the banking system is lower, while the riskiness of the portfolio and the credit losses are higher than in the Eurozone banking groups.10

This clearly highlights the increased funding risks. While the private sector loan portfolio doubled (households’ loan portfolio tripled) bank deposits increased by only 50 per cent between 2004 and 2008.

As a result, the foreign-owned banks’ loan/deposit ratio exceeded 100 per cent in 2000. Lending grew sharply, peaking at 180 per cent by the end of 2008. From 2004 onwards, the local banks also had to increase their foreign funding. At that time, their loan/deposit ratio also went over 100 per cent and further increased to 130 per cent by the end of 2008.

Finally, not only the financial risk but also the risk linked to asset liquidity increased. Due to high loan activity, the portfolio of liquid assets declined steadily. This was particularly striking in the case of local banks, where the ratio of liquid assets to total assets decreased from nearly 50 per cent to 5 per cent between 2001 and 2007.

A 2004 IMF report warned the Hungarian government about high risks linked to household loans deposited in foreign currency. However, the government did not take any steps towards placing restrictions on foreign currency loans – as happened in other CEE countries – because of fierce political competition.

2.4 The end of virtual abundance

At the beginning of the financial crisis, Hungary had fallen nearly €3 billion into debt, which was due to mature within one year. However, this was not a very significant amount compared to the much larger debts amassed by the banks operating in the country: their debt amounted to €30 billion, which seemed impossible to resolve through financ-

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10 See BANAI ÁDÁM–KIRÁLY JÚLIA–NAGY MÁRTON, Az aranykor vége Magyarországon, 2010
ing and renewal after the freezing of the interbank market in the short term.

The IMF Consultation Discussions Concluding Statement welcomed steps by the government for fiscal adjustment, but it also warned about borrowing in foreign currency by the private sector:

“Although external financing needs declined, the composition of financing remained largely debt-creating and net external liabilities amounted to about 100 percent of GDP. Despite the economic slowdown, private sector credit growth remained robust, raising debt burdens. With most new borrowing in foreign currency, the private sector’s net foreign currency liabilities increased. Fiscal adjustment in 2007 was substantial, but the budget deficit and government debt were still high. The general government deficit narrowed from 9½ percent of GDP in 2006 to 5½ percent of GDP in 2007, reflecting a broadly balanced mix of higher revenue – partly due to improved tax administration – and lower expenditure. However, even with the sharp decline in the fiscal deficit, government debt only stabilized at 66 percent of GDP. With substantial amortization due in 2008–09, gross financing needs are high. Indicative expenditure ceilings were introduced with the 2008 budget.”

However, after the collapse of the Icelandic banking system, the speculative capital focused on Hungary. The fear was that global panic and speculation by foreign investors would result in the withdrawal of foreign exchange and the selling of government bonds, which in turn would have resulted in the collapse of the Hungarian Forint.

2.5 Questioning the need for the financial package

As already mentioned above, some economists questioned the aim and need for the whole financial package. A wide variety of opinion exists regarding the usefulness of the package. While most of the data makes us think that the IMF loan was necessary and it was the only way to save the country from bankruptcy, there are also other interpretations, which are outlined below.

No need at all

Economist and university professor László Bogár blamed the debt trap, as rising interest rates increase the amount of debt, while society had actually reduced consumption. While the creditor anticipates future consumption for the borrower as a future income, the country cannot repay its debt because of the decreasing income. It is tragi-comical that Hungary had the same experience with the IMF in 1982 and in 2008, when loans were received based on the strategic assumption that the IMF loans would protect us from ‘speculative attacks of the markets’, and allow us to decrease the debt level, or at least decrease the debt ratio. None of this happened.

The IMF’s efforts do not insulate against the predatory nature of speculative markets, but, in fact, complement the markets. To avoid the hysteria of the speculative markets, countries ask for the protective wings of the international financial institutions, but ultimately they find themselves in almost the same situation. The only difference is that the markets kill quickly and brutally, while the IMF requirements – which you accept freely for the relatively lower interest – kill slowly, at the same time as destroying the original integral socio-economic system of the country.12

Economist István Varga lists three reasons why taking the IMF loan for Hungary was not necessary in 2008:

The Hungarian government was not dangerously indebted: Before the crisis, the government’s net foreign debt – taking into account the reserves of the Central Bank of Hungary – was €16.48 billion and it was decreasing, while the banks had a debt of €35.2 billion. During the year it increased by €5 billion, up to €40.5 billion. Thus, the majority of the net

foreign debt was private, only one-quarter belonged to the state. Around 80–90 per cent of this debt was owed to large foreign-owned banks and companies, and the majority of this was capital movement within banking groups, including financial flows for moving their large profits tax-free.

The second false presumption was that Hungary was expelled from the financial market: The sale of government bonds happens through previously annually announced auctions, but only for 11 selected customers. They are the biggest bond dealers, banks and funds. They are the ‘financial market’ itself, including Deutsche Bank, Citibank, CIB, Erste and other well-known commercial banks. If the 11 selected banks do not buy government bonds in a coordinated manner it is a cartel, and scandal, and the very opposite of the definition of an open market.

Hungary has a very high level of public debt, which makes it vulnerable, and has to be reduced as soon as possible: We see in the IMF documents that the level of debt was not excessive and it showed a declining trend. In the EU, as a comparison, the Hungarian government debt was in the middle of the field and improving. We see that the banking system itself dampens lending, thus reducing GDP, and therefore increasing the debt ratio proportionately.

Aid for the banking sector not for the country

Analysts expected that the IMF loan would be linked to a structural stabilisation package. However, this did not happen. Former Socialist Finance Minister László Békesi, writing about this in a newspaper article, claimed that it was historically unprecedented and inexplicable that the IMF had not imposed strict conditions:

“The current conditions do not affect the large distribution mechanisms, while the redistribution rate will not be less. They do not affect the administration, the municipal system or re-organisation of the social benefits. They not force Hungary to join the euro area etc.”

According to Békesi, the reason behind this is most likely that the primary beneficiary of the loan was not Hungary, but the foreign parent companies and parent banks, which had major interests and were in big need of capital.

As mentioned above, much of the country’s short-term foreign debt of €26 billion was in the form of borrowings from parent companies and banks. These were easily accessible during normal circumstances, but not during the crisis. As Magdolna Csath, an economist and a university professor, wrote: “It is also clear that the main purpose of the financial package was to ensure continuous funding of the banking world at any cost – even at

Figure 4: General government gross debt in EU – 2007, % of GDP

Source: Eurostat

See http://magyarnarancs.hu/belpol/az_imf-hitel_tortenete_es_kovetkezmenyei__nehez_napok_ejszakai-70117
the cost of the economic recession, and downgrading the people's living standards.”

From a different point of view, the IMF also admitted this in its Staff Report when it explained the purpose of the loan: “In addition, banks from different euro-zone countries are active and prominent in Hungary. If unaddressed, any crisis in Hungary could have significant negative spill-over effects back to the home markets of these banks.”

The main purpose of the IMF loan is clear from the kind of proposed structural conditionality the bank gave to Hungary. Two out of three conditions were concerned with the banking sector:

- Submission to parliament of draft support package for domestic banks and request initiation of extraordinary procedure for early passage (by 10 November 2008)
- Passage of the draft fiscal responsibility law (by end of December 2008)
- Submission to parliament of a law granting the Hungarian Financial Supervision Authority special structural benchmarks remedial powers to accelerate the resolution of any failed bank (by end of December 2008).

3.1 Borrowing €20 billion: easy business

On 9 October 2008, the Forint and the OTP Bank shares suffered a big drop in value over a couple of hours. Some believed that speculators encouraged the collapse of the Hungarian Forint. The Central Bank of Hungary and the government wanted to show strength immediately. The Central Bank had €17.4 billion in reserves, but feared it was not enough.

According to official sources, on the same day, the government contacted the IMF and the European Central Bank (ECB). In the next few weeks there was a parallel communication: one negotiation started with the international financial institutions discussing fiscal adjustment, and the other was the communication with the Hungarian public that there would not be any more fiscal adjustment in the future.

Meanwhile, IMF experts received the requested information from the Ministry of Finance and the Central Bank, and they developed their macro path forecast.

Negotiations continued with the IMF from 23–26 October. András Simor – Governor of the Central Bank of Hungary, Ferenc Gyurcsány – Prime Minister, János Veres – Minister of Finance and Gordon Bajnai – Minister of Development rewrote the budget according to the new macro path and saved new reserves. The results – the withdrawal of the 13th month pension and freezing of public sector wages – were presented to the public after 28 October by the Prime Minister.

According to information from state officials, the European Commission played a major role in the negotiation process, making it a matter of prestige, so the EC could portray itself as an active player in resolving the crisis. Meanwhile the Commission also pushed for strong fiscal cutting, while the IMF played the “good cop”.

3. The process of IMF involvement in the crisis in Hungary

According to the French newspaper *Le Monde*[^14], Dominique Strauss-Kahn, the then IMF chief, asked that only the real necessary requirements would be included in the negotiations. Thus, the social security system and unemployment benefits were not mentioned explicitly in the agreement documents. The IMF had accepted the need to preserve the social safety net as well. IMF ‘only’ called for a reduction in public sector spending, which they claimed to be too significant with its 50 per cent share of GDP. For the reduction of the state debt, the IMF asked to freeze public sector salaries and withdraw the 13th month pension benefits. This change could be described as significant in the policy of IMF, which had previously imposed stricter conditions. As a comparison, in the case of Iceland, the IMF imposed three conditions; six conditions were imposed on Hungary, and 100 on Indonesia.

3.2 Negotiations without any meaningful participation

There was clearly double communication from the government – one line of communication with the IMF and the other with the national stakeholders. Days before the agreement with the IMF, the government published and negotiated the second version of the budget (which still calculated economic growth for 2009) with the National Interest Reconciliation Council and the trade unions. On this basis, the unions noted with relief that there would be no freeze of wages in the next year. In addition, the Finance Minister also promised not to withdraw the 13th month pension. Ultimately, however, both statements proved to be false.

On 17 November, the Hungarian Parliament adopted the new revised 2009 budget, which planned to keep public spending in 2009 at the 2008 level. However, before this decision was made by the Parliament, the government had already struck the deal with the IMF and had already received the first tranche of money.

What was offered to the IMF by the Ministry of Finance and the Central Bank of Hungary – without any consultation with the social partners, or even with the national Parliament – according to the Letter of Intent sent on 4 November 2008 included the following:

To reduce the government’s financing needs and improve long-term fiscal sustainability:

- Fiscal consolidation: as a result, the general government deficit is projected to fall to 3.4 per cent of GDP in 2008. This will be achieved mainly by not using contingency reserves.
- The 2009 budget will be amended to reflect the deterioration in the economic outlook and to further reduce the government’s borrowing requirement.
- The tax cuts previously envisaged for 2009 will be cancelled and we will not make any changes in the tax code that could lead to lower net revenues.

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● The necessary adjustment will focus on the expenditure side: (i) keeping nominal wages in the public sector constant throughout 2009; (ii) eliminating the 13th monthly salary for all public servants; (iii) capping the 13th monthly pension payment for pensioners at EUR 340 and eliminating the 13th monthly pension payment for all early retirees; (iv) postponing the indexation of selected social benefits; and (v) trimming operating expenditure allocations to all ministries across the board.

● Prioritisation of investment projects co-financed by EU funds and programmes.

● Continuation of budget consolidation in the 2010 budget – to be discussed with IMF staff as part of the programme – and beyond.

To maintain adequate capitalisation of the domestic banks and liquidity in domestic financial markets, the following was put forward:

● Insurance coverage of retail deposits to be raised from EUR 25 thousand to EUR 55 thousand (in line with EU agreements) but also pledged to provide a blanket guarantee on all deposits.

● A private debt resolution strategy will be put in place.

● Providing a banking sector package contains provisions for added capital and funds a guarantee fund for interbank lending. Funding will be divided as follows: Total funding of HUF 600 billion will be divided evenly between the Capital Base Enhancement Fund and the Refinancing Guarantee Fund. The package is available to private Hungarian banks of systemic importance.

● The Central Bank of Hungary is determined to gradually bring inflation down to the official target of 3 per cent.

● In response to increased stress in domestic finances, the Central Bank has taken a number of measures to improve liquidity: foreign exchange swap facility; auction facility to purchase government bonds from market makers of these securities; a two-week refinancing window at a fixed price; and six-month tender with no fixed price. The MNB stands ready to further expand its toolkit as needed.

As is clearly visible from the Letter of Intent, the government promised budgetary austerity in every area, but not for the financing of EU projects, for which sources from Hungary would be provided. This suggests that mainly large infrastructure projects could continue to be financed, mainly of interest to foreign companies. In turn, the domestic small- and medium-sized companies could not count on anything. All these promises were made without any consultation with civil society or with the opposition parties and without any meaningful debate in Parliament on 4 November.

In addition, the Letter of Intent analyses the situation of the Hungarian economy and its future prospects. There is not a single word about the responsibility of the government that governed the country for six years during this period. The document suggested that the economy is in trouble primarily due to the external crisis. It implies that the global financial crisis led the domestic financial difficulties, and not because of the irresponsible policy of the government described in the previous chapter.
Furthermore, it is a sign of the good relationship between the Hungarian government and the IMF that, in the Staff Report, the bank also did not refer at all to bad governmental policies. The IMF Staff Report was on the same side as the government. They even acknowledged the efforts of the government, stating that: “Hungary’s successful macroeconomic adjustment has been disrupted by the global financial crisis.” This calls into question the objectivity of the analysis.

4.1 Receiving the loan
The 2008 IMF loan itself is a 17-month, SDR 10.5 billion (€12.5 billion, US$15.7 billion, 1,015% of the IMF quota) Stand-By Arrangement under the exceptional access policy, being considered under the Emergency Financing Mechanism (EFM). Officially the loan was granted under the following circumstances: “Against the backdrop of global deleveraging, the two key objectives are (i) substantial fiscal adjustment to ensure that the government’s financing needs will decline; and (ii) to maintain adequate liquidity and strong levels of capital in the banking system.”

The size of the loan was a shock for the financial analysts who calculated that a loan of around €10 billion was needed. Hungary’s short-term debt was €26 billion, and the Central Bank’s foreign exchange reserves were €17 billion, so they expected a package of the difference between these two figures. In fact, the amount of the loan was double this figure, which could be drawn until March 2010: the EU provided €6.5 billion, the IMF provided €12.5 billion and the World Bank provided €1 billion. The interest rate of the IMF loan was around 2–5 per cent and of the EU loan was 3–4 per cent.

The size of the loan was also a big surprise for the government. Álmos Kovács, Secretary of State of the Ministry of Finance who led the negotiations with the IMF, told us that they expected to have a loan agreement for around €2–3 million or maybe €5 million with the IMF. It was the IMF that offered the exceptionally high amount. It was probably because, while Ministry of Finance focused more on the governmental debt, the IMF took into consideration the vulnerability of the banking sector.

The loan had a significant impact on the IMF Fund’s liquidity. It reduced the one-year forward commitment capacity (FCC) by SDR 10.5 billion, about 8 per cent of the FCC. Hungary became the second largest exposure in the Fund’s lending portfolio, and Hungary’s share of total Fund credit outstanding would be about 27 per cent, second only to Turkey. Meanwhile the IMF acknowledged that the proposed arrangement with Hungary entailed significant financial risks to the Fund, as a range of factors might impair Hungary’s capacity to repay the Fund. This might include the potential for accelerated capital outflows and potential difficulties in securing adequate capital market access, against the backdrop of Hungary’s already high debt burden and the possibility that the pace of recovery from global deleveraging will be gradual.

The agreement enabled the uptake of the loan until March 2010, exactly the end of the mandate of the reigning government. The repayment of the loan has been the duty of the new elected government since 2010.

Programme performance was to be monitored by quarterly reviews by the IMF, according to the following Quantitative Program Targets:

- cumulative change in net international reserves
- non-accumulation of external debt arrears
- 12-month rate of inflation in consumer prices
- ceiling on the total debt stock of the central government system.
4. IMF loan and conditionality at policy level

Parallel to the IMF loan, the World Bank provided €1 billion through the objectives of the Financial Sector and Macro Stability Policy Loan Programme for Hungary. They claim to: (a) support fiscal reforms designed to ensure long-run fiscal and macroeconomic sustainability and restore investor confidence, improving access of the government, banks and the corporate sector to external funding; (b) support the financial stability programme, designed to ensure adequate levels of liquidity and healthy capital cushions, able to absorb the effects of the international crisis and the contraction of economic activity; (c) support to pension reforms designed to preserve adequate benefits while tightening eligibility criteria and containing expenditures to improve the sustainability of the pension system; and (d) encourage cost containment and deficit prevention in the health sector while ensuring access to care.

4.2 Use and re-payment of the loan

Although the loan deal was made very quickly, and Hungary accessed the first €6.9 billion instalment immediately, the use of available funds just started six months later. This caused a HUF 20 billion interest loss, according to the State Audit Office’s 2012 report on government debt: “There were no concrete plans for the use of the loan, only selected economic policy objectives when the signing has taken place and even at the drawn of the loan. According to the Government Debt Management Agency debt management needs did not justify such a rapid uptake of the IMF loan.”

The use of the loan began in April 2009. In the meantime, the first instalment was in the foreign currency deposits placed in the Central Bank of Hungary. €3 billion served as the contingency reserve of the state budget. The interest rate of the foreign currency deposit was significantly lower than the interest rate paid by the Bank to IMF: the difference was around HUF 20 billion of lost interest.

Overall, out of the available €20 billion, Hungary withdrew €14.2 billion from the IMF and the EU. The majority of the funding financed the state budget but, for example, the new government bought the shares of MOL, the Hungarian Oil Company for around €1.7 billion with the IMF loan in 2011. This was possible because the IMF had not stated how the loan should be used.

In August 2013, the Government Debt Management Agency and the Central Bank of Hungary repaid the entire loan to the IMF before the end of the period, saving more than €10 million in interest repayments.

As described above, the banking sector was even more vulnerable than the governmental sector – with an exceptionally high loan-deposit ratio. Meanwhile, the World Bank loan, which would really get to the root of this issue, was never used by Hungary. Unfortunately,

| Table 2: Use of the financial package 2008–2010 – billion € |
|-------------|-------------|-------------|-------------|-------------|-------------|
| Drawn       | 6.9         | 5.9         |              |              |              |
| Budget finance | 0          | 6.9         | 1.4         |              |              |
| Deposit     | 5.9         | 3.1         | 2.5         | 3           | 3.5         |
| Further loan activity | 1.7 | 1.0 | 0.5 |              |              |
| Capitalisation |              | 0.1 |          |              |              |

Source: Government Debt Management Agency

18 See http://www.tozsdeforum.hu/tozsde/kotveny2/visszafizettuk-imf-hitelt/
this issue has never been addressed in any way since then, and still exists today.

4.3 Consequences of the IMF loan

Hungary was hit hard by the economic crisis. GDP fell by nearly 8 per cent between 2008 and 2009. Compared to other countries of the Visegrad Group, the Hungarian economy experienced a much more serious downturn, and just recovered slowly. Following the crisis, while most OECD countries increased their social spending (especially unemployment benefit, child-care benefit, means-tested social benefit) in real terms, Hungary is one of the few countries where social benefits were reduced during each year of the crisis. Between 2008 and 2010, social spending was reduced by 9 per cent in real terms, and by a further 4 per cent between 2010 and 2012. This 13 per cent reduction compared to the 2008 level is comparable to the level of cuts in Greece.19

To keep to the criteria imposed by the IMF agreement, Prime Minister Ferenc Gyurcsány – and, a few months later, the new Prime Minister Gordon Bajnai (who was promoted from Economy Minister, a post he held during the overspending of previous years), accepted harsh austerity measures:

- Budget cuts for local governments and public media.
- The retirement age was further increased, to 65, effective from 2012.
- Maternity leave was cut from three years to two, along with various cuts in family allowances.
- Public sector wages were frozen for two years.
- Thirteenth month public sector wages and 13th month pensions were eliminated.
- Energy price compensation for the poor was eliminated.
- Severe cuts in support for public transport were made.

The overwhelming majority of the long list of anti-crisis measures in the programme were expenditure side cuts hitting ordinary citizens. On the revenue side:

- The value added tax was drastically increased from 20 per cent to 25 per cent (with a special 18 per cent key for dairy and bakery products, as well as communal heating).
- The basis for the calculation of personal income tax was broadened to include gross wages plus contributions paid.
- A 5 per cent cut to employers’ contributions to social security was introduced, a measure that was intended to increase employment, with no apparent success.

The government was relieved of introducing a meaningful property tax, a recurring issue repeatedly defeated by liberal opinion leaders since the transition. This tax would have helped to balance the unjust tax burden on wage earners vis-a-vis asset holders, but it was found by the Constitutional Court to be ‘inadequately prepared’.

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The results of the programme were very disappointing when compared to the hardships endured by the population of Hungary. The overall budget deficit became 3.9 per cent in 2009, and remained at 3.8 per cent in 2010. This is not much of an achievement given that it was already 3.7 per cent in 2008. The primary deficit faired similarly: it rose from 0.4 per cent to 0.5 per cent, after already having been 0.4 per cent in 2008. These insignificant changes must be viewed in light of the fact that the debt-to-GDP level rose from 65.8 per cent of GDP to 78.9 per cent as a result of the IMF loan. At the same time, GDP fell by 6.3 per cent in 2009 and stagnated at -0.2 per cent in 2010.

While the primary target of the IMF financial package was the banking sector, on the one hand we can say that there was no big bankruptcy after the crisis in Hungary. On the other hand, the loan activity of the banks stopped and has remained at a very low level until today. Compared to the end of 2008, the stock of loans of the corporate sector was 90 per cent at the end of 2009, 85 per cent at the end of 2010, and 80 per cent at the end of 2011. A similar trend happened in the household sector, which we could interpret as a positive step for households, although they are still heavily indebted.

5. With or without IMF after 2010

In 2012–2013, the new government of Viktor Orbán had to undertake negotiations with the IMF for yet another loan, because of international pressure on the Hungarian currency. During negotiations, however, market financing rates and IMF rates converged. The Hungarian State Debt Management Centre calculated that at around 4.05 per cent plus fees, the IMF loan was too high a benchmark for institutional borrowing. Hungary was able to issue dollar denominated debt at lower costs. Naturally, market-based debt came without all the strings attached. The Orban government ran a billboard and newspaper ad campaign making outlandish claims about what the IMF would have demanded in exchange for a loan. Due to the IMF’s policy of communicating solely with governments and not with the population at large, it was unable to effectively refute the claims. The Orban government, claiming to fight a ‘freedom fight’ against the IMF, clearly won the communication battle. It ended up sending the IMF packing out of Budapest, a move that made it popular in both extreme left and extreme right wing circles across Europe.

Although the government won the communication battle, ironically the situation is that previous Hungarian governments had already implemented most of the measures that the IMF demanded in other countries, such as freezing the wages of civil servants, reductions in the size of the public sector, the elimination of thirteenth month wages and pensions, the raising of the retirement age, and so on. Thus, these could not have been requested in exchange for a loan. On other matters, such as tax reductions and labour market liberalisation, the IMF even complimented the Orban government.

However, the government introduced a number of special sectorial taxes. The first such taxes were introduced in the banking, telecommunications, retail and energy sectors, and were meant to be temporary. They then became permanent features of the government’s tax policy, and were even extended by other special taxes in areas such as fast food. The Orban government was not the first to introduce such special taxes, but the scale of it was totally new. Revenues from special taxes increased from €0.27

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20 [http://liia.lv/site/docs/Politics_Economic_Sustainability_Baltics_Visegrad_European_Crisis.pdf](http://liia.lv/site/docs/Politics_Economic_Sustainability_Baltics_Visegrad_European_Crisis.pdf)

21 [http://liia.lv/site/docs/Politics_Economic_Sustainability_Baltics_Visegrad_European_Crisis.pdf](http://liia.lv/site/docs/Politics_Economic_Sustainability_Baltics_Visegrad_European_Crisis.pdf)
billion in 2009 to almost €2.5 billion in 2013, that is, from 0.3 per cent of GDP to 2.6 per cent of GDP.

In the last five years, the government has taken several different unconventional steps, which had huge positive and negative impacts on the state budget. This included cutting social benefits, nationalisation of different sectors (among others foreign-owned banks and the private pension system) and setting a low flat income tax rate. While the government claimed that one of its main aims was to reduce the public debt, they have not achieved this.

In its latest Staff Report of April 2015, the IMF acknowledged the efforts of the government, while criticising the sectorial taxes as a step in the wrong direction:

“The economy is recovering steadily helped by supportive macroeconomic policies and improved market sentiment. There has been a welcome decline in vulnerabilities but debt levels remain elevated, leaving the economy prone to shocks, and medium-term growth prospects appear subdued. The government took steps to address these challenges, but the overall strategy relies on measures that increase the role of the state in the economy and shift the burden of the adjustment to specific sectors. This may deter private domestic and foreign direct investment.”

6. Recommendations

We can see that, with or without the involvement of the IMF, Hungary seems set to stay in the debt trap. During 1995 and 2001, Hungary decreased the gross debt rate from 85 per cent to 55 per cent of GDP, but it was a one-time opportunity, when the country could use the funds from intensive privatisation. Since Hungary has sold off everything over the last few decades, this way is not open any more. Nowadays Hungary is even trying to nationalise strategic sectors.

While the gross debt rate is depends on several factors (GDP, currency rate), so it is hard to get simple conclusions, and it can hinder the facts. In the past years the primary balance of the Hungarian state budget had surplus -except 2011 due to a one time effect. The interest expenditures are much higher than the budget deficit, the interest expenditure was 8.4 %, the budget deficit was 4.2 % compared to the expenditure side of the state budget in 2013.

Just narrowing our focusing on the financial issues and some highlighted numbers, and try to find solutions within the sector, leads to failure. There are several other problems in the world. We cannot separate complex connected problems, and solve them one by one. We have to find the driving forces, the causes of the problems, and approach them in a systemic way. Separation will necessarily lead to a problem treatment, which is devoid any reason orientation.

### 6.1 Sustainable economic models

The limitations of the existing macroeconomic models became visible during the crisis, as the system remains viable only as long as consumption continues to grow. However, there is no model proposing a stable economy that does not require economic growth. As there is no macroeconomic model of sustainability, creating it is an urgent need.

Not only for economic reasons, in 1987, the World Commission on Environment and Development (WCED) released the Brundtland Report, which introduced the

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23 [http://www.ksh.hu/statszemle_archive/2013/2013_08-09/2013_08-09_797.pdf](http://www.ksh.hu/statszemle_archive/2013/2013_08-09/2013_08-09_797.pdf)
idea of sustainable development, and urged powerful and sustainable economic growth. Sustainable economic growth means a growing economy, which considers social justice and the carrying capacity of the environment. The concept failed in practice in the last two decades as the growing economy did not create social equality and enhanced the ecological overshoot. Today humanity - as the ecological footprint shows - uses the equivalent of 1.5 planets to provide the resources we use and absorb our waste. This number is almost the same in Hungary.

We urgently need a new type of economic growth model, which is decoupled from environmental burdens, and helps social justice, not deepens injustice.

Sustainable society calls for two parallel conditions to be met. We call for the moral of a modest life to meet the carrying capacity of the Earth, and we badly need the techniques of sustainable resource use.

6.2 Austerity

Austerity measures are not bad, there are the right place and right time to use them. But to use it as an universal tool is false. There are a lot of economists who already proved that, (Kenneth Rogoff, James Robinson, Paul Krugman etc.) and already some IMF documents underlined it. It is time to apply it in practice.

6.3 The role of money

The idea that the economy has to generate the resources to eradicate social inequality and environmental problems is false. The truth is that social inequality is caused by the unequal distribution mechanism of opportunities and of burdens. The financial institution system is also contributing towards an unequal distribution.

The economists Binswanger and Creutz expect that real ecological revolution cannot occur without solving the problems of the financial system and the role of money. In his book *The Money Syndrome*, Creutz demonstrates that the existence of interest redirects the income from those who are working for money to those who have accumulated wealth funds. The burden created by the debt interest will not let us out of the growth trap, since only with growth can you ensure that you can repay your debts.

The growth constraint is associated with the increased use of the environment, because we must use more resources. The economic growth in absolute terms cannot be separated from the growth of environmental burdens. The two fundamental unsustainable factors – the expansion of social injustice and environmental problems – are linked to the financial system.

Therefore social inequality cannot be solved with money alone, but with other types of allocation, and equal access and sharing of resources and burdens.

6.4 Tax justice

CEE countries have joined the tax race and tried to attract investors by low tax rates with questionable results. For instance, a tiny Hungarian village (Újlengyel) with 1,600 inhabitants and no local tax was – at least on paper – the headquarter for three oil companies, including the biggest offshore drilling company in the world, and a dozen other

multinationals. According to Tax Justice Network, Hungary lost $241 billion due to global tax evasion in the last few decades.  

While international agreements – and unharmonised national tax systems – laid the groundwork for this system, development banks have joined the dirty work. At the World Bank between July 2009 and June 2013, the International Finance Corporation – the World Bank’s private financing arm – supported financial intermediaries that were registered in tax havens with $2.2 billion of public money, according to Eurodad’s report Going offshore.  

NGOs and trade unions from CEE countries have to join their allies globally to challenge the system of injustice corporate tax evasion.

### 6.5 Capacity building

In Hungary, negotiations with the IMF and the management of the whole debt issue is easily hidden from the public debate, as there is no real information and knowledge among civil society and among NGOs. Although there are many debates in the media about government debt at a general level, this is just the interpretation of the different political sides. There is no independent, reliable source of clear information for the public. There are no independent bodies that can act as interpreter of public interest.

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25 [http://www.taxjustice.net/2014/01/17/price-offshore-revisited/](http://www.taxjustice.net/2014/01/17/price-offshore-revisited/)

26 [http://www.eurodad.org/goingoffshore](http://www.eurodad.org/goingoffshore)