Lessons Learned: Péter Ákos Bod

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During Hungary's transition from socialism from 1990 to 1994, Péter Ákos Bod served as minister of industry and trade and then for three years as governor of the National Bank of Hungary (Magyar Nemzeti Bank, or MNB). Following his public sector career in Hungary, Bod served as a director of the European Bank for Reconstruction and Development. Currently, he is a professor at Corvinus University in Budapest in the department of economic policy. This Lesson Learned is based on an interview with Bod on April 26, 2022. The full transcript can be accessed here.

Governments of emerging or transitioning economies should take both a long view and a short-term view in deciding key issues such as opening their markets, permitting foreign investment, and accessing foreign debt, because these decisions can create vulnerabilities that will have long-term impacts.

A performance gap between expectations and reality makes economic governance extremely challenging in Hungary, said Bod. Deep historical and institutional links to neighbors Austria and Germany have shaped financial realities in contradictory ways. "Hungary is very—as an ex-politician, I can say—very hard to govern, because expectations are very high, but the productivity and the capital stock, the size of the country and size of the market is very, very different from that of, say, Germany."

From the 1950s through the '80s, while Hungary was still a communist country, public disappointment and frustration regarding the standard of living in relation to neighboring Germany and Austria caused the government to take steps to reform some sectors of its economy, which paid off in certain respects. However, Bod explained that when the reform-socialist government was not able to meet the “high expectations of Western-like living standards,” it borrowed expansively:

The socialist government kept borrowing from the IMF, World Bank, and Western capital markets, hoping that if it invested well, then Hungary can grow, and then the living standard can be maintained by a growing economy.

As a result, the reform-socialist government had to seek credit assistance to cope with unprecedented levels of debt to Western banks.

In 1990, the country elected a democratic, pro-market government and transitioned to a democracy and market economy. But unlike some of its peers (such as Poland and Slovenia), it avoided sovereign default and bankruptcy, maintaining its huge sovereign debt of USD 20 billion.

The country needed still more cash, and Bod criticizes the European Community and the West for not providing financial assistance to Hungary and other countries transitioning out
of communism. Bod believes they offered too little too late, and each looked for someone else—Germany, the EU, the IMF, the United States—to take the lead. Even though Hungary had pursued some market reforms, its transition from communism to a complete market economy was traumatic. Bod explained:

Nineteen ninety was the first full year, when I became a minister, with the contraction of 5% of GDP. The IMF did not believe it; they thought it would be 2% to 3% decline, and that would be over in a year. And then ’91, a further 11% decline. Minus 11! Just imagine. Worse than the great financial crisis, or COVID, or the Second World War’s last year. It’s shocking.

Hungary’s leaders were eager to negotiate for debt relief, according to Bod, but they lacked leverage over their Western creditors. The IMF and powerful Western countries were reluctant to make any concessions. According to Bod, “The reluctance of the Western community to offer real money … was a mistake.” But he attributes this posture to a lack of understanding. Bod said:

Nobody could imagine, me included, that the collapse of a bad system, the centrally planned economy, would be followed by a very tough transition. Instead of a year or two of a harsh transition, it took nine years for Hungary to [return to its pre-transition] level of output.”

If governments do not address their fundamental weaknesses and build sound institutions as they evolve, they will not be prepared to withstand a financial crisis.

Hungary’s EU membership in 2004 created false confidence in the country’s ability to repay hard-currency loans. EU membership spurred deeper financial integration, including Western bank takeovers, government borrowing, and private borrowing from Swiss banks on a mass basis. This pre-2007 expansion of hard-currency debt made Hungary vulnerable to the GFC and rested on the false assumptions that Hungary would soon join the Eurozone, enjoy European Central Bank bailout protection, and immediately start to receive EU grants, which did not happen. During the GFC, the government lost access to the credit markets and again was supported by loans from the IMF and the EC. “The fact that the financial crisis shook Hungary deeper than most of the neighbors is also an indication of the fragility of the socioeconomic system,” Bod commented.

Hungary’s GFC experience also has a long tail, explained Bod: “after the financial crisis, the attitude towards Western financial capitalism had changed. [Prime Minister Viktor] Orbán, who started as a liberal politician in 1988, gradually became anti-liberal and also anti-financial.” In 2011, a constitutional amendment adopted by Orbán’s government turned the country away from the euro.¹

Bod also observed problematic developments in the central bank and a seeming erosion of its independence:

So, the central bank is independent, but the central banker’s view on economic affairs was a clearly pro-growth one. [The governor] says that Hungary should grow out of the debt, and that the central bank’s job should be similar to the US Fed’s mandate, which is not in Hungarian law. The Hungarian law says the main task of the central bank is to protect the value of currency, period. There’s no mention of full employment, there’s no mention of growth in the Hungarian constitution concerning the charter of the National Bank. But in reality, the central bank governor until very recently kept the policy rate well below the rate of inflation; he started to change his mind half a year ago. The negative interest rate has been the case for a decade. And he admitted that, for him, to grow is as important as anything else.

The country’s position does not seem to have improved much, stated Bod; public debt is about the same as pre-GFC levels, although external exposure is less. Bod argued, however, that the biggest vulnerability for the country is its chosen economic policy.

The nationalist developmental state model chosen is not sustainable within the European integration, and we missed some opportunities to turn to a more value-added, higher service component, and less classical manufacturing activities. During our conversation, I tried to understand the motives of Orbán. But now I feel that, even if he truly believes in a patriotic economy policy, Hungary cannot efficiently integrate into the European Union with this attitude and policy. So, he is doomed to failure.

According to Bod, tensions between nationalist politics and Hungary’s need for foreign capital are likely to shape Hungary’s financial markets for the foreseeable future.

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