

The lesser-known beginnings A conversation with György Surányi about the start of his academic career, financial reforms and his first term as Governor of the Central Bank

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The phase of György Surányi's professional career following 1995 – and, above all, his second term as Governor of the Central Bank – is widely known and well documented. However, we know far less about the nearly two decades that preceded this: how he turned towards finance and research as a university student; what intellectual environment shaped him at the Institute for Financial Research; how he became involved in the preparations for the two-tier banking system; what he learnt at the World Bank about debt crises; and what role he played in the economic reforms immediately preceding the transition to a market economy. Our conversation therefore deliberately focuses on this lesser-known phase of his career, tracing his career path right up to his first term as Governor of the Central Bank in 1990–1991.

Before university, you hadn't yet set your sights on an academic career. What drew you to economic research, and specifically to finance?

It's true that before university I hadn't considered an academic career. At the University of Economics, however, I found myself in such an inspiring environment that this changed very quickly. I was fortunate because our lecturers – Iván T. Berend, Miklós Riesz, István Hagelmayer, Tamás Bánfi, János Száz, László Antal, János Kornai, Mária Augusztinovics and Antal Mátyás – did not simply give conventional lectures. They conducted research, published papers, debated amongst themselves, and encouraged the students not to simply learn ready-made answers, but to think, argue and ask questions. For me, this was my first realisation that economics is not merely a collection of subjects, but an intellectual endeavour.

My first piece of writing was an end-of-course essay, written at the encouragement of Iván T. Berend. In my second year, I took an alternative module with him on the economic history of Central and Eastern Europe. There were only four of us on the course, and the seminar was led by the vice-chancellor himself every other week. In the dissertation, I analysed the New Economic Policy (NEP) introduced in the Soviet Union in the 1920s, which had numerous parallels with the Hungarian New Economic Mechanism of 1968. I was interested in the circumstances under which the two reforms were launched, the similarities between them, and, finally, the political and institutional processes that led to their rollback. Looking back, perhaps even this work already reflected the interest that would later run through my research: how economic institutions function, and what happens when economic rationality comes into conflict with other considerations.

I was originally admitted to the foreign trade programme, which was the most popular at the time. In the third week, on the recommendation of István Király, I attended a course taught by István Hagelmayer and Tamás Bánfi, which focused on monetary theory and the functioning of the gold standard. After the lecture – which simply blew me away – I went up to Hági (István Hagelmayer) and told him that I was studying foreign trade, but would very much like to switch to the finance programme. “My dear colleague, if the dean agrees, I’ll allow it,” he replied. Miklós Szuhay gave his consent. Tamás Bánfi, however, viewed my transfer with somewhat greater reservation: what was an international trade student doing on the finance course?

Two weeks later, we sat a mid-term exam. The syllabus was Péter Erdős’s book “Contributions to the Theory of Contemporary Capitalist Money...” and I had to catch up on three weeks’ worth of material. I started reading it and couldn’t put it down. I was captivated by the book’s momentum, its logic, its style, the way the train of thought was structured from A to Z, and how the elements of the system meshed together almost like cogs in a machine. The mid-term exam went very well. Back then, there were few students on the financial policy course, and the lecturers knew everyone personally. When Tamás Bánfi came to my name whilst handing out the papers, he simply said: ‘Well, that’s not bad at all. A five.’ That moment marked the beginning of a lifelong friendship.

By my third and fourth years, I already wanted to be a researcher. In my dissertation, I attempted to resolve the internal contradictions within Marx’s theories of value and inflation. According to one of our lecturers, I did so from an anti-Marxist standpoint. He did not mean this as a compliment. This was repeated at the OTDK as well. This did not in the slightest affect István Hagelmayer, who, as one of the assessors, wrote: ‘My young colleague’s argument is better than mine.’ I was awarded a first-class degree and received an invitation to join the Institute for Financial Research. By then, it had effectively been decided that research and finance would be my career path.

What was the professional environment like at the Institute for Financial Research at that time, and how did your university career tie in with this?

It was the start of ten truly wonderful years. I was able to work in excellent company, alongside some truly outstanding people, such as I. Hagelmayer, L. Antal, L. Lengyel, L. Bokros, É. Voszka, I. Szalkai, W. Riecke and L. Asztalos. The institute's management – Director István Hagelmayer and Deputy Director László Antal – provided a unique degree of research freedom. This meant not only that I could tackle interesting questions, but also that I could truly think through problems without any real taboos. For a researcher, this is a particularly valuable situation: there was no need to know in advance what the 'correct' result would be. I focused primarily on monetary theory, monetary policy and the functioning of the banking system, but given the nature of the place – ours was the research institute of the Ministry of Finance – macroeconomics, and within that fiscal policy, were naturally also on my mind.

The institute was also a special place because the functioning of the economy could not be treated as a purely theoretical matter. From the late 1970s and throughout the 1980s, the serious financial and institutional tensions within the Hungarian economy became increasingly apparent. The study of money, credit, the banking system or corporate finance was therefore both academic work and an analysis of the problems facing the functioning economy. This duality – the constant interplay between theory and practice – remained a defining feature for me in later years as well.

Meanwhile, from 1978 onwards, I also taught continuously at the University of Economics. In a sense, I was in a rather privileged position, as I mainly saw the positive side of university work: I was able to teach and work with students, whilst at the same time not having to get involved in the institution's day-to-day struggles. I wrote and defended my master's thesis on the contradictions in the financial regulation of investments, whilst my doctoral thesis was based on the book I co-authored with Lajos Bokros. My 1996 habilitation thesis dealt with certain interrelationships between inflation and monetary policy. For a long time, research and teaching were closely intertwined for me.

When did you come to be involved not only in researching the banking system, but also in its practical reform?

In 1983, Lajos Bokros and I travelled to London on a private visit, where we met with senior executives from the four largest banks in the City, as well as from the Bank of England. This was a particularly important experience because it gave us a first-hand insight into the workings of the institutions within a developed financial system. We encountered concepts and structures which were, at that time, either unknown or were barely understood within the domestic financial sector. One such example was the 'subordinated joint stock loan', for which Lajos and I coined the Hungarian term subordinated loan capital ("alárendelt kölcsöntőke"), which has, of course, since entered everyday usage. An article we wrote about our experiences on the trip to London, entitled 'Competition

in Reality', was published in Economic Review (Közgazdasági Szemle) and generated quite a stir.

This trip was also important because it highlighted the difference between the Hungarian single-tier banking system and a genuine system based on competing commercial banks – something we had previously only encountered in books. At that time in Hungary, the MNB still performed both central banking and significant commercial banking functions within a single institution. The question, therefore, was not simply how to establish new banks, but also how to separate monetary policy from commercial banking operations, and how to turn banks into genuine economic actors.

In 1984, I was asked to become secretary of the banking reform committee, which had been established under the leadership of the legendary Minister of Finance, István Hetényi, and brought into being by the Hungarian Socialist Workers' Party (MSZMP). When I received the invitation, I immediately told him: "I am not a party member, nor even a member of the KISZ, and I have no intention of joining." Hetényi replied: "Don't worry about that." I then asked: "Is this whole thing going to be a serious undertaking?" His reply was very typical of him: "Don't worry, whatever I take on is serious."

Alongside experts from the MNB, researchers specialising in the banking system also worked on the committee, including Sándor Ligeti, Márton Tardos, Tamás Bauer, Tamás Bácskai, and Péter Medgyessy from the Ministry of Finance. Decentralisation was by no means a conflict-free process. Within the MNB, particularly on the part of János Fekete, there was serious resistance to the separation of commercial banking functions from the central bank. Hetényi, however, kept his promise: on 1 January 1987, a two-tier banking system was established in Hungary. For me, this was the first major economic reform in which I was not only an analyst but also a direct participant and one of its architects.

In 1986, you joined the World Bank. How did that period shape your subsequent thinking, particularly on the issues of public debt and solvency?

In 1985, I applied for a job at the World Bank. Out of around four thousand applicants, I made it into the top thirty-six, but I wasn't among the twenty-two who were ultimately hired. A year later, however, a telex arrived from Washington: they wanted to hire me as a consultant in the Financial Development Division. I worked there from September 1986 until the end of 1987. I had the opportunity to meet some truly outstanding professionals, including György Szapáry and György Kopits, as well as colleagues who went on to have distinguished careers at, amongst others, the central banks of Hong Kong and Israel. In Washington, one had access to a completely different quantity and quality of information on the functioning of the international financial system than was available in Hungary at the time.

The World Bank proved to be an incredible source of information. At that time, the economic and financial crises in Latin America, the situation of ind-

ebted countries and possible crisis management strategies were at the centre of international financial thinking. It was there that I truly understood what it means for a country to become insolvent. I did not encounter it as an abstract concept, but through very concrete economic and social consequences: how quickly a country's room for manoeuvre can be restricted, how a financing problem can turn into a general economic crisis, and how difficult it is to regain the confidence of creditors.

At the same time, it was also evident that there is no single, mechanical formula for crisis management. The Brady Plan later emerged from these Latin American experiences; rather than the previous practice of sustaining debt through new loans, it prioritised the actual reduction and restructuring of debt. For me, however, the most important lesson from was not a specific scheme, but the realisation that solvency and credibility are fundamental constraints on a country's economic policy. If these are lost, very little room for manoeuvre and even less freedom remain.

During this period, in consultations with experts at the World Bank and the IMF dealing with Hungary, it was becoming increasingly apparent that it was no secret to my colleagues that the actual size of Hungary's public debt might differ from the officially reported figure. This later became a very specific issue for me in 1989, after I became State Secretary at the National Planning Office. My years in Washington therefore not only provided me with international experience, but in a sense also shaped the way I would later view the issue of Hungary's solvency.

You returned home at the end of 1987. How did you experience the years of reform immediately preceding the change of regime?

I was due to head the so-called 'capital' division of the Ministry of Finance's department dealing with international finance, but my appointment was blocked. The reasons given were that I did not speak Russian, I was not a party member, and I came from an institution with a 'tainted past'. On the recommendation of László Antal, I instead went to the Prime Minister's Office, where I took up the post of Senior Adviser in the Economic Policy Secretariat. An extremely exciting year and a half followed, because, following the earlier partial reforms, it was now possible to envisage truly fundamental changes.

1 January 1989 marked an important breakthrough: the liberalisation of the labour market, prices, wages and foreign trade were all steps that fundamentally altered the operating logic of the previous economic system. However, the reforms did not proceed according to a single, unified programme from any one institution. There were significant conflicts between the Hungarian National Bank (MNB), the National Planning Office and the Ministry of Finance, often driven by differing views on how the economic transition should be implemented.

One of the major debates centred on the liquidity of the banking system. It seemed to me that the MNB had withdrawn liquidity from commercial banks without good reason. I tried to use calculations to demonstrate that this

would not simply be a problem for the banks: if companies could not access adequate financing, they would be unable to pay one another, and payment chains (domino effects) could develop. The heads of the four major banks at the time listened to this argument with great relief. All the more so because Péter Medgyessy, speaking on behalf of the government, also accepted this, and the deepening liquidity crisis was resolved accordingly. The professional relationship I established with the bank executives at that time later became an important foundation, even in my capacity as Governor of the Central Bank, for the dialogue between monetary policymakers and the participants in the banking system.

At the same time, I continued to teach at the University of Economics. For me, these roles were not sharply distinct from one another. At the university, it was possible to reflect on the very same financial interrelationships within a theoretical framework as those we encountered on a daily basis in economic policy. By the end of the 1980s, my experience as a researcher, lecturer and economic policymaker had become closely intertwined.

By 1989, you were already working directly on the programmes for the economic transition. What was your most important lesson from that period?

In the summer of 1989, I was appointed as a delegate to the Blue Ribbon Committee, established by the Hungarian Academy of Sciences (MTA) and the Soros Foundation. The committee's task was to prepare for the transition to a market economy, privatisation and financial reforms – in essence, we were working on the programme for economic transition. The Blue Ribbon Committee enjoyed the support of the MDF, the SZDSZ and the government led by Miklós Németh. A wide range of domestic and international experts were involved, including Iván T. Berend, Silvia Ostry, István Szalkai, Márton Tardos, Sir Alan Walters, Guillermo De la Dehesa, Herbert Giersch, Béla Balassa, Paul Marer and István Hetényi. This was a unique situation because by then the question was no longer how to make the old system function somewhat better. We had to find answers to what institutions a market economy needed, and in what order these could be established. It was in the summer of 1989, when the Blue Ribbon was formed, that I also met József Antall (MDF), who, together with János Kis (SZDSZ), supported the development of a programme that could serve as a compass for the new, freely elected government.

Following a number of meetings, in 1990, after the election, several people recommended to him (Antall) that I be appointed Governor of the Central Bank. He initially approached Sándor Lámfalussy, but Lámfalussy declined the post because he felt he did not have a sufficient understanding of domestic economic conditions. This led to my appointment as Governor of the Central Bank, but in the months leading up to it, another issue was of paramount importance to me: uncovering the true state of Hungary's finances.

In 1989, I became the first non-party member to be appointed State Secretary at the National Planning Office; for me, this already signalled the change

of regime. Before my appointment, I asked Ernő Kemenes, the chairman of the National Planning Office (who was also the first non-party member to hold a ministerial post), not to present an economic programme to Parliament that contained false debt figures. This was supported by him, as well as by Péter Medgyessy, Deputy Chairman of the Council of Ministers, and Prime Minister Miklós Németh. The moment of truth came in early October 1989. This came immediately after Hungary had opened its western border to East German refugees. At that time, our political standing in the world – particularly in West Germany – was exceptionally favourable. At that time, we were negotiating, on behalf of the government, a foreign loan of one billion ECU. For this very reason, the stakes were particularly high regarding the impression our foreign partners would form of Hungary's actual financial situation.

I suggested that, in this situation, the true extent of Hungary's national debt should be made public. This was by no means a self-evident position. There were those who feared that if creditors saw the real figures, the country might lose its creditworthiness, and that it was precisely this honesty that would trigger a payment crisis. I was convinced of the opposite: if creditors were to realise later on that the official figures did not correspond to reality, our credibility would collapse. Disclosing the true figures therefore does not jeopardise, but rather strengthens our creditworthiness in the longer term and safeguards our solvency.

The issue was also discussed at a closed-door government meeting. There was a serious debate, but in the end the position that the actual figures must be published was unequivocally accepted. For me, this decision was closely linked to what I had learnt a few years earlier at the World Bank: in times of debt problems, credibility is not a matter of communication, but one of the most important conditions for access to finance.

How did all this lead to your first appointment as Governor of the central bank, and what do you consider to be the most important aspect of the 1990–1991 period?

I took over as Governor of the MNB on 1 July 1990. Substantive cooperation with the government was exemplary, whilst an extremely difficult period lay ahead. It was not simply a matter of pursuing a new economic policy: we had to make the institutions of an entirely new economic and financial system operational, whilst old relationships were rapidly breaking down, the foreign trade environment had changed radically, and companies and banks found themselves in a completely new situation.

Inflation was one of the most striking phenomena of this period. In the summer of 1990, inflation peaked, accelerating to 38 per cent. From today's perspective, this is appalling; at the time, however, it was by far the lowest rate in the context of the transition in Central and Eastern Europe. At the time, of course, this could at best be described as a relative success: naturally, the aim was not to accept high inflation, but to avoid an even more severe financial collapse

whilst the economic system was being completely overhauled. I therefore regarded it as one of the most important achievements of the Hungarian economy that, despite the exceptionally high external debt resulting from the extraordinary costs of transition, we did not lose our solvency.

For me, this was not merely a technical achievement. All my previous experience led back to the question of solvency: the Latin American debt crises at the World Bank, the 1989 debate on the true extent of Hungary's public debt, and the conviction that a country's room for manoeuvre disappears very quickly if it loses the confidence necessary for external financing. Monetary policy therefore had to adapt simultaneously to the internal tensions of the economic transition and to the strict external constraint that Hungary had to remain financeable.

In November 1991, we signed a three-year medium-term agreement with the IMF. It was clear that, during the period of economic transition, we needed access to international credit and the safety net and guarantee that such an agreement provides. The aim was not simply to have a source from which to borrow, but to ensure that the stability of the balance of payments and the country's external feasibility of financing were maintained even during the transition.

My term as Governor of the Central Bank came to an end on 1 December 1991, when the new Central Bank Act came into force. The reason for this was not professional, but political in nature. I had signed the Democratic Charter, which was particularly unacceptable to the radical wing of the ruling party. My successor was Péter Ákos Bod. I then spent three years at CIB, before returning to head the Hungarian National Bank in 1995.