

KÁLDOR *VERSUS* VARGA – THE HUNGARIAN THREE-YEAR ECONOMIC RECONSTRUCTION PLAN OF 1947

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After a monetary reform in 1946, the Communists helped by Jenő Varga and the Social Democrats advised by Nicholas Kaldor each drafted an economic reconstruction plan introducing central planning. Having already campaigned for economic planning after the war, Káldor was also in favour of a Keynesian income and fiscal policy. Good trade relations with the Soviet Union were in his eyes a precondition for economic recovery and stability. But the non-participation of Hungary in the Marshall Plan weakened the authority of the Social Democrats *vis-à-vis* the Communists who were now pressing for a Soviet-type planning system and the dictatorship of the proletariat.

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*“The present danger is not one of unemployment
due to lack of demand but one caused
by lack of coordination of resources [...].
In absence of an overall plan, this danger
is likely to grow not diminish.”*

Káldor (*The Times*, April 3, 1947)

Miklós Káldor¹ and Jenő Varga were two influential advisers who had worked on establishing the three-year reconstruction plan that the Hungarian government adopted in July 1947. The first one, living and working in Great Britain, advised the Social Democratic Party (abbreviated as SZDP in Hungarian), while the second one was living in Moscow and was asked to help the Hungarian Communist Party (abbreviated as MKP in Hungarian). Both visited Budapest in late 1946 to advise the coalition government, in which both the Social Democrats and the Communists had ministers.²

Having been a People's Commissar of the Hungarian Republic of Councils in 1919 and later on the Komintern's leading economist, Varga's reputation was already firmly established when he visited Budapest in 1945 for the first time since 1920.³ In 1945, he was also Molotov's adviser on matters of German reparation payments (Mommen 2011: 159–166). Hungarian-born Káldor, active in British politics, was a relative outsider. He had studied in England during the Great Depression and during World War II, he became close to Keynes and his theory of aggregate demand. It is less known that Káldor did show a personal interest in Hungarian matters already during the war. He was a member of the *Angliai Magyar Tanács* (Council of Hungarians in England), a united political organisation of Hungarian refugees living in Britain. This body was formed in April 1944. Members of this political organisation were, *inter alia*, Tamás (Thomas) Balogh, Károly (Charles) Polányi, and Mihály (Michael) Polányi (Borbándi 2006).

The Social Democrats and the Communists agreed on the principle of preparing a state-led reconstruction programme for a thorough modernisation of the country. Káldor's views did not differ that much from Varga's. However, Varga's great example was the Soviet economy, while Káldor's plan was inspired by the

¹ Given the context of the present paper, we use the Hungarian accented spelling of Káldor's name in the main text, but not in the reference section, where we follow the language of the original publications.

² The coalition government included two other parties, the Smallholders (Független Kisgazdapárt, FKGP) and the National Peasants' Party (Nemzeti Parasztpárt, NPP). The country's first two prime ministers were both from the Smallholder party, a reflection of the election results.

³ Varga was in charge of the Ministry of Finance during the short-lived communist revolution.

economic policy of the British Labour Party. Both advisers thought that a parliamentary road to socialism was possible. For Káldor, the redistribution of income and wealth through a comprehensive welfare system based on the solidarity of all citizens was essential. For Varga, collectivisation and nationalisation remained the main objective for the vanguard party of the proletariat.⁴

When arriving to Budapest in October 1946,⁵ Káldor joined a team of the Economic Research Institute, who had to compete with a Communist draft worked out by Varga and his team. The two plans did not differ that much. Káldor's one was even received with much respect by the Communists for its better quality (Thirlwall 1987: 104).

THE POLITICAL AND ECONOMIC CONDITIONS

Right from the beginning of the new epoch, the Soviet Red Army played a prominent role in keeping political order. For the Hungarian Communists it was now a matter of establishing their authority by implementing urgent economic and social reforms. Inter alia, Varga advised Mátyás Rákosi, the Communist Party chief and Deputy Prime Minister, on economic problems such as the repair of the railway system and financial and monetary problems. He wrote a memorandum on agrarian reforms too.

The MKP was hoping to gain the electoral support of the working classes and the poor peasants. However, the results of the parliamentary elections of November 4, 1945 were disappointing for the Communists. The Smallholders'

⁴ Those readers who are familiar with the economic history of the post-war years, may recall that another prominent Hungarian economist, Professor István Varga (not a relative of Jenő Varga) also played an important role in the stabilisation programme (see Majoros 2000, 2003). [Editor's Note]

⁵ According to his own recollection that is often quoted in the Hungarian sources, he was in Budapest for two months in the December-January period (Kaldor 1979: 79). This is incorrect; the two-month continuous stay was probably an exaggeration. He was certainly in Budapest at the end of October because it is indicated in his first article in *The Manchester Guardian*. A letter to the Editor appeared on November 19, 1946 in *The Times*. It seems that he was already back in London at that time. All together he had five articles published in *The Manchester Guardian* in the October-November period. The Communist plan was published on October 15. The Socialist draft was ready in late December. In early January, an SZDP commission was already discussing the party's own draft. In the recollection of other contemporaries (Kemény, Dabasi-Schweng), there is no reference that Káldor had come again in (or stayed until) January 1947, although Ránki (1963) is certain that Káldor was present at a meeting on January 8. Interestingly, in the remaining part of the year, Káldor did not publish any other articles on Hungary than the ones in *The Manchester Guardian*. In sum, Káldor's stay in Budapest is not sufficiently documented (Ránki 1963:70).

Party obtained 57 per cent of the popular vote. With only 16 per cent of the vote, MKP finished as the third party just behind the SZDP. In order to re-establish the political equilibrium in the coalition, the two urban working-class parties formed a Left Bloc, which was extended to the National Peasants' Party. From now on, Rákosi's tactic consisted of purging the dominant Smallholders' Party and the Social Democrats of their right wings.

As inflation started to reach dangerous levels, already in February 1946, Varga advised Rákosi to balance the budget by imposing a strictly monetarist policy. In April 1946, he pleaded for a thorough monetary reform and cutting state expenditures while increasing tax incomes. A monetary stabilisation plan was worked out by the Hungarian administration and the National Bank. In order to stabilise the exchange rate of the pengő (the Hungarian currency of the time), the government concluded separate agreements with Washington and Moscow. The monetary stabilisation plan was implemented on August 1, 1946, together with the introduction of a new currency, the forint (HUF).

Fixed prices were combined with a strict deflationary monetary policy. The whole operation was also eased by the previous American declaration that the booty taken from Hungary by German and Hungarian Nazis, including the gold reserves of the Hungarian National Bank with a value of USD 2 million, would be returned. But no radical structural economic reforms were discussed. Monetary stabilisation was also largely dependent on trade recovery and the foreign loans the government tried to attract in combination with trade treaties. That was also Varga's view (Varga 1946). He even lectured on these subjects for the masses in a Budapest football stadium and he then revealed that the Hungarian bourgeoisie had opposed a high devaluation rate of the national currency.

Then, on Varga's instigation, an economic recovery plan was worked out by a team of Communist economists led by Ernő Gerő. He was assisted by economic specialists such as István Kossa (National Bank), István Friss, László Házy, and Zoltán Vas.⁶

PREPARING AN ECONOMIC RECONSTRUCTION PLAN⁷

Although not all monetary difficulties had disappeared with the introduction of the new currency, confidence in the forint was soon established. Inflation remained relatively low. However, state intervention through the awarding of con-

⁶ Gerő, Friss, Házy and Vas belonged to the Moscow faction of the Hungarian Communist Party, therefore they were natural allies of Varga.

⁷ For a detailed historical account of events in English, see Brus (1986).

tracts and allocating materials in combination with credit financed by the state created an insatiable need for more governmental loans as long as the private banks could not mobilise enough savings. This was still one of the main sources of inflationary pressure. The reparation payments (about 7 per cent of the national income) and heavy occupation costs would also be a source of inflation. In addition, the state had to keep the nationalised sector afloat. All mines had been nationalised. In January 1946, the Supreme Economic Council was formed with the task of securing efficiency in economic management by allocating raw materials and bank credits the commercial banks were unable to allow. In the summer of 1946, special bureaus were created for the administration of textiles, timber, wood, iron, etc. in order to streamline production, and for the purchase and allocation of strategic raw materials as well as finished and semi-finished products. In coal mining, all free-market operations were forbidden. In November 1946, the five largest firms in heavy industry⁸ were brought under state supervision. These firms now operated as trusts fulfilling production targets set by the government. About two-thirds of their output went to the state at low prices. Hence, one could also speak of a “gradualist strategy”, making the state the majority shareholder of many enterprises without officially nationalising them (Berend – Ránki 1985: 182–188).

The Communist plan was attentively studied by a team of 30 Social Democrats assisted by Miklós Káldor (Kemény 1952: 23). Within six weeks, they published their own plan, which was even more ambitious than the Communists’ (see *Table 1*). Both development plans were very daring as they also proposed to increase productivity in industry as a precondition to the creation of abundance. Piece wages and Stakhanovism would become the standard in industry (Kornai 1950). Meanwhile, the Communists tried to refine their planning proposals per economic sector. Therefore, they installed commissions for industry, agriculture, foreign trade, finance, transport, communication, cooperative associations, social policy, and culture.⁹ In December 1946, the government announced that an overall Three-Year Plan would be outlined (Gerő 1947; *3 éves terv* 1947). Gerő established a commission in which members of the different coalition parties prepared a final draft of the reconstruction project. These members were the SZDP (György Kemény, László Faragó, and Artúr Székely), the Communists (Zoltán Vas, István Antos, and György Markos), the Smallholders (Sándor Gönczy, Jenő Rácz, and Artúr Kárász), and the National Peasants (Imre Kovács and Lóránd Dabasi-Schweng).

⁸ Ganz Villamossági Részvénytársaság, Ganz-MÁVAG, Rimamurány-Salgótarjáni Vasmű, Weiss Manfréd Művek and Győri Vagon- és Gépgyár. See Government Decree 23.500/1946.

⁹ Memorandum signed by I. Friss, October 15. Party Archives, 274 f. 12/100.

Table 1. The Three-Year Reconstruction Plan – GDP forecasts

Name of the partys	1938	1946/47	1947/48	1948/49	1949/50
	Million HUF				
SZDP	23,376	14,806	17,755	21,383	24,823
MKP	23,376	12,000	15,200	18,000	21,200
Percentage					
SZDP	–	100.0	119.9	144.4	167.7
MKP	–	100.0	126.7	150.0	177.5

Source: Judik (1947: 7).

The Communists and the Smallholders clashed on several planning issues in the commission. In a speech given by Gerő on January 11, 1947, at the Central Committee, he called his colleague Jenő Rácz “a Horthyst bourgeois economist”.¹⁰ By then, Minister of Finance Rácz was replaced by Smallholder Miklós Nyárádi. The Communists remained the driving force of the special commission. Leading the Planning Bureau was now their ambition. After spending the war in Brussels as an undercover agent of the Komintern, Andor Berei had returned to Budapest in early 1946; he was now in charge of all planning tasks.¹¹

Together with the founding of a new central planning body, the three-year plan was adopted in July 1947. The ambition was to achieve, by 1949, an increase of about 17 per cent in the national income, exceeding the 1938 level. How to finance this ambitious plan was still a problem. The Social Democrats, but also the Communists, were hoping for foreign loans. At that time, the Hungarian government had joined the other Central European countries in applying for participating in the Marshall Plan. Finally, the Soviet Union forbade the Central European countries to participate in the Marshall Plan. On August 1, 1947, the Three-Year Plan providing for a state-directed economy went into effect (Kemény 1952).

KÁLDOR'S VISION ON POST-WAR RECONSTRUCTION

As already mentioned, Káldor, along with Varga, was the main inspirer of the Three-Year Plan. It is, however, difficult to trace their individual contributions to the discussions within their respective political parties. We know much about Varga's views because they were published in pamphlets and journals. Káldor published a series of articles in *The Manchester Guardian* in October and November 1946, in which he commented on the situation in Hungary. He also sent

¹⁰ Party Archives, 274 f. 12/102.

¹¹ Memorandum signed by Berei, May 9, 1947. Party Archives, 271. 12/107.

a letter to *The Times* in defence of his appreciation of the situation in Danubia. In these articles, his evaluation of the economic situation was rather optimistic and he defended the government's foreign policy of signing trade agreements with the Soviet Union.

During World War II, Káldor published his Keynesian views on post-war reconstruction and the British welfare state in the press (Kaldor 1947). In general, these views were perfectly in line with the post-war economic and social policy of the Hungarian government. In his pamphlet *Economic Reconstruction after the War* (1942), Káldor argued for economic and social reforms after the war. A return to pre-war unemployment should be avoided by state intervention in the economy. After World War I, economic controls had been abolished too quickly. Hence, "post-war reconstruction", he argued, "required an equally swift and large-scale transfer, only in a different direction. The system of war-time controls is therefore just as necessary for the return to peace-time economic conditions as for war" (Káldor 1942: 11).

Káldor's Keynesian conclusion was that "it all comes down, finally, to the size of consumers, purchases, and to what the business men expect these purchase to be in the future" (Kaldor 1942: 18). The government had to fix maximum prices so that the most competitive firms could survive and grow. "It would at the same time prevent that monopolistic exploitation of the consumer which we usually associate with the domination of the market by large and efficient concerns. The Government's war-time policy with respect to utility, clothing and furniture shows how much could be done in this direction" (Kaldor 1942: 22–23). At the end of his paper, Káldor also argued that this method of forcing industries to sell at truly competitive prices – and at prices at which only the efficient, and not the inefficient firms can survive – is the only one by which capitalism could be made work. "It is the only method of allowing full scope for the economies of large-scale production without creating powerful monopolists whose very existence endangers the stability of the state. The alternative solution is socialism: for the state to take over production directly and to plan production units at their most efficient scale" (Kaldor 1942: 23).

The tone of this pamphlet was optimistic. Káldor argued that the economic situation of Britain was less disastrous than commonly believed. In addition, he defended the idea that rationing and price control could eliminate inefficiently producing firms. The allocation of raw materials and finances should be allowed according to well-defined basic needs. Import controls had to secure the most important imports and with capital flows regulated, nationalised key industries could gain economies of scale (Thirlwall 1989).

In 1943, Káldor published (together with J. Robinson, A. A. Evans, E. F. Schumacher, and P. Lamartine Yates) the pamphlet *Planning of Abundance* distributed

by the National Peace Council. Robinson wrote in defence of the Beveridge Report that it advocated the “mildest and most reasonable” reforms (Kaldor 1943: 6) on abolishing unnecessary poverty by means of public works, controlling prices, national investment. Again, Káldor defended the Beveridge Plan, but now by stressing its economic implications and he rejected all objections against it. Transfer expenditure did not reduce the amount of consumables available to the community, “but merely re-distributes it between different persons” (Kaldor 1943:23). In addition, Káldor also rejected the silly idea that the Beveridge Plan would impose a heavy burden on industry. That would only be the case if the plan were to reduce productivity. Tibor Barna confirmed Káldor’s theory in a study that employers’ contributions raise prices, not only by the amount of the tax, but in proportion to the increase in prime costs caused by it; for exactly the same reason for which a general rise in wages is likely to be followed by a proportionate rise in prices (Barna 1945: 99). Káldor could observe that phenomenon in Hungary when he was staying there. Hence, several of Káldor’s Keynesian ideas contained in these two pamphlets were later incorporated into the economic and fiscal reforms implemented by the Hungarian government.

KÁLDOR’S ARTICLES IN *THE MANCHESTER GUARDIAN*

Káldor’s articles published in *The Manchester Guardian* in October and November 1946 give us a good idea of his analysis of the situation in Hungary.¹² He was amazed by the fact that monetary reforms had brought inflation down and “the hordes of money-changers, speculators, and black marketers, which filled the city to overflowing, disappeared by a gust of the wind”. The citizens of Budapest even found an atmosphere that recalled the long-forgotten days of the early 1930s. There were now plenty of goods in the shops, but no buyers. Cafés and clubs (brothels) were closing down. According to Káldor, Hungary and Greece experienced a major inflation of “the classic German type”. The thesis of the League of Nations experts that once an impoverished country falls prey to a major inflation, it could not get out of it “without substantial financial help from abroad”, proved to be wrong. Hungary introduced the forint without any foreign help (unless the return of the National Bank’s gold from Germany be regarded as such), while the country was making reparation payments on a very heavy scale. If the Hungarian experiment succeeds, he wrote, “many of the accepted ideas about the causes and cures of inflations” needed revising (Kaldor 1946e).

¹² It is less known even among Káldor specialists that an article on this subject was published by him in *The Economic Journal* as well. (Kaldor 1946g) [Editor’s note]

According to Káldor, the original cause of the Hungarian inflation was the complete breakdown of economic controls at a time of extreme scarcity. He also pointed to the fact that the Hungarian war-time controls were introduced only half-heartedly, and that the rationing system was never extended beyond a few staple foods. After liberation by the Russians, the administrative machinery was virtually non-existent and encouragement was given to private trading to provide the cities with foodstuffs. So all restrictions were cancelled and there followed four months of complete *laissez-faire*. The result was that the population survived, but the cost of living had meanwhile risen 15 times the previous level. A 15-fold increase in prices was, however, the maximum that the available currency in circulation could support. In the summer of 1945, the improvement in the food situation was sufficient to offset the effect of newly-printed notes and the rate of increase in prices had slowed down. But in autumn, the government had to extend very large credits to industry. At the same time, the trade unions made an attempt to establish “some automatic relation between wages and the cost-of-living index and to raise money wages at least to some recognisable fraction of the pre-war real wages” (Kaldor 1946e), which made the acceleration of inflation “inevitable”. In this period, there was also “an enormous increase in officials of all kinds”, both in public and private offices, as well as of wage-earners doing purely unproductive work. “The scaling down of all these unproductive employments, particularly the dismissal of hordes of unnecessary officials, is perhaps the most painful after-effect of the inflation”, Kaldor (1946e) argued. He also signalled that wages had lost all relation to the value of the work done. Real wages consisted of the calorie minimum paid according to the number of dependents and quite independently of the amount of work performed. Hence, the “usual incentives to efficiency” were lacking (Kaldor 1946e).

According to Káldor, the basic idea behind the stabilisation plan was that the currency system could only be kept stable if the various classes were prepared to accept an income which was no greater than the money value of the real goods and services that could be made available for them. A consistent price, wage, and salary structure was regarded as “the first requirement of a genuine stabilization scheme” (Kaldor 1946f). A balanced budget was a second necessity, while adequate gold backing was a third necessity. However, this last condition had “a purely symbolic significance”. It was regarded necessary that the new currency should be generally perceived as being sound by the population. When the Americans returned USD 32 million of gold the Nazis had removed from Hungary and kept in Frankfurt, the Minister of Finance elaborated plans for a balanced budget. Hence, the Supreme Economic Council started negotiations for the creation of a consistent wage and price structure. Settling the price and wage system in one collective contract was a new feature of the Hungarian stabilisa-

tion scheme. Káldor (1946f) reported that in May 1946, the Hungarian government, “largely on the initiative of the Communist members, began to take steps in all three directions in order to establish a sound currency in time for the new harvest.” Hence, the first task was to estimate the real national income for the coming year and the proportion that was available for consumption. The level of wages and salaries, and house rents were now settled as percentages of pre-war incomes and prices. One estimate set Hungary’s national income at 60 per cent of her pre-war income. In view of the reparation payments and reconstruction expenditures, the average of income payments was fixed at 50 per cent of the pre-war rate, payable if output per head in the factory reached 75 per cent of pre-war production, with appropriate increases for higher productivity. The rate for salaries was fixed at 35–42 per cent and house rents at 40 per cent of pre-war levels for small dwellings and 60 per cent for larger ones.

Another important step was the fixing of wheat prices at 400 forints per ton or 2.2 times the pre-war “pengő” price. Other agrarian and industrial prices were fixed by taking wheat prices as a standard. For agricultural prices as a whole, the coefficient was 2.7 and for industrial prices 4.4. Industrial prices were fixed so high in relation to agricultural prices to ensure that the people in the towns should be fed for no more than they could afford in terms of manufactures. In the future, these high prices might be gradually reduced. The new currency, the forint, was converted so high in terms of gold that the free market prices for gold and dollars fell steeply. In no time, the National Bank gathered 10 million dollars in dollar notes, which business firms and individuals were compelled to surrender in order to acquire forints. Next, the prices of manufactured goods fell by some 10 per cent from the initial level. The black market in foodstuffs vanished as soon as the peasants surrendered their grain to the governmental offices.

After this monetary operation, inflation suddenly vanished. Foodstuffs appeared in the market “as if by magic and were offered at or below official prices; the black market in foodstuffs vanished”; however, Káldor (1946f) also signalled two main problems in this period: shortage of credit and the necessity of maintaining a balanced budget. Business credits were granted only within very narrow margins, for working capital purposes. As long as the budget deficit was not removed, the government remained very chary in releasing credits to industry. Káldor thought that the new tax rates would be adequate for securing the 1,800 million forint tax revenue provided for the stabilisation plan and that the danger was more on the expenditure side. About 100,000 state officials were nonetheless dismissed. He also noted that on a total expenditure of 2,100 million forints, some 750 million forints had been set aside for reparation payments and the costs of the Soviet army of occupation and the allied missions in Budapest. Káldor also criticised the fact that the Russians had made heavy demands and communicated

them only one month ahead. The three Allied missions were amounting to about a third of the total costs of the Red Army at the time. Hence, the government was hoping for a speedy conclusion of the peace treaty. Káldor was rather optimistic about the “real” effects of the currency stabilisation now that the factories spoke of considerable improvements in efficiency. On the other hand, unemployment was still high in the building industry. Káldor even foresaw a critical period at the end of the year, when the currency in circulation would reach saturation point. Only if state expenditures could be fully covered by taxation by then could a lasting stabilisation be successfully accomplished. Then, the way would be open for a “renewal of long-term investment” (Káldor 1946f).

Having visited Austria as well, Káldor could compare the situation in Vienna with that in Budapest. In contrast to Budapest, he reported, Vienna was an “occupied city” having only recently emerged from fighting. There were few shops and cafés open. In Budapest, the rubble had mostly been cleared away. While in Vienna the black market was still the main topic of conversation, in Budapest the black market was over. “But more important perhaps than any of these, the oppressive atmosphere of the occupied town, which hangs over Vienna in much the same way as over the cities of Germany, is almost completely absent in Budapest.” The behaviour of the Russian troops had radically changed for the better in the last six months, all requisitions and industrial removals had ceased, and the occupation authorities intervened to a minimum extent in local affairs. Laws passed by Parliament were no longer submitted to the Allied Control Commission’s approval. On Russian insistence, the land had been distributed to the peasants, a radical measure which was only contested by the Conservative Right and the Catholic Church. Moreover, the “elimination of the class of feudal landowners and of the traditional bureaucracy from their position of power and influence amounted to a social revolution whose permanent consequences will prove far more significant at present,” but it was the Russian occupier, rather than the “internal forces of the revolution”, which were to be held mainly responsible (Káldor 1946b).

Káldor had observed that the local party system suffered from two important defects, which would later be confirmed by historical studies (Palasik 2000; Mevius 2005; Kenez 2006; Vida 2008). Firstly, the political parties had acquired masses of new members “who either had no political convictions or experience at all” and whose “political sympathies were most unreliable.” Secondly, the six parties offered a wide selection of political outlooks, but “they did not really command the support of important sections of the public”. The Communists and Social Democrats commanded the allegiance of the industrial working classes and the National Peasants’ Party appealed to the landless peasants. The Smallholders represented the small farmer with 10 to 30 acres. The latter were in favour

of the division of the large estates, but they would have much preferred to see the land divided among the deserving small farmers than to see it given away to the landless day labourers. The two liberal parties of the Western pattern had no wide following “outside the (now largely depleted) Jewish middle classes” of the towns (Káldor 1946c). The Conservative and Catholic interest groupings were not represented in Parliament from which the Fascists were also excluded. Hence, the Smallholders could obtain 57 per cent in the last elections thanks to the votes of the submerged parties of the Right. This lack of a Right in Parliament was, according to Káldor, “a serious mistake”, which could lead to an unhealthy political atmosphere and which could retard the country’s democratic development. Káldor (1946c) also noted that the right-wing voters were steadily pushing the Smallholders’ Party to the right. The Catholics and other reactionary groupings had a “large but undefined influence over the strongest party in government”, which left them “with far more room for manoeuvre” than they would have as an open Parliamentary opposition. Communists and Socialists, he argued, would certainly not be opposed to the creation of a Catholic party, but the group around Cardinal Mindszenty was unwilling to back this project.

Káldor mentioned that according to the Armistice Agreement, Hungary had to pay reparations to the amount of USD 300 million of 1938 purchasing power, of which USD 200 million were payable to the Soviet Union and USD 100 million to Czechoslovakia and Yugoslavia. The agreement stipulated annual instalments of USD 50 million a year. A new agreement was then negotiated in lengthening the period of delivery to eight years. The Hungarian-owned share in the Transylvanian coalmines of Petrozsény was set off against reparations claims. Hence, the amount of deliveries was fixed at some USD 22 million for the initial period, rising to USD 45 million in 1949. About 25 per cent of the current factory production, or 15 per cent of all industrial production, with 60 to 70 per cent of the output of the iron, steel, and engineering industries, was now going to the Soviet Union. Káldor (1946d) also estimated that about 5 per cent of industrial equipment had already been taken by the Russians as “war booty”, which was not credited as reparations.

Under the Potsdam Agreement, the Soviet Union was entitled to acquire all (pre-war) German property in Hungary, or 5-8 per cent of factory production. Among these firms was the originally Austrian-owned Danube Steam Navigation Company, which also owned the coalmines around the city of Pécs. Joint-stock Soviet-Hungarian companies were created in shipping, aviation, bauxite, and oil production. Under a Soviet-Hungarian trade agreement, the Soviet Union delivered to Hungary some USD 20 million worth of raw materials. Barter agreements on a smaller scale were also signed with the Scandinavian countries, Romania, Czechoslovakia, Poland, Switzerland, and France. Hence, Káldor (1946d) concluded that “both as regards direct participation in Hungary’s industries and as

regards foreign trade, Russia will have much the same importance for post-war Hungary as Germany had in the interwar period.” However, Germany was then only interested in buying foodstuffs and selling industrial products, while the nature of the trade with the Soviet Union was the reverse. He did not expect that the development of the trade with Russia would mean the reduction or elimination of Hungary’s trade with the West. The Russian connection would instead assist Hungary’s industrialisation. In addition, Hungary could also develop other foodstuffs than cereals, such as poultry and eggs, while in the sector of the machine tools, machinery parts and other manufactures the country would largely depend on imports from the highly industrialised countries of Western Europe.

Káldor’s optimistic forecasts for Hungary’s economic and political development were certainly not shared by many opinion-makers. Rather negative articles on the situation of Hungary were published in *The Times*. As usual, Kaldor (1946a) sent a letter to the editors protesting against their one-sidedness. He refuted the assertion that the trade agreement Hungary had signed with the Soviet Union was extremely unfavourable. Hence, financial stability and trade with the Soviet Union would hasten economic reconstruction, while trade with the Soviet Union bypassed trade with the countries of Western Europe. However, the trade balance showed an important deficit as well.

THE THREE-YEAR PLAN

The Three-Year Plan launched on August 1, 1947, aimed at raising Hungary’s national income to a level higher than before the war. Investments eliminating bottlenecks were given priority (*Jelentés* 1948). The main debatable issues were the share of agriculture in investments and the necessity of long-term foreign loans. The Social Democrats reckoned with relatively greater investments and tried to keep investments in agriculture even lower than did the Communists (Schweng 1952: 9). In the course of its execution, the plan was modified several times. After the first five months, a special drive was organized in order to quicken the pace so that the targets of the Plan could be achieved by December 31, 1949. Each establishment or factory was required to appoint a plan agent reporting on what progress had been made. An Investment Bank was set up in order to replace the commercial banks and became the cashier of the Planning Bureau. The central bank, obtaining special powers, was from now on the banker of the nationalised industries.

Already in the beginning, the right-wingers of the Smallholders’ Party were visibly no longer accepting predominance of the “Marxist parties” in government. The discovery of a “conspiracy” concocted by some leading Smallholders prepared the ground for a rift in the government. Rákosi succeeded in having a

group of right-wingers arrested and others expelled from Parliament. The Smallholders' Party broke into pieces and Prime Minister Ferenc Nagy resigned from office before new elections were held. Hence, the Parliamentary elections on August 31, 1947, brought a victory for the Communists as the defenders of the social revolution. With 22.5 per cent of the total vote, the Communist Party came first, preceding the Social Democrats and the Smallholders. The four-party coalition obtained 61 per cent of the vote, but this time, the Communists could clearly dominate the other parties when pushing for more radical economic reforms.

Meanwhile, the Cold War was already under way. George Marshall's Harvard speech on June 5, 1947, promising reconstruction credits to any European country that applied made it clear that Washington would refuse any new bilateral financial accord. Only a package deal obliging the European countries to coordinate their policies was acceptable. In the meantime, the Soviet leadership still believed in a possible advantageous arrangement with Washington. Hence, Varga defended the Communist thesis that the primary purpose of the Marshall Plan was to forestall, or at least mitigate, the worst effects of the coming overproduction crisis by seeking new markets in Europe. Varga argued that because the Marshall Plan was largely driven by economic necessity, it would be possible to exploit this need for its own ends. At this stage, the Soviet leaders wanted to ensure that the countries which had suffered most from German aggression would obtain priority for receipt of US credits. Hence, Stalin urged the political leaders in Warsaw, Prague, and Belgrade to work out a programme. The Hungarian government was also interested in the American project. In the end, all went wrong at the Paris Conference meeting on June 26, 1947, and the Soviet delegation left the French capital. Varga now argued that the Marshall Plan tried to bring the Eastern European countries into the orbit of American influence. The Eastern European countries should thus refuse American aid. For the Hungarian Social Democrats, this refusal was a painful reverse as they were looking for foreign loans in order to finance investments. Their position in government was now considerably weakened, but they nonetheless refused to repudiate their alliance with the Communists. Apparently, there was no alternative. Breaking with the Communists would imply civil war and a return of the Right in government.

By March 1948, nationalisations embracing all companies with more than 100 employees as well as the public utilities and banks were completed. By May 1948, 20 directorates of the various branch ministries were set up to administer the nationalised industries. By now, the civil bureaucracy had been already purged and politicised to the point where the staffs of governmental agencies and offices headed by non-Communist ministers were no longer responsive to their nominal chiefs without Communist assent. The point of no return was reached when, in early 1948, the Communists asked the Social Democrats to merge into

one big workers' party. The westernising faction led by Minister of Industry Antal Bán opposed this move to the left and quit. With other expatriated Social Democrats, he then founded a Hungarian Socialist Party in exile. A unification congress was nonetheless held on June 12–13, 1948, which gave birth to the Hungarian Workers' Party. On February 1, 1949, the Hungarian Popular Front for Independence – an umbrella organisation of coalition parties – was created by the Communists, which obtained 96 per cent of the popular vote in the elections on May 15, 1949. Meanwhile, all other political parties had already been banned. The pace of economic reforms was now speeded up (Vas 1950). In June 1949, the Council of National Economy took over the role of the Supreme Council of Economy, and on August 20, 1949, the Constitution of the People's Republic of Hungary was proclaimed. A Five-Year Plan of a Stalinist model was launched on January 1, 1950, but this time under the dictatorship of the proletariat.

CONCLUSION

The dictatorship of the proletariat can be seen as the logical outcome of a process the Communists had been striving for after 1945. With the decisive help of the Soviet Union, they had steadily reinforced their position in all state institutions and they had succeeded in absorbing the leftists in the Social-Democratic Party and driving out the moderates. A “third road” to socialism without authoritarian planning imagined by the Hungarian Social Democrats did not exist. No other political or social forces were available at that moment to form a reformist coalition government of a Western type. The “Kaldorians” were then hoping for foreign loans to speed up the process of economic recovery, but this hope soon vanished. Stalin and the Hungarian Communists saw the Marshall Plan as Washington's attempt to interfere in the internal affairs of the European countries.

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