Privatization Helps: The Hungarian Example

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As Greece works out of financial crisis, it should look to Hungary fifteen years ago for part of the answer. Far too large a segment of the Greek economy remains locked up in public hands. Their sale to the private sector, as Hungarians discovered, while not a panacea, will help reduce catastrophic public debts, and salaries and pensions will become the responsibility of private owners rather than the government. The Greek Parliament's austerity plan would raise 70 billion euros from privatization by 2015. The government will sell stakes in banking, airports, water utilities, motorway concessions, port operations, state land, and mining rights. Selling assets to the private sector will also improve managerial know-how, increase transparency, and encourage confidence in a Greek recovery.

There is a precedent for this, although on a much smaller scale, in the similar challenges Hungary faced in the mid-1990s. In 1995, Hungary's economy was in a dangerous free-fall. Its foreign debt, which Hungary had refused to disown after the fall of communism, was approaching $30 billion, the highest per capita debt in all of Central and Eastern Europe. A quick look at Hungary's dilemma revealed that there was no easy solution in sight. The country's annual budget, bloated with social program spending, was $3 billion in the red; most of that would have to be borrowed, causing the debt burden to balloon further. The balance of payments showed a $4 billion deficit, largely due to the long-deprived Hungarians' rush to buy luxury foreign goods. The really frightening number, however, was the rate of inflation. We grow concerned in the United States if inflation runs a few percent a year. In Hungary, the inflation rate had skyrocketed to 30 percent annually! That meant the average Hungarian could buy only two-thirds the groceries and household goods with forints as they could in the previous year. The sharp decline in the forint's value was a catastrophe for consumers and prospective outside investors alike.

Both the US government and the International Monetary Fund (IMF) concurred that Hungary's economic problems could result in a crash and perhaps necessitate a costly bailout by the United States. A similar economic disaster had developed in Mexico the year before, which had turned to us for massive economic aid to avoid defaulting on its loans and going bankrupt.

The numbers told the story. Nearly 70 percent of Hungary's economy was still controlled by the government. Although more than $10 billion had been invested in Hungary from abroad since the end of the Cold War, much more restructuring needed to be done. Selling state-owned industries to foreign entities that would pay dollars, marks, or yen to buy and upgrade Hungarian factories and facilities was seen as a way to transform Hungary's lagging economy and outmoded industrial sector and boost the country's financial position.

As a result of US and IMF warnings and advice, Hungarian Prime Minister Gyula Horn made crucial new economic decisions in early 1995. He replaced the finance minister and the interim head of the central bank with two Western-trained bankers: Lajos Bokros as finance minister and György Surányi as president of the National Bank of Hungary, both highly respected by their counterparts in many Western capitals. Dubbed the "Dream Team," a term the press picked up on, the new appointees didn't disappoint when they immediately stressed the necessity for reducing Hungary's large deficits.

The new financial team made the privatization of Hungarian industry a top priority; they agreed that the importation of new capital into the Hungarian economy and the infusion of Western managerial experience brought to privatized companies was the soundest way for Hungary to jump-start itself out of its financial dilemma. From that point on, the pace of privatization accelerated. With the urging and consultation of the United States, the Hungarian privatization agency, given the green light in 1995, sold 42 companies in its first four months, which brought in about $620 million of new capital. Most of that money went to repay foreign debt, putting the country on a stronger financial footing. The Hungarian government's signal that foreign investment was welcome resulted in additional direct foreign investments of $10 billion by 1997, reducing government ownership of industry to less than 30 percent.

The size of Greece's current financial crisis and its potential devastating impact, if not resolved, are much greater than those challenging Hungary or Europe in the 1990s. Hungary's default would not have threatened European governments or financial institutions. And like Hungary in the 1990s, the need for Greece to reschedule its foreign debt, reduce its public employment, and take unfortunate, but necessary, austerity measures, all take precedence. But, privatization, long overdue, will complement these measures and, most importantly, establish a healthier climate for sustainable recovery and the ultimate restoration of confidence in Greece's future.