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**The Merchants of the Kremlin: The
Economic Roots of Soviet Expansion in
Hungary**

Laszlo G. Borhi

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I. Introduction

Most historical literature has emphasized the differences between the postwar course of Hungary and that of the other satellite nations—specifically Romania, Poland, and Bulgaria—whose process of Sovietization was deemed to be more drastic and predetermined. In fact it has been suggested that had it not been for the Marshall Plan, a kind of democracy in East Europe might have survived.¹ Charles Gati, in his influential work *Hungary and the Soviet Bloc*, claimed that “it was the otherwise fully justified if belated American response to the sovietization of Eastern Europe...that prompted Stalin to speed up the sovietization in Eastern Europe, including Hungary.”² According to Gati, Communist party leader Rákosi was instructed to shelve revolutionary objectives for ten to fifteen years.³ There is no documentary evidence, however, to prove that such a Soviet instruction was given. Furthermore, there is new evidence—only some of which was available to Gati—that contradicts the view that Hungary's sovietization was a response to American policies. Finally, the scenario according to which Hungary was allowed to enjoy some measure of democracy until late 1947 does not take into consideration the dynamic, ruthless process of sovietization to which Hungary was subjected after 1945. Although Hungary had free elections in 1945, the government and the parliament that were elected had virtually no control over the country they were suppose to govern. New evidence suggests that in 1947 there was no change of paradigm in Soviet policies towards Hungary; sovietization had been intended from as early as 1945, and it proceeded more rapidly and effectively than previously imagined.

¹ Of the more recent literature which argues that the Marshall Plan caused a shift in Moscow's policy towards Eastern Europe: Vladislav Zubok and Constantine Pleshakov, *Inside the Kremlin's Cold War: From Stalin to Khrushchev* (Cambridge, MA and London: Harvard University Press, 1996), pp.103-108 and Vojtech Mastny, *The Cold War and Soviet Insecurity: The Stalin Years* (New York: Oxford University Press, 1996), p. 27.

² Charles Gati, *Hungary and the Soviet Bloc* (Durham: Duke University Press, 1986), p. 6

³ Charles Gati, *Hungary and the Soviet Bloc*, p. 37.

This paper concentrates on Soviet economic penetration in Hungary, which in itself was seen by contemporary observers as being capable of nullifying the results of the 1945 elections. The Soviet economic drive stood behind and indeed supported the gradual but drastic course which carried Hungary firmly into the Soviet sphere. In order to put Soviet *economic* expansion in Hungary into context, first I will briefly discuss the *politics* of sovietization.

Initially, the Hungarian Communist leadership talked about building a people's democracy. But they made it clear that socialism would take the back seat only temporarily, out of consideration to Soviet-Western relations and to preserve Hungarian unity while the German army was still on Hungarian soil. As Mátyás Revai explained: "If we expected the Red Army to implement the dictatorship of the proletariat, we would not be taking into account that the alliance between the Soviet Union, the United States and Britain would fall apart."⁴ Stalin gave the top-ranking Muscovite Communist Ernő Gerő clear instructions: "Don't be grudging with words, don't scare anyone. But once you gain strength, then move ahead."⁵ Rákosi's restraint did not last long. On 14 April 1945, only a few days after the last German soldiers were driven from Hungarian soil, he talked to the Hungarian Communist Party's (HCP) Central Committee about a new line. Rákosi mentioned the "changing international environment," i.e. "the growing Communist influence" in Romania and Czechoslovakia. He declared that "among such neighbors Hungarian democracy cannot be satisfied with the situation of four months ago, when we had to justify to the world that the government was not Communist. We overdid it a little. The persons we needed then can be gotten rid of, and the international situation is forcing us to do this as well."⁶ We now know that Rákosi discussed the issue of setting up a new Communist International (Comintern) with Stalin as early as March 1946 in the course of his secret mission to Moscow. Upon his return, he informed the Party Central Committee of his talks in Moscow,

⁴"Rossiski Tsentr Hranenie I Izuchenie Dokumentov Noveisei Istorii," RTsHIDNI, fond 17, opis 128 ed. Hr. no. 7. See also Bennett Kovrig, *Communism in Hungary from Kun to Kadar* (Stanford: Hoover Institution Press, 1979), p.169.

⁵ Quoted by Mihaly Korom, op. cit. pp. 333-334.

⁶"Information by Mátyás Rákosi to the HCP Central Committee on the political situation," 14 April 1945, RTsHIDNI, fond 17, opis 128, ed. hr. no. 37.

emphasizing Stalin's view on the Cominform and the sovietization of Hungary. On sovietization, the Hungarian party chief reported that:

...whenever a country achieves the conditions for the liberation of the proletariat or for socialism, it will be carried out, with no regard for whether the respective country is in a capitalist environment or not. This is also a new perspective, because in a country where these conditions are present, it [sovietization] has to be realized. This is fresh encouragement for all communist parties, whether or not the conditions for the liberation of the proletariat are created in their own country.⁷

Rákosi discussed the prospects for the revival of the Comintern as well. His speech, delivered in May 1946, coincided in time and content with the 28 May secret address of Nikos Zachariades, leader of the Greek Communist Party (KKE). Zachariades explained that the February-March congress of the Czechoslovak Communist Party, which had been attended by the representatives of European communist parties, decided on the strategy of a "consistent and uncompromising struggle against Anglo-Saxon imperialism." He told the KKE Central Committee that "the peoples of Europe, with the USSR as their beacon, will march forward towards their complete liberation, and no power, including the Anglo-Saxons, can stop this advance."⁸

Events count more than words. In November 1945, Hungary enjoyed free elections which were won by the Smallholders Party by a landslide. But no sooner were the coalition talks concluded (in which the Ministry of the Interior was assigned to the Smallholders) than Molotov intervened asking Marshall Kliment Voroshilov, the Chairman of the Allied Control Commission (ACC) in Hungary, to change the arrangement in favor of the communists, even though the regular and the political police both would have been overseen by a communist deputy minister without such a maneuver. Moreover, Molotov demanded two deputy prime ministerships, one for a communist candidate and one for a Social Democratic candidate. In a

⁷ This truly sensational document was published with introduction by Csaba Békés. See *Cold War International History Project Bulletin* 10 (March 1998):p.135.

⁸ Quoted in Eduard Mark, "The War Scare of 1946 and its Consequences," *Diplomatic History* 21: 3 (Summer 1997): p. 395.

new round of talks initiated by Voroshilov, Rákosi and the Hungarian premier, Zoltán Tildy proposed a compromise which was acceptable to Voroshilov, but not to Molotov. Molotov instructed Voroshilov and the Soviet Ambassador in Hungary, Georgii Maksimovich Pushkin, to put pressure on the Hungarians to negotiate a new deal. As a result, the communist Imre Nagy was put in charge of the Ministry of the Interior, while Rákosi and the ultra-left wing Social Democrat Árpád Szakasits were appointed deputy prime ministers.⁹

In March 1946, the communists embarked on the road to liquidate their chief rival, the Smallholders Party, based on an ultimatum from Rákosi. This came as no surprise, since communist leader József Révai had said that there would be a clash with the party's "right wing."¹⁰ As a result, several deputies were expelled. On 14 August 1946 the HCP Central Committee resolved that "we must break into the ranks of the Smallholders Party from above and below."¹¹ The pretext was the unmasking of the alleged anti-Republic conspiracy of the "Hungarian Community," a right-wing organization. On 9 January 1947, it was decided that a purge of the Smallholders would be demanded on the grounds that they had allegedly participated in the conspiracy. The attack focused on the party's general secretary, Béla Kovács, who was ambushed in Baden bei Wein and eventually taken to the Soviet Union in 1951, where he was tried in 1952. Premier Ferenc Nagy was forced to resign on 1 June 1947 while on vacation in Switzerland. Called back to give testimony on new information concerning the conspiracy, he decided not to return to Hungary. He was replaced by the pliant Lazos Dinnyés, who quickly proved his worth to Moscow by carrying out Soviet instructions to refuse to participate in the Marshall Plan. Elections followed in August, but were of little concern to the communists since Rákosi had been assured by Molotov that Soviet troops would remain in

⁹ "Voroshilov jelentései a Tildy kormány megalakulásáról" [Voroshilov's Reports on the Formation of the Tildy Government.] introduction by István Vida. *Társadalmi Szemle* 2 (1996.)

¹⁰ "The Meeting of the HCP Central Committee," 14 August 1946, RTsHIDNI, fond 17, opis 128, ed.hr.no. 37.

¹¹ *Ibid.* ed. hr. no. 121

Hungary.¹² In the elections, 460,000 Hungarian citizens were disenfranchised and an undetermined number of votes were fraudulently won by the communists, who still only managed to obtain 22 percent of the vote. Urged on by Moscow, Rákosi eliminated the remnants of the political opposition and nationalized what was left of the private economy. In the summer of 1948, the remainder of the Social Democratic Party merged with the communists to form the Hungarian Workers' Party (HWP). Sabotage trials clamped down on "bourgeois" experts, and a year later, probably at Soviet instigation, Rákosi rid himself of his intra-party opposition. Yet, Hungary's sovietization differed from that of Bulgaria, Romania and Poland in that total Soviet domination was first achieved in the economic sphere.

Most Cold War literature emphasizes the security and ideological aspects of postwar Soviet conduct and their relation to the causes of Cold War conflict. Economic expansionism as the tool of, and perhaps, the aim of Soviet foreign policy is, by and large, neglected even in works that emphasize that the Soviet takeover was premeditated or, even worse, knew no limits.¹³ This is quite surprising in view of the wide attention focused by the New Left and also in the so called post-revisionist literature on the perceived economic motives of American foreign policy.¹⁴ The economic aspect is missing from specialized literature dealing with the sovietization of Hungary.¹⁵ Such an absence is all the more conspicuous in light of the fact that historical and

¹² For the Molotov-Rákosi conversation, see: *Moszkvának jelentjük... Titkos dokumentumok, 1944–1948* [Report to Moscow...Secret Documents, 1944–1948], Lajos Izsák and Miklós Kun, eds. (Budapest: 1994).

¹³ On Stalin's alleged ambitions in Western Europe, see R.C. Raack, *Stalin's Drive to the West, 1938–1945* (Stanford: Stanford University Press, 1995). Igor Lukes, *Czechoslovakia between Stalin and Hitler: The Diplomacy of Edvard Benes* (New York: Oxford University Press, 1996).

¹⁴ See e.g. William Appelman Williams, *The Tragedy of American Diplomacy* (New York: Dell Publishing Co., 1962). The economic aspect of American conduct is emphasized also by John Lewis Gaddis, "The Emerging Post Revisionist Synthesis on the Origins of the Cold War," *Diplomatic History*, 7:3 (Summer, 1983).

¹⁵ Stanley M. Max, *The Anglo-American Response to the Sovietization of Hungary* (Ann Arbor: 1980). Stephen D. Kertész, *Between Russia and the West* (Notre Dame: University of Notre Dame Press, 1984). Charles Gati, op. cit. Bennet Kovrig, *Communism in Hungary: From Kun to Kádár* (Stanford: Hoover Institution Press, 1979). One paper, however did call attention to the significance of the economic sector in

theoretical works generally acknowledge the role economic factors play in expansionism, even though Marxist-inspired theories of economic imperialism are more or less discredited. Through the act of omission, then, historians perhaps unintentionally lend credence to the Marxist view that economic imperialism is the vice of capitalist powers only.

The role of economics in expansionism is widely disputed. According to Martin Wight, political, cultural and economic expansion is sometimes included as part of territorial expansion. Edward Luttwak argues that powers expand because it is in their power to do so and the motive of profit is only a side issue. As for the Kremlin, there were no merchants there, he says. Hans Morgenthau, in his classic *Politics Among Nations*, lists economic penetration as a tool and rarely an end for conquest. He argues that common characteristics of economic imperialism are “on one hand to overthrow the status-quo by changing the power relations between the imperialist nation and the other, and on the other hand to do so not through the conquest of territory but by way of economic control.”¹⁶ Kenneth Waltz, by contrast, expressed that “States use economic means for military and political ends and military and political means for economic ends.”¹⁷ That is, for Waltz economic imperialism is both a means and an end.

Based on evidence from the Hungarian archives, I found that the Soviet Union used drastic and very rapid economic penetration during its occupation of Hungary to destroy the economic pillars of Hungarian independence and, consequently, to further Hungary’s subjugation. The Soviets did so in several ways: first, by gaining control of key sectors of Hungarian economy using newly funded Soviet companies and joint Soviet-Hungarian companies operating in Hungary; second, by abusing its rights to Hungarian reparations and finally by reorienting Hungarian foreign trade. These measures, coupled with the steady

Hungary's Sovietization: András B. Göllner, “Foundations of Soviet Domination and Communist Political Power in Hungary,” *Canadian–American Review of Hungarian Studies* 3:2 (Fall 1976).

¹⁶ Hans J. Morgenthau, *Politics Among Nations, the Struggle for Power and Peace*. Revised by Kenneth W. Thompson, 6th edition (New York: Alfred A. Knopf, 1985) p. 73.

¹⁷ Martin Wight, *Power Politics* (London: Royal Institute of International Affairs, 1946) 40. Edward N. Luttwak, *The Grand Strategy of the Soviet Union* (London: 1973), pp.73– 74. Hans Morgenthau, *Politics*

introduction of elements of a centrally-planned economy through the communist-controlled Economic High Council, furthered Hungary's political subjugation. Using these methods, Moscow extracted machinery, foodstuffs, finished goods and raw materials, plus a continuous flow of monetary payments, that far exceeded the amount set by the Hungarian Armistice Agreement and Peace Treaty. In fact, at least in the beginning of the Cold War, the Hungarian economy was rigged to serve the needs of the Soviet economy.

II. Soviet Economic Penetration of Hungary

Reparations

Due to the outcome of the World War I reparation settlement, Washington espoused the idea that reparations should be extracted only to the extent it was possible to do so without ruining the losers' economies. In other words, reparation payments should not be fixed in advance, but ought to be calculated as a function of the given economy's capacity to pay. This principle was to be asserted in Hungary, which initially was jointly occupied. In fact, Department in December 1944, the British Foreign Office accused the U.S. State of attaching more importance to maintaining the standard of living in Hungary than to the justifiable exigencies of the Allies. Nonetheless, the British shared the principle. Since the Soviet view prevailed in the reparation settlement on 15 June 1945, however, Hungary's reparation obligations were fixed in advance in one sum, although Moscow conceded to change the size of the payment, eventually fixing it at \$300 million. This was to be paid over six years by deliveries in kind, the value of which would be judged by the Soviet Union alone based on 1938 world prices, on top of which they would receive a maximum bonus of 15 percent. According to an Office of Strategic Sources (OSS) report of October 1944, Hungary would be able to pay \$50 million annually for

Among Nations — The Struggle for Power and Peace (revised by Kenneth W. Thompson. New York: 1985)
Kenneth Waltz, *Theory of International Relations* (Berkeley: 1979), p. 94.

a protracted period without hurting its economy.¹⁸ Of course, at the time the report was written, no one could have known that the Hungarian economy was to suffer far more from October 1944 until the end of the war than it had prior to that time. Nonetheless, the OSS estimate coincided with the Soviet position, as outlined to the Western powers by Molotov on 30 December 1944.¹⁹ After the reparation payments were agreed upon, however, the Germans and later the Soviets dismantled and carried off a significant portion of Hungary's production capacity. Moreover, the labor force decreased drastically from late 1944 to April 1945 due to war losses and German as well as Soviet deportations. Finally, Hungary's capacity to pay the fixed amount of \$300 million was undercut by the arbitrary way in which the Soviets determined the price for the goods delivered to them. Averell Harriman, the U.S. Ambassador in Moscow, correctly asserted:

I must confess that I have sympathy for the Soviet view that \$50 million a year of goods as reparation payments from Hungary over [a] 6 year period is not in fact excessive... On the other hand, it seems clear that the manner in which reparations are completed, the character of goods demanded, and the value placed on them, are all matters which would vitally affect the recovery and stability of the economy of Hungary and Central Europe. *Whoever controls reparation deliveries could practically control [the] Hungarian economy and exercise an important economic influence in other directions.*²⁰ [My emphasis - L.B.]

Harriman could not accept the Soviet position that only countries with a vested interest in reparations could decide "the way in which they are collected." "*The British and we have an equal interest in the stability of Europe even though neither of us are demanding reparations from Hungary.*"²¹ [My emphasis - L.B.] To him, the reparations clause of the armistice agreement was unacceptable since it contained no provision for the Anglo-Saxon members of the ACC to have a say in reparation matters. For this reason the ambassador recommended that the Secretary of State put pressure on the Soviets to allow Anglo-Saxon

¹⁸OSS Research and Analysis Branch, microfilm no. 2417 (23 October 1944).

¹⁹30 December 1944, *FRUS* 1945 vol IV, pp. 948-950.

²⁰"Harriman to Stettinus," 31 December 1944, NAW DC, RG 59, 740.00119.

²¹*Ibid.*

participation in those problems. Harriman received instructions as of 13 December 1944 to “dissociate from the reparation clause,” but the Ambassador did not think that this would be “effective in changing the Soviet position.” He recommended that Soviet non-cooperation in economic matters “such as in the case of Hungary” should have a negative impact on other Soviet interests, such as U.S. lend-lease shipments.²²

Yet even before the first reparation shipments were sent, the war-torn country’s economic burdens were significantly increased when the Soviet Union placed on Hungary the responsibility of supplying the Soviet army with food, fodder and coal. This was done despite the fact that Article 11 of the Armistice Agreement only obligated Hungary to supply the Allied (Soviet) *High Commission* and the Allied missions of the ACC. In a memorandum to the ACC in 1945, Foreign Minister János Gyöngyösi wrote that supplying the Red Army had “nearly exhausted Hungary’s food reserve. The value of foodstuffs given to the Soviet Army in the months of April, May and June alone amounted to 1.5 billion pengős.”²³ In the second, third and fourth quarters of 1945, 64,500 tons of flour, 23,000 tons of beef, 91,000 tons of oats and 175,000 tons of hay were to be shipped to the Soviet Army, amounts which would have stretched public supply even if the Soviets had been willing to pay for the shipments, which was not the case. Not to mention the 52 tons of sweets “for non-smokers,” 25,000 buckets with zinc coating, soured cream, cottage cheese, milk, tea sugar, matches, tobacco, ground pepper, etc., which were all on the Soviet list for the three months.²⁴ For the last quarter of 1945, the Red Army demanded 40,000 tons of coal and 25,000 cubic meters of wood as well, although there was a serious shortage of both products.²⁵ All in all, Hungary was made to cater for 1-1.5

²²*Ibid.* Artúr Kárász, chairman of the Hungarian National Bank in 1945, commented in his memoirs: “In my view the Communists wished to realize the country’s conquest by indirect means. The chief method of this new type colonization was the transformation of the economy.” Reparations were used by the Soviets to effect such a transformation.

²³1945, MOL KÜM vegyes admin, XIX-J-1-k 4/fh 165, doboz ikt.sz.n.

²⁴1945, MOL KÜM SZU tük, XIX-J-1-j IV-483.1 24, doboz ikt.sz.n.

²⁵1945, MOL KÜM SZU tük, XIX-J-1-j IV-483.1 24, doboz 1912 11062/1945 M.E.

million men in 1945,²⁶ an additional burden which was not taken into consideration when reparations were calculated.

Reparations to be paid to the Soviet Union were spelled out by the agreement signed on 15 June 1945. This agreement was never discussed openly, and its text remained secret until the recent declassification of archival records. In the course of the preparatory talks, the Soviet representative declared that the 1938 world market prices would serve as the basis for calculating reparation shipments. The Hungarians argued that the armistice agreement made no mention of world market prices. Furthermore, for many of the goods demanded by the Soviets no such prices had existed, making “1938 world market prices” impossible to calculate. To accept 1938 prices—which were obviously lower than the current ones—would seriously strain the economy and might cause inflation. These observations were conveyed to Voroshilov's deputy, Major-General Stahurskii and Pushkin. To make things even more difficult, Moscow demanded the dismantling of plants that were actually producing goods for reparations. General Valerian A. Zorin, who represented the Soviet government at the negotiations, pointed out that the reparations talks were not normal commercial negotiations and hence different principles would prevail.²⁷ For the factories, the situation was made even harder by the fact that, besides fulfilling reparation obligations, they had to satisfy the Red Army's military orders, too. Deliveries under the reparations agreement came under three major headings: 1) “Existing equipment,” which meant that specified machinery in certain power stations and plants had to be dismantled and transported to the Soviet Union. The stipulation involved nearly all the significant industrial plants: e.g. the power stations at Ajka and Hatvan, certain units of the most significant and developed Hungarian industrial complexes, the Manfred Weiss Works, units of Lampart, Rimamurányi Salgótarjáni Vasmű (Rimamurányi Salgotarjáni ironworks), Almásfüzíté Timföldgyár (Almásfüzítő Aluminium oxide works); 2) “New machines,” which included railway equipment, ships and metals to be produced according to

²⁶Sipos Péter, “Two Armies - Two Occupations in Hungary in 1944-1945,” *Bulletin du Comité International d'histoire de la Deuxième Guerre Mondiale*, op. cit. p 138.

²⁷MOL KÜM SZU tük, XIX-J-1-j IV-536 29, doboz ikt.sz.n.

technical parameters prescribed by the Soviet Union; 3) “Agricultural goods”, such as grain, seeds, livestock, and horticultural products.

The composition of the reparations shipments, mostly industrial products, was in itself a great setback for the Hungarian economy. It was no coincidence that the Hungarian government's original proposal had primarily offered agricultural goods towards reparations. In spite of the serious food shortage in the Soviet Union, Moscow preferred machines to agricultural products. More than half of Hungarian industry and practically all of Hungarian heavy industry was under Soviet supervision and working for reparations.²⁸ According to the figures given by historians Pet and Szakács, international obligations flowing from reparation payments amounted to 30 percent of the total budget until 1948. The major part of this went to the Soviet Union.²⁹ Other data, however, suggests that this was only an average. The figure was much higher in the years 1945- 1946, which were key years for Hungarian economic recovery and political-economic independence. Artúr Kárász thought that reparations made up 50 percent of the 1945 budget;³⁰ István Kertész estimated it to be 60 percent, in the last 4 months of 1945 and 40 percent in the first half of 1946.³¹

Although reparations were fixed according to 1938 “world market prices,” in actuality the prices of goods were set by the Soviets. In the course of negotiations, they determined which products they wanted and what their 1938 values were. In order to squeeze the largest possible amount of the \$300 million, they made up prices which were both unrealistic and fictitious. One example of such a practice was the case of floating cranes and ships produced by Ganz Co. The prices for the floating cranes were determined by the Hungarians according to 1938 prices (that is in accordance with the letter of the armistice agreement, which made no mention of “world market”), while those for the ships were calculated according to the costs of

²⁸Pető Iván-Szakács Sándor, “A hazai gazdaság négy évtizedének története,” *Vizgazdasági és Zöngéki V`nyukiado*, 1 (Budapest: 1985), p. 21.

²⁹*Ibid.* pp. 90-91.

³⁰Kárász Artúr, op. cit. pp. 81-86.

³¹Stephen D. Kertész, *Between Russia and the West: Hungary and the Illusions of Peacemaking*, (Notre Dame: University of Notre Dame Press, 1984), p. 43.

the vessel “Tisza” built in 1939. Lieutenant-Colonel Riabchenko protested, saying that the prices given were far higher than they would be in America. Hungarian experts countered that the Americans were making larger ships and, more importantly, in mass production. This made their prices lower than those Hungary could offer. Riabchenko was not moved; he insisted on world market prices, disregarding the argument that in many cases Hungarian products had no world market values since they had been previously produced only for domestic consumption.³² In a 1947 note, the Hungarian government charged that due to under-pricing, \$145 million worth of goods already delivered were in actual fact worth \$225 million. Disregarding actual 1938 prices, 270 vertical milling machines and 550 radial drilling machines were shipped at one-third of the “real price”, 525 locomotives for half, 15 thousand electric engines for only 15 percent.³³

Since the exchange rate of the Hungarian currency (peng) to the dollar was 5.16 to 1, calculated with the 10 and 15 percent bonuses, 933 million pengs worth of goods should have been shipped to the Soviet Union. Research undertaken by the Hungarian National Bank in 1945, however, concluded that one “reparation dollar” cost the Hungarian economy 10.2 pengs to produce,³⁴ i.e., nearly double the official exchange rate. In turn, this meant that 200 million dollars worth of goods cost 26 million 1938 pengs to produce or purchase- twice as much as originally planned.

The cost of shipping added 15 to 20 percent, and the penalty for late shipment another 5 percent to the original costs, for a grand total of ca. 2,520 million pengs in 1938 prices. Considering that national income dropped by 50 percent (compared to 1938 figures), reparations according to a 1947 estimate amounted to 19 to 22 percent of the national income.³⁵ This figure does not include the extra costs accruing from the arbitrary fixing of prices.

³²1945, MOL KÜM SZU tük, XIX-J-1-j IV-480.1 23, doboz ikt.sz.n.

³³“The Foreign Minister's note verbale,” MOL KÜM SZU tük, XIX-J-1-j IV-536.2 30, doboz 452/Pol./res-1947.

³⁴“Note on Hungary's reparation obligations,” 1945, MOL KÜM SZU tük, XIX-J-1-j IV-526.5 28, doboz ikt.sz.n.

³⁵ “Memorandum to the Minister of Industry,” 30 November 1947, HNA, XIX-F-1-b doboz. 11-025-1947.

The maintenance of the Red Army and, though to a much lesser extent the ACC, came to 262 million 1938 pengos. This figure is 10 percent of the national income at the time, adding up to 29-32 percent together with the reparations. As a result of war damage, reparation and reconstruction burdens, per capita national income plummeted from 543 pengos in 1938 to 177 in 1945. The most unfortunate consequence of all this was the worst inflation in Hungarian history; eventually people's money had to be weighed on a scale because it had lost all value.

While industrial production in 1945 was only 35 percent of that in 1938, and production of reparation goods required significant expenditures for imports, industrial equipment taken by the Soviet Union for reparations in 1945 amounted to 250-300 million pre-war pengos (\$50 million.)³⁶ The National Bank wanted reparations not to exceed 30 percent of the national income, since a 50 percent decrease of the latter put an unbearable strain on the economy, but the government approved the list of shipments. As a result, the quantity of goods available shrank drastically. This, combined with newly-acquired purchasing power, led to runaway inflation. An opportunity was in turn presented to eliminate the market economy under the pretext of "stabilization," and to adopt a Soviet-type economy under the heading of state intervention. Obligations to the Soviets involved industries that were the cornerstones of reconstruction. At the same time, the Soviets dismantled plants as a penalty for tardy shipments. The vicious circle was completed by the fall of production, making it more difficult to meet delivery deadlines, thus giving the Russians the right to take possession of even more industrial objects.

One of the activities that was the most injurious to the Hungarian economy was the dismantling and transportation of industrial plants and machinery out of Hungary. This practice was started by the Germans and continued by the Soviets, who took entire factories as war booty. The best known case was the dismantlement of the pride of Hungarian industry, Egyesült Izzó, which produced lighting equipment. Egyesült Izzó (Tungsram) was in part American-owned and represented contemporary high technology. The Soviets began

³⁶ "Note on Hungary's reparation obligations," 1945, MOL KÜM SZU tük, XIX-J-1-j IV-526.5 28, doboz ikt.sz.n.

dismembering it in the spring of 1945, while German and Soviet troops were still fighting in Western Hungary. On 28 March, the first shipment of machinery was sent to the USSR under the guidance of Soviet General Galdin. The process of dismantling Egyesált Izz\ lasted eight weeks and required 600 to 700 wagons. Ninety-six percent of the production capacity was taken away, as well as 50 percent of the light bulb stock, 75 percent of the raw material stocks of the Újpest plant (Budapest), plus 90 percent of the raw material and semi-finished stock from the warehouses at Tárnok. The looted material was valued at \$12 million, or 6 percent of Hungary's reparation obligations to the Soviet Union. Despite the Hungarian government's repeated requests to the Soviets to deduct the value of the companies and equipment that they had seized as war booty from the sum to be paid for reparations, the Soviet government refused.³⁷ The United States sent four notes to the Soviet Union on the Tungram issue, but received not one response. Only when the American representative in the ACC, General William S. Key, intervened did the Soviets give an elusive first answer.³⁸ Later, they were forced to acknowledge that Tungram was not on the list of reparations, and that it had been war booty. Tungram was not an isolated case, and in June 1945 the Hungarian government requested that the ACC halt “the dismantlement and transportation of equipment from factories and plants.”³⁹

The Hungarian Ministry of Foreign Affairs pointed out that the dismantlement of industrial objects “weighed heavily on Hungarian economy,” and therefore the Hungarian government “most emphatically demands that the Soviet army prohibit without delay and most seriously the still continuing requisitioning and transport of industrial equipment, finished products, raw materials and other goods not included on the list of reparations, and also, that all the goods that the Soviet army had already taken, but which under international law could not be regarded as war booty, be either restored to Hungary or be counted as reparations.”⁴⁰

³⁷MOL KÜM SZU tük, XIX-J-1-j IV-536 30, doboz ikt.sz.n.

³⁸1945, FRUS 1945 vol IV, p. 825.

³⁹1945, MOL KÜM vegyes admin, XIX-J-1-k 4/fh 165, doboz ikt.sz.n.

⁴⁰“The Foreign Minister's Note Verbale,” 1945, MOL KÜM vegyes admin, XIX-J-1-k 4/fh 165, doboz 174/F.B.

Nevertheless, the list of machines and equipment taken by the Russians as war booty was a long one. At the top was Tungstram, followed by Felten and Guillaume Cable and Wire Ltd., whose partial dismantling seriously hindered the flow of reparation shipments. Several dozen others appeared on the list of partially or fully requisitioned plants, including some of the cream of Hungarian industry: Magyar Optikai Művek (Hungarian Optical Works), Goldberger és Fia (Goldberger and Son Textile Works), Ganz és társa (Ganz and Associate) Ltd. (machine industry), Dunai Repülőgépgyár (Danube Aircraft Factory), Magyar Finommechanikai Művek (Hungarian Precision Engineering Works) and Weiss Manfréd Konzervgyár (Manfred Weiss Canning Plant.) Since no answer was forthcoming, Prime Minister Ferenc Nagy presented himself personally (!) at Voroshilov's office in order to repeat the above request, but his mission was unsuccessful.

One part of Manfred Weiss's machines was put into wagons in 1944 by the Germans, who ran out of time to take them out of the country. They were then taken over by the Russians, who stored the valuable equipment at various railway stations without packaging or putting canvas on them, leaving them to the vicissitudes of weather.⁴¹ The Soviets took the inventories of other units, without dismantling them. Hofherr and Schrantz Ltd. agricultural machine plant, Magyar Wagon- és Gépgyár (Hungarian Wagon and Machine Works), and Neményi Papírgyár (Neményi Paper Mill) were some of those affected.⁴²

Some historians have argued reparations exerted a *positive* influence on the Hungarian economy as well:

...it promoted reconstruction, the modernization of industry and important technological development. Its direct positive impact was that it made possible the solution of the seemingly desperate raw material situation ... the restoration of foreign trade links, and therefore contributed to Hungarian industrial development. On the other hand, massive orders to industry, especially heavy industry, promoted the

⁴¹"The list of companies dismantled fully or partially by the Soviet authorities, which are not on the list of reparations," MOL MEL, XIX-A-j-1893/1945 ikt. sz. n. and MOL KÜM SZU tük, XIX-J-1-j IV-536/5 31, doboz 116/45.

⁴²MOL KÜM vegyes admin, 4/fh 166 doboz 55, 824/II/2-1945.

introduction of mass production..., reparations became the source of modernizing Hungarian economy.⁴³

But reparations had *no* stimulating influence on the Hungarian economy at all. This would have been so *if* Hungarian industry had had an unused capacity to produce. It did not; reparations exceeded Hungarian productive capacity and diverted sources during a critical phase of economic reconstruction. They caused a shortage of goods, and therefore contributed to hyperinflation. The official and black market exchange rate of the dollar soared in the last two months of 1945, exactly when reparation burdens were the most excessive. Inflation was nurtured also by the large amount of easy to forge bank notes circulated by the Red Army. It is hard to agree with the statement that reparations solved the miserable shortage of raw materials, in view of the long list of such articles requisitioned by the Soviet Union or shipped there under reparation arrangements.

The Potsdam Declaration

The Soviet Union had at its disposal yet another way to acquire Hungarian (and other Axis) assets. The Potsdam Declaration, adopted at the 14 July-2 August 1945 conference in Potsdam, enabled it to dismantle and take possession of German property in Bulgaria, Hungary, Romania and the Soviet zones of Germany and Austria. Soviet authorities more often than not abused this provision and seized property that had little or nothing to do with German ownership. If a company was saved from Soviet seizure, it was an exception and not the rule. One such rare instance was Budapest Ford Motor Company Ltd. Ninety eight percent of its shares were owned by Cologne Ford Motor Co., which in turn belonged 52 percent to Ford Motor Co. Dearborn, Michigan.⁴⁴ Jóvátételi Hivatal (Office of Reparations) was going to hand over the company's full capital to the Soviets based on the decision made by a Soviet-Hungarian committee which was in charge of implementating the Potsdam Declaration. Ford

⁴³Berend T. Ivan, "Uzzuepites es Nagytobe," *Elleni Harc* (Budapest: 1972), pp. 49-50.

⁴⁴MOL KÜM USA admin, 23/d 51, doboz 40.150/4/1946.

turned to the Supreme Economic Council in order to have the decision reversed. This time intervention was successful and the economic division of the ACC modified the original ruling, giving only 43 percent of the capital to the Russians, leaving the remaining 57 percent with the original owner.⁴⁵

The Potsdam Declaration enabled the Soviet Union to acquire financial institutions as well, as the Hungarian government was forced to hand over property that belonged to Austria, France, the United States, England and other countries. One such example was Creditanstalt Bankverein, the Hungarian assets of which were handed over to the Soviet Union, even though the Austrian ACC in Vienna ruled that the bank was Austrian property. The basis for the Soviet Union's seizure of these assets was that the Austrian government was forced to give the shares of Creditanstalt Bankverein to the German Goering group after the 1938 Anschluss. However, according to the 3 January 1943 London Declaration, assets seized by Germany through coercion following the annexation of a country were not to be considered German assets. The Soviet Union signed the declaration.

A similar dispute occurred over Magyar Általános Hitelbank (General Credit Bank of Hungary), which controlled 40 percent of Hungarian industry. The Office of Reparations handed over 205,290 shares (23.3 percent of its registered capital) to the Soviet Union. These shares were the property of the German Dresdner Bank, yet the Germans acquired them through coercion from a French group under Banque de l'Union Parisienne and Union Européenne in 1941. This was obviously a situation in which the London Declaration should have been applied, but Moscow thought otherwise. France protested under the Declaration, and was joined by Great Britain and the United States. General Vladimir P. Sviridov, Acting Chairman of the ACC, responded by saying that Germany had acquired the shares legally, since according to his information, Germany had paid for them. The Soviet division of the Soviet-Hungarian committee rebuked a repeated French protest sent in May 1947 by referring to Article 24/2 of

⁴⁵*Ibid.*

the Peace Treaty.⁴⁶ The Hungarian government then informed France that it was not in a position to represent the French claim towards the Soviet Union, therefore Paris should turn directly to Moscow.⁴⁷ A U.S. protest against the Soviet Union's acquisition of 19,375 shares that had been seized by E.V. Nicolai Co. from Rothschild Bank as a result of an intervention by German authorities was also unsuccessful.⁴⁸ However, the U.S. managed to save IT&T from being taken over by the Soviets even though 14 percent of the company was held by a German group.⁴⁹

Moscow's offensive on the economic front clearly alarmed Washington. By the end of 1945, it was evident that if economic collapse could not be halted, free elections would be held in vain. The American minister in Budapest, Arthur H. Schoenfeld, who as Minister to Helsinki during the Russo-Finnish war had experienced Soviet policies first hand, claimed in the spring of 1946 that “one time economically independent Hungary has in the space of little more than a year gone far towards becoming a Soviet economic colony... In one year, the USSR has acquired more far reaching control over Hungarian commerce and industry than the Germans [had]...”⁵⁰ Clearly, the Soviet Union was striving for a similar role in Hungary's economy as its predatory predecessor—that is to become Hungary's major investor and foreign trading partner. In November 1945, Hungarian Minister of Finance Ferenc Gordon and Hungarian Minister of Public Supply Károly Bárányos demanded a review of Hungary's economic situation and Anglo-American intervention on behalf of the country. U.S. Minister Schoenfeld believed that public dissatisfaction due to the economic chaos would bring down the ruling government and lessen the enthusiasm for democratic development. To prevent this from happening he

⁴⁶This article obliged Hungary to restore from its territory assets that were seized in United States territory by force or coercion, irrespective of any later transaction, through which the present owner of those assets got hold of them.

⁴⁷MOL KÜM SZU tük, XIX-J-1/j IV-510/c 26, doboz ikt. sz. n.

⁴⁸*Ibid.*

⁴⁹“Schoenfeld to Marshall on Soviet economic penetration,” 21 March 1947, NAWDC, RG 59 86-4-50/5-747.

⁵⁰“The American Minister in Budapest to the Secretary of State,” 2 May 1946, FRUS 1946 vol VI, p. 293.

proposed that U.S. ACC representative Maj. Gen. William S. Key initiate negotiations with Voroshilov on Hungary's economic rehabilitation, and he recommended the expansion and acceleration of U.S. assistance.⁵¹ But Acting Secretary of State Dean Acheson only agreed to the implementation of the first recommendation, a tripartite approach to Hungarian economic problems.⁵² Yet, Schoenfeld continued to urge aid to Hungary partly to deny the communist claim that because the Western powers were disinterested in the country's well-being Hungary had to depend on Soviet goodwill, and partly to counterbalance Moscow's economic monopoly.⁵³

In early 1946, Hungary received \$10 million, and in July Congress approved a \$50 million Exim-Bank loan. Though the loan for Hungary was substantially lower, many interpreted this as a sign that the U.S. would not desert Hungary.⁵⁴ Byrnes was quick to sober the optimists; \$10 million was not a "loan," and the U.S. government would not guarantee that the amount's worth of surplus property would in fact be available. He repudiated Premier Ferenc Nagy's statement that a fuller understanding of Hungary's economic plight would result in further American loans.⁵⁵

Although the Hungarian minister in Washington, Aladár Szegedy-Maszák, proposed that an Exim-Bank loan be floated to Hungary, in mid-May 1946 Schoenfeld changed his mind and no longer supported the idea in view of Soviet economic penetration. The minister's change of heart was probably prompted by the ongoing Soviet-Hungarian talks on the establishment of joint-venture companies. In contrast to his February memorandum, he now thought that limited American assistance would not suffice to secure Hungary's economic independence until a Soviet-American accord on Eastern Europe was concluded. He bitterly stated that only Minister of Supply Károly Bányos opposed Soviet actions but had no political influence, while the Finance Minister Ferenc Gordon "cared only

⁵¹ "Schoenfeld to Marshall," December 1946, FRUS 1946 vol IV, pp. 918-920.

⁵² *Ibid.*, p. 921.

⁵³ "Schoenfeld to Byrnes," 2 February 1946, FRUS 1946 vol VI pp. 256-257.

⁵⁴ "Schoenfeld to Byrnes," 27 February 1946, FRUS 1946 vol VI p. 263.

⁵⁵ "Byrnes to Schoenfeld," 2 March 1946, *Ibid.* p. 264.

about momentary expedience and his personal safety.”⁵⁶ Schoenfeld also thought that the prime minister, upon his return from Moscow, deemed it tactically expedient not to oppose his pro-Soviet entourage, which was reflected by frequent allusions to his attachment to Hungarian-Soviet cooperation. The minister claimed that an Exim-Bank loan to Hungary would not have any important political effects, stating that “the situation had altered since February when assistance could have helped Hungary's ability to remain economically independent of the USSR. Unilateral American assistance now would make little contribution to Hungary's recovery because the Soviets would neutralize its beneficial effects.” Furthermore, “key Hungarian officials would divert American aid to the USSR.”⁵⁷ Although Byrnes actually recommended another \$10 million loan to Hungary, Acheson replied that the chairman and the chief economist of Exim-Bank had refused this option based on Schoenfeld's telegram. When Gordon raised the question of an Exim-Bank loan during the Hungarian government delegation's official visit to Washington in June 1946, his request was denied. State Department experts pointed out that the Bank did not want to make loans which the Department desired for broad political reasons but *were contrary to good banking standards*. The Bank had stated the likelihood of Hungary getting a loan was nil and told the Department to stop pressuring them. It was concluded that, “given the present state of the Hungarian economy, the credit policy of EximBank and other Federal agencies, the State Department has no available means of extending economic assistance to Hungary and thereby implementing its political objectives” there.⁵⁸ Clearly there was *no financial interest* in helping keep Hungary out of the Soviet sphere.

The most important effort to halt Hungary's economic sovietization came on 2 March 1946 when George F. Kennan, then with the U.S. embassy in Moscow, intervened with Molotov about the status of the Hungarian economy, *linking Hungarian rehabilitation with*

⁵⁶ “The Minister in Hungary (Schoenfeld) to the Secretary of State,” 2 May 1946, FRUS 1946 vol. VI p. 294.

⁵⁷ “Schoenfeld to the Secretary of State,” 2 May 1946, *Ibid.* pp. 293-294.

⁵⁷ “Schoenfeld to Byrnes,” 27 February 1946, FRUS 1946 vol VI, p. 263.

⁵⁸ “Memorandum of Conversation by Robert McKisson of the South-East Division,” *Ibid.* pp. 228-229.

⁵⁸ “Schoenfeld to Byrnes,” 27 February 1946, FRUS 1946 vol. VI. p. 263.

that of Europe as a whole. Kennan argued that his government was particularly interested in Hungary's economic stability, primarily in view of Hungary's contribution to "European recovery in general." He went on to remind the Soviet foreign minister that when signing the Hungarian armistice, Harriman had reserved the right to return to the question of reparations unless U.S. interests were observed. He referred also to the Yalta Declaration, according to which the three allies were to coordinate their policies in order to seek democratic solutions to the economic problems of the former Axis states.

Kennan objected to the Soviet Union's refusal of the American offer to cooperate, and criticized the Soviet government for not informing Washington of its intentions about the future of the Hungarian economy. He stated that Hungary's economic situation was deteriorating drastically, which not only made it impossible for the country to contribute to Europe's economic recovery, but threatened it with internal economic and financial collapse as well. "It is clear that this situation is due in a very considerable degree to the overburdening of the country with reparations, to requisitions, to the maintenance of very large occupying forces, to the interference of occupying authorities in economic matters and to the failure of those authorities to take energetic steps to combat inflation and other undesirable tendencies."⁵⁹ In Kennan's view, this situation was unacceptable to his government on two counts. First, if a nation was unable to take part in Europe's recovery, then the United States' burden in supplying Europe increased. Second, it was incompatible with the U.N.'s objectives to let the living standard of a nation sink below the poverty level. Kennan declared that the United States wanted to assure that the stipulations of the U.N. Charter related to cooperation among the nations for better labor conditions, economic adaptation and social security would be implemented. Finally, he warned that unless the Soviet Union cooperated with Washington on Hungary, it would be excluded from international economic cooperation under the aegis of the U.S. government.

The United States is at present engaged in the promulgation of a broad economic program of economic cooperation, designed to lead to the greatest possible freedom of international exchanges for all nations, great and small. It believes that this

⁵⁹ "The Charge in the Soviet Union (Kennan) to the People's Commissar of Foreign Affairs (Molotov)," 2 March 1946, FRUS 1946 vol VI pp. 265-267.

program will be mutually beneficial to all who participate in it, and wishes to see no nation deprived of those benefits. But it is self-evident that no nation can claim the benefits of broad international collaboration in the economic field unless it is willing to recognize corresponding obligations in its own international dealings: to refrain from seeking special privilege in particular areas and to use its best efforts, in collaboration with those of other countries, for the general promotion of world prosperity...The U.S. will necessarily have to be guided by this fact in formulating its economic policies.⁶⁰

Setting a deadline of 15 March, Kennan demanded that, within the framework of the ACC, the Soviet Union cooperate with the other two allies in “devising a program which will not only put a stop to the present disintegration in Hungary, but will also provide a framework within which the rehabilitation of that country and its earliest reintegration with the general economy of Europe will be possible.”⁶¹

Kennan’s warnings notwithstanding, Soviet reparation claims continued to receive priority over the demands of either the Western Allies or Hungary's own rehabilitation. The Soviets put forth their demands without consulting the British or the U.S. representatives in the ACC, and London and Washington’s position on the issue was not taken into account when the Potsdam Declaration was implemented. Because the burden of reparations and exports to the Soviet Union was so high, Hungary was unable to earn foreign currency and thus unable to keep its payment obligations to the United States. Hungary, after all, still owed Washington \$10 million borrowed prior to the war. Damages caused to American property in Hungary during the war were estimated at another \$35 million, but the American government postponed the collection of its claims.

The Soviets took their time in responding to Kennan's demarche. Deputy Foreign Minister Andrei J. Vishinsky's answer did not arrive until 21 April, in which he refuted the American charges and ignored the threats, but recommended cooperation. The failure by the Kennan note to noticeably alter Soviet behavior was significant enough that Kennan still

⁶⁰ “The Charge in the Soviet Union (Kennan) to the People’s Commissar of Foreign Affairs(Molotov),” 2 March 1946, FRUS 1946 vol. VI pp. 265-267.

⁶¹“Kennan's note to Molotov,” March 2 1946, NAWDC, RG 59 864-30/5-546. See also FRUS 1946 vol. VI-265-267.

remembered it 50 years later.⁶² Perhaps as a result of U.S. intervention, concessions were forthcoming when the Hungarian government delegation visited Moscow in April. The payment period for reparations was extended from six to eight years; Hungary was relieved of paying for the costs of the railway line built by the Red Army; and \$6 million worth of penalties for tardy shipment of goods were cancelled.⁶³ Furthermore, the Soviet leadership agreed to deduct the value of Hungarian investment in two mines on former Hungarian territory in Romania. Yugoslavia and Czechoslovakia also agreed to reduce installment payments,⁶⁴ decreasing from \$100 million—in theory at least—to \$33 million annually. Even so, the budget deficit was still \$20 million, not including the yearly \$50 million consumed by the Red Army.

At the April/July 1946 Paris meeting of the Council of Foreign Ministers, the Soviet Union proposed that Hungary be compensated by the Allies for one-third of its territorial losses suffered in the fight against Germany,⁶⁵ while Secretary of State Byrnes advocated reducing reparations. Both proposals were turned down. In order to halt the further deterioration of the Hungarian economy, the United States sent another note to the Soviet Union on 23 July, proposing to renegotiate Hungarian reparations. The note, which was made public to enhance the effect, alleged that payments to the Soviet Union tied up 80 to 90 percent of Hungarian heavy industry. It also alleged that of the \$345 million worth of damages inflicted on Hungarian industry (according to “reliable estimates”) \$124 million worth were caused by the Soviet Union. Moscow was again called upon to work with the United States and Great Britain in order to formulate an economic stabilization program. To help with stabilization, the American government returned the Hungarian National Bank gold reserve,⁶⁶ which had been removed to Austria in late 1944. This time it was Soviet Deputy Foreign Minister Vladimir G. Dekanozov

⁶²*Diplomatic History* (Summer 1996), pp. 527-536.

⁶³Vida István, “Iratok a magyar kormányküldöttség 1946,” *Ivi amerikai látogatásának történetéhez*, (Levéltári Közlemények: 1987), pp. 245-279.

⁶⁴FRUS 1946 vol. IV, pp. 260-261.

⁶⁵ FRUS 1946 vol. IV.

⁶⁶*Department of State Bulletin*, (1946), pp. 229-232.

who refuted the note within four days.⁶⁷ Washington never made another attempt to force the Soviets to cooperate in solving Hungary's economic problems, not even when requested to do so by the Hungarian government.⁶⁸

Hungary unsuccessfully attempted to qualify as “German” only such companies, which had been German owned even *before* the Anschluss.⁶⁹ The Soviets clung to their “liberal” interpretation of “German assets.” Their argument that it did not matter when or in what way assets were acquired by Germany made it possible for the Soviet Union to broaden its economic expansion. At the same time, Hungary was forced to assume responsibility for liabilities towards third countries on property taken over by the Soviets.

The Soviet government's list bore witness to the fact that Moscow was intent on controlling strategic branches of industry, including manganese, mining, aluminum, and coal as well as transportation industries and textiles. Among the companies to be taken over were Gróf Zichy Béla Urkuti Bányaművek (Count Béla Zichy Mine of Urkut)—Hungary's most significant manganese mine, Dunavölgyi Timföldgyár Rt (Danube Valley Aluminiumoxide Works), Transdanubia Bauxit Rt (Transdanubian Bauxite Ltd.), Bakonyi Bauxit (Bauxite Co. of Bakony) and Aluminium Ércbánya Ipari Rt (Aluminium Ore Industry Ltd) in the aluminium industry. Hungary had been among Europe's top producers of aluminium ore. Of the country's significant coal mining industry Urikány Zsilvölgy Hungarian Coal Ltd., Salgótarján Coal Ltd., Felsőmagyarországi Bánya és Kohómű Rt (Felsőmagyarországi Mine and Foundry Ltd.), and Magyar Általános Kőszénbánya Rt. (Hungarian General Coal Ltd.) were on the list of Soviet acquisitions. Industrial assets which Hungary was forced to give up included Dunai Repülőgépgyár (Duna Aeroplane Works), Orenstein és Iparvasutak Koppel Általános Gépgyár

⁶⁷ *Ibid.* pp. 263-265.

⁶⁸ This list was based on one prepared by the Hungarian National Bank for Dresdner Bank in 1942 of those companies, which under the 1942 German-Hungarian agreement were allowed to transfer dividends to Germany.

⁶⁹ On 14 April 1945, the Soviets presented Hungarian authorities with a provisional list of German assets to be handed over to the Soviet Union. Fifty companies were enumerated, the German owned assets and shares of which were to become Soviet property under the Potsdam Declaration.

Rt. (Orenstein and Koppel Industrial Railways General Machine Works), the most prestigious Hungarian industrial plant, Ganz and Co. Electric, Machine Wagon and Ship Plant Ltd., AEG Unio Hungarian Electric Ltd., as well as significant textile plants—in short, the Soviets took the most meaningful parts of what remained of Hungarian light and heavy industry.⁷⁰

The Hungarians maintained that only a minor part of the shares of the listed companies were in German hands. The Hungarian government produced documentary evidence to support its position: Bakonyi Bauxite Co. had been Swiss-owned, and the German shares of the coal mines Salgótarjáni Kőszénbánya, Urikányi Kőszénbánya, and Felsőmagyarországi Bánya és Kohómu had been repurchased by Hungary during the war. The shares of Dunai Repülőgépgyár Rt. had been in Hungarian hands all along, while less than 5 percent of the shares of Ganz és Társai Electric were actually German-owned; over 76 percent of Telefongyár Rt.'s (Telephone Works Ltd.) were American, while other companies had Austrian proprietors or the Germans acquired their ownership by coercion.⁷¹ While these companies were handed over, plants designated for reparations were being dismantled and shipped to the Soviet Union. When Soviet authorities deemed that insufficient progress was being made dismantling them, the ominous accusation of sabotage was often voiced in order to prompt the Hungarians to proceed more quickly.

Companies acquired by the Soviet Union under the Potsdam Declaration became Soviet companies operating extraterritorially and, producing for the Soviet Union. Their final fate was decided in 1952. According to a protocol signed between Hungary and the Soviet Union what remained of them—seventy-seven altogether—were resold to Hungary. That is how, e.g., the manganese mine of Urkut, or the well-known Austrian delicacy chain Meinl, renamed “Csemege,” returned to Hungarian possession.⁷²

⁷⁰“The prime minister's (Zoltán Tildy) note to the chairman of the ACC (Voroshilov),” MOL KÜM SZU tük, XIX-J-1-j IV-536.4 31, doboz 96-615/II-1945.

⁷¹ *Ibid.*

⁷² Among the compensation to be paid for them by the Hungarians to the Soviet Government between 1953-1956 were 2 million tons of bauxite, 3 million meters of cotton textile, 2.5 million meters of rayon and 1.4 million meters of woollen fabric.

One of the most significant Soviet claims against Hungary based on the Potsdam Declaration was the collection of German claims against Hungary. Before the Armistice, a clearing agreement had been in effect between Hungary and the Reich, in which Hungary had a significant surplus. Nonetheless, Sviridov demanded a payment of \$200 million, although Hungary's claim of 750 million Reichsmarks were waived by Article 30 of the Peace Treaty. This particular issue was settled after months of negotiations in Moscow between the Hungarian Minister of Finance Nyárádi and the representative of the Soviet agency overseeing Soviet property abroad, General Merkulov. According to the settlement, \$45 million were to be paid. Out of that sum, \$30 million had to be redeemed in three years, which the Soviet Union agreed to use or invest in Hungary; the remaining \$15 million was to be paid in four years.⁷³

Moscow insisted that the Hungarian treasury and firms settle their debts on a valorized basis to those Soviet companies taken over under the Potsdam Declaration. Inflation, however, so damaged the functioning capital of the national economy that few companies were able to pay their debts in cash. Therefore, they were forced to hand over all or part of their shares, enabling the Soviets to acquire the claims of these companies. Such a “snow ball” effect gave the Soviets an opportunity to slowly but surely get hold of a major part of industry.

Trade and the Joint Companies

Although the *New York Times* reported on 23 September 1945 that the Soviet Union had signed a treaty of economic cooperation with Hungary which would allow Moscow to exploit Hungary's major industries, natural resources, agriculture and transport, such a treaty had already been initialed much earlier. In the course of their visit to Moscow, Minister of Commerce Ern` Ger` (the second man in the Communist Party) and Minister of Industry Antal Bán (deputy secretary-general of the Social Democratic Party) had concluded a commercial and economic treaty of cooperation on 27 August without clear authorization by their

⁷³MOL KÜM XIX-J-1/j Szu tük, IV-526.5 28, doboz ikt. sz. n. For an account of the negotiations by the Hungarian negotiator see: Nicholas Nyaradi, *My Ringside Seat in Moscow* (New York: Crowell, 1952).

government. Upon his return to Budapest, Ger` commented that “the foundations of a lasting economic and commercial cooperation between Hungary and the Soviet Union had been laid.”⁷⁴ The trade agreement provided raw material and a market for the Hungarian textile industry, while the agreement on economic cooperation secured broad Soviet participation in the Hungarian economy. Hungary and the Soviet Union could participate in equal parts in existing or future companies in the iron, steel, aluminium, oil, electric, chemical and machine industry, banking, and in water, air and road transport. Joint-venture companies were to be established for industrial and agricultural development as well. The Soviet Union was to receive a 50 percent share in the joint-venture companies, the functioning capital of which was to be supplied by the Soviet Union. While the commercial part of the treaty was widely accepted, the section on economic cooperation was not approved of by several prominent politicians. The President of the Smallholders party and minister of reconstruction was against the treaty's ratification on the grounds that “it could involve the monopolization of the whole Hungarian economy, which in turn could facilitate the growth of the Soviet Union's political influence.”⁷⁵ János Ers, the head of the Office of Reparations, by contrast, argued that “Hungarian-Soviet trade of \$30 million will make it possible for Hungarian industry to make a huge leap in the field of reconstruction.” As part of the agreement, the Soviet Union was obliged to furnish raw material for the textile industry, iron and other metals, tractors, fertilizers, lorries, even sugar and raw materials for the chemical industry.⁷⁶

The significance of the treaty was not lost on the U.S. representative in Budapest; Schoenfeld thought that the ratification of the treaty “remains a critical Hungarian political issue. Non-Marxist ministers have thus far resisted but admit that in absence of outside resistance ratification is inevitable.”⁷⁷ In the meantime Voroshilov and Pushkin threatened to take all German assets to the Soviet Union in case the treaty was not ratified. Although Schoenfeld tried

⁷⁴Quoted in: Sipos Péter-Vida István, “Az 1945. augusztus 27-én megkötött szovjet-magyar gazdasági egyezmény és a nyugati diplomácia,” *Külpolitika*, 4(1985), p. 102.

⁷⁵ *Ibid.* p.14.

⁷⁶MOL KÜM Szu tük, XIX-J-1-j. IV-571/a 37, doboz ad 10 respol 1945.

⁷⁷ “Schoenfeld to the Secretary of State,” 6 October 1945, FRUS 1945 vol IV, p. 882.

to persuade Washington that a lack of Western assistance made the position of those resisting Soviet pressure hopeless, the State Department did not directly support the refusal to ratify. It was well aware that the West would be unable to counter Soviet repressions. Thus, for example, the Soviet Union could deny Hungary important raw materials which Britain and the United States would be unwilling to provide.⁷⁸

While the British encouraged the Hungarian government to turn to the ACC regarding the treaty,⁷⁹ Byrnes instructed the Budapest mission not to support those who wanted to turn down the agreement since the United States could neither compensate for those economic losses which a possible Soviet retorsion could inflict on the country, nor provide those goods, capital, and technical aid which Hungary would obtain in the framework of the accord.⁸⁰ At the same time, the Truman administration informed Moscow that the U.S. government was seriously concerned about the treaty; in particular about the clauses which gave the Soviet Union exclusive positions in trade, market and raw materials. It was therefore requested that the treaty's implementation be postponed until the peace treaty was signed.⁸¹ Since no Soviet response was forthcoming, the State Department decided to publicize the affair, declaring that the treaty violated the spirit of Yalta.⁸² Simultaneously the U.S. representative in the ACC called on Voroshilov “not to press the Hungarian government on behalf of the ACC to ratify the proposed agreement.”⁸³ Washington wanted to have the agreement modified so that, in the field of industry, agriculture, investment transport, banking, processing and Danubian shipping, it was made compatible with the most favored nation clause of the 1925 U.S.-Hungarian treaty.⁸⁴ The agreement envisioned in Washington would have provided equal opportunities for each country

⁷⁸Department of State Research and Analysis Branch, microfilm no. 3467.

⁷⁹Sipos Péter-Vida István, “Az 1945. augusztus 27-én megkötött szovjet-magyar gazdasági egyezmény ...” op. cit. p. 107.

⁸⁰FRUS 1945 vol. IV, p. 887.

⁸¹*Ibid.* pp. 888-889.

⁸²*New York Times*, 23 October 1945, p.1.

⁸³“Schoenfeld to the Secretary of State,” 25 October 1945, FRUS 1945 vol. IV, p. 898.

⁸⁴*Ibid.* p. 899.

in the economy and commerce, an “Open Door” type arrangement. Washington stated it would be “concerned” if the treaty were not modified in such a manner, especially since Romania's case showed that a similar agreement provided dominant, even monopolistic status for the joint-venture companies.⁸⁵

Given that the United States was opposed to the monopolization of Hungarian trade by the Soviets, it refused to negotiate its own commercial agreement with Hungary until the signing of the peace treaty.⁸⁶ In fact, the U.S. repeated what Great Britain had done in the face of German economic expansionism during the late 1930's: it recognized the dangers, but refused to alter its trade policies to counter it. Thus, e.g., Hungarian meat products—the country's main export item—were kept out of the U. S. because allegedly they did not meet U.S. animal health standards. The U.S. government did indicate, though, that it would validate the 1925 U.S.-Hungarian treaty even before the conclusion of a peace treaty and that it would work with the Allies to restore the Hungarian economy, and would support the activity of the American private companies in Hungary. It was implicitly promised that Hungary would be involved in the new liberal economic order. The Hungarian government was called upon to make sure that the treaty with the Soviet Union did not impinge on American economic interests, that it did not restrict American opportunities to reach Hungarian markets and raw materials, and that Hungary would extend to the U.S. commercial and investment opportunities similar to those offered to the Soviet Union. Finally, Hungary was told that the peace treaty would need to guarantee the most favored nation status and equal treatment of American citizens.⁸⁷

This position was in line with traditional American economic diplomacy and the recognition in American government circles that the economic division of the continent would seriously hinder the triumph of a new liberal political and economic order. Acting Secretary of State Dean Acheson summed up Washington's goals in terms of Hungary's future economic treaties: “We deem it essential that the satellites do not conclude treaties, agreements or

⁸⁵*Ibid.* pp. 908-909.

⁸⁶*Ibid.* p. 912.

⁸⁷*Ibid.* pp. 924-926.

arrangements which deny to Allied nationals access on equal terms to their trade, raw materials and industry,” and appropriate modification would have to be made of “any existing arrangements which may have that effect.”⁸⁸

Pressed from all sides, the Hungarian government was in dire straits. Prime Minister Béla Miklós Dálnoki convened a special meeting of the council of ministers in order to discuss ratification. Several members thought that Ger` and Bán had only had authorization to conclude a treaty on trade, and that the agreement they had initialed went well beyond their mandate. Dálnoki himself was of the opinion that the Provisional National Government's scope of authority did not extend to determining the nation's economic future for five years or more. For this reason, Ger` gave the treaty's text to members of his government and the political parties for further study.

In his presentation at the Council of Ministers' meeting, State Secretary István Balogh, a Smallholder, who was willing to cooperate with the Communists, proposed the treaty's ratification. He did not think that concerns about increased Soviet political influence were justified. He believed that the treaty was “beneficial for reparations,” but to turn it down would signal “the lack of confidence vis-á-vis the Soviet Union”; Hungary would not receive the benefits it desired and “a revolution would have to be counted with in the spring.”⁸⁹ In order to reassure world opinion, Balogh proposed that a *lettre d'envoi* be attached to the agreement to the effect that it did not discriminate against the United States and other countries, and was related *primarily* to those German assets which went to the Soviet Union on the basis of the Potsdam Declaration. Balogh's attitude was typical of the Smallholders in that he thought that concessions would appease the Soviets and their Hungarian Communist allies. Ger` thought that the treaty would safeguard the economy against a crisis. Minister of Industry Bán, representing the Social Democrats, and Foreign Minister János Gyöngyösi sided with Balogh, emphasizing that there was nothing exclusive about the treaty. Minister of Reconstruction Ferenc Nagy promised his support so long as it was clearly expressed that the treaty concerned German

⁸⁸*Ibid.* pp. 923-924.

⁸⁹“Record of the Meeting of the Council of Ministers,” MOL MEL XIX-A-83-a 21/45.

assets and was non-exclusive. The harmony was suddenly disturbed when Minister of Defense János Vörös, a general in Horthy's army who had joined the movement only to surrender to the Russians, expressed his disagreement with ratification and left the session in a huff. The Minister of Religion and Public Education proposed that the views of the British and American members of the ACC be sounded out, after having been informed that they objected to the treaty. He was told off by Ger`, who stated, "we have only one ACC and it is headed by Voroshilov and with his knowledge there is nothing more to talk about." Thereafter, the Council of Ministers forwarded the treaty to the Political Committee of the National Assembly and the Nemzeti Főtanács (Supreme National Council) with the above modifications. Surprisingly, the Soviets conceded to modifying the treaty, guaranteeing equal economic rights for all countries.⁹⁰ The Supreme National Council, not the parliament which would probably have rejected it, ratified the treaty in December 1945 with the stipulation that "this agreement by no means impedes the Hungarian state from concluding economic or commercial agreements of any kind with other states."⁹¹

In view of Hungary's tragic economic plight in April 1946, Schoenfeld proposed the rescheduling of Hungary's reparations—to which the Soviet Union agreed—specifically reducing burdens deriving from supplying the occupation army, the shipping of food and medicine, as well as raw materials and equipment.⁹² Schoenfeld believed that the Soviet Union refused to assist Hungary's economic recovery in order to promote economic collapse since that was a necessary part of Moscow's strategy of penetration, in full swing since the previous summer.⁹³ The Soviets, he thought, would be interested in reviving the Hungarian economy only when the program of economic penetration ended and "no sooner." The Soviet Union would then have a stake in increasing the productivity of its newly acquired property, and would want to attract American capital. The United States would then either give aid, which would benefit the Soviet Union, or deny assistance altogether. Schoenfeld urged rapid and decisive American

⁹⁰ It is a different question that nothing was realized of Stalin's compromise.

⁹¹ FRUS 1945 vol. IV, p. 926.

⁹² "Schoenfeld to the Secretary of State," FRUS 1946 vol. VI, pp. 258-259.

help before Hungary became “the Soviet Union's economic colony.” He also believed that the economic treaty would place Hungary firmly in the Soviet sphere of influence.⁹⁴ The American minister in Budapest was of the opinion that nearly all sectors of the Hungarian economy were under Soviet control, with only a small segment remaining free. Ministers of the government were allowed to leave Hungary to negotiate loans and economic benefits only with Soviet authorization. Danube shipping, air traffic, oil, bauxite, and aluminium production were under the Soviets control, and the Soviets did their best to divert foreign trade towards their own sphere. Communist sympathizers held key positions in the ministries of industry and transport as they did in the Supreme Economic Council.⁹⁵

Beside reparations and the seizure of “German assets,” Soviet-Hungarian joint-venture companies were the third major means of Soviet economic penetration, even if the Russians and their sympathizers tried to portray these ventures as economic assistance rendered to Hungary. The Soviet contribution consisted of assets seized under the Potsdam Declaration. Hungary's share was made up of remaining Hungarian property such as equipment, installations, and raw materials to be discovered by bauxite and oil companies. As a result of an overvaluation of the Soviet and an underestimation of the Hungarian contribution, Moscow acquired a larger share of the economy than the value of earlier German assets justified. Moreover, the companies had Hungarian presidents, but real power was vested in the Soviet directors.⁹⁶ The joint-venture company system was by no means unique to Hungary, similar ones were set up in Romania, Bulgaria and even China, but newly available documents from the Hungarian National Archives now provide an insight into how these companies promoted Soviet economic interests in Hungary.

“Joint-venture” companies were set up in the sensitive industries of transportation, oil, and bauxite. On 29 March 1946, a Soviet-Hungarian shipping agreement was signed, according to which a joint shipping company, MESZHART (Hungarian-Soviet Shipping Ltd.) was

⁹³*Ibid.* p. 260.

⁹⁴“Schoenfeld to the Secretary of State,” NAWDC, RG 59 864.00/1-3146.

⁹⁵“Report on events in Hungary,” 31 January 1946, NAWDC, RG 59 864.00/1-3146.

established. The company controlled navigation on the Danube, its tributaries, Lake Balaton, and on the seas, as well as the operation of ports, stations, ship factories, maintenance installations, and the management of companies involved in the production and procurement of fuel. MESZHART's capacity was significantly increased by the Soviet contribution. A 1947 agreement improved Hungary's maritime navigation by giving the contracting parties the right to use each other's ports and port services on the most favored nation basis—an arrangement that obviously benefited land-locked Hungary.

A similar accord was concluded a few days later, when MASZOVLET (Hungarian-Soviet Airlines) was set up, which was in charge of organizing and controlling Hungarian air traffic plus participating in the international airline network. MASZOVLET was given the right to exploit all civil airports and their installations for 30 years, and handed territory to construct new ones. A protocol to the agreement entitled the Soviet civilian air fleet to transit Hungarian airspace and gave it landing rights in Hungary, something that had been denied to the United States. Except for Hungarian and Soviet planes, no civilian aircraft were allowed to fly over or land in Hungary without Soviet permission,⁹⁷ even though Prime Minister Ferenc Nagy had previously promised the United States landing rights in Hungary. This exclusive access was preserved despite the 1947 Peace Treaty's provisions to the contrary.⁹⁸ On 8 April 1946, Deputy Prime Minister Árpád Szakasits and L. Nikolaievich Bobkov signed the Hungarian-Soviet Bauxite Agreement, establishing three joint-venture companies. The Soviet Union thereby gained a 50 percent interest in Alumíniumérc Bánya és Ipar Rt. and its subsidiaries, which controlled 90 percent of the country's bauxite resources, and obtained another 50 percent share in the second largest company in the bauxite industry, Magyar Bauxitbánya Rt.

⁹⁶“Memorandum on Soviet economic penetration,” 7 May 1947, NAWDC, RG 59 864.50/5-747.

⁹⁷*Ibid.*

⁹⁸Article 33/D stipulated that Hungary could not grant exclusive or discriminatory rights to commercial flights in international air traffic and should grant equal rights to all Allied Nations to acquire international commercial air flights on Hungarian territory.

The Soviets contributed former German assets in the Hungarian Bauxite Co. (acquired based on the Potsdam Declaration) and the equipment they obtained through reparations.⁹⁹

Special provisions were made to increase Hungarian bauxite production for internal consumption and export, but it stipulated that *the Soviet Union's needs would enjoy priority*. The companies were granted all their predecessors' rights to explore new bauxite deposits for an indefinite time.¹⁰⁰ The agreement provided that Hungarian authorities were to make available to these companies foreign currency (without restrictions) in order to cover their expenditures abroad. This provision put these companies in an exclusive position since other Hungarian firms and foreign companies operating in Hungary were not allowed to keep their receipts. The joint-venture companies were also exempted from all taxes and duties.¹⁰¹ The companies were directed by a board of directors, the managing-director and his deputy, plus the Assembly of Shareholders. The president of the board of directors was always Hungarian, while the managing director, who was responsible for administration, was always a Soviet citizen. He was the one who wielded real power since he was able “to act in all matters relating to the company;” he was empowered to sign agreements, issue bonds, and he was responsible for the acquisition, encumbrance and lease of assets, and for raising loans. The managing director, responsible also for the companies' banking and credit operations, had the right to hire and fire the firm's employees and to set their wages and salaries.¹⁰²

The German assets of Alumíniumérc Rt. and its subsidiaries, Victoria Vegyészeti Művek Rt. (Victoria Chemical Works, Ltd.), Tapolcai Ipar Rt. (Tapolcai Industrial Ltd.), Magyar Bauxitbánya Rt. (Hungarian Bauxite Mines Ltd.), and Dunavölgyi Timföld Rt. (Dunavölgy Alumíniumoxide Ltd.) were acquired by the Soviet Union.¹⁰³ Although the companies were

⁹⁹ See Eduard Mark, *The War Scare of 1946 and its Consequences*.

¹⁰⁰ The three joint venture companies: Szovjet-Magyar Bauxit-Alumíniumércbánya és Ipar Rt., Magyar-Szovjet Bauxit Rt., and Dunavölgyi Timföld Ipar Magyar-Szovjet Bauxit Alumínium Rt., were set up without time limit.

¹⁰¹ See Eduard Mark, *The War Scare of 1946 and its Consequences*, op. cit. 395.

¹⁰² See Eduard Mark, *The War Scare of 1946 and its Consequences*, op. cit. 395.

¹⁰³ MOL KÜM SZU tük, XIX-J-1-j IV-548 34, doboz 97 res/h 1946.

supposed to operate under Hungarian law, the Soviet managing directors often disregarded them and acted arbitrarily. Bauxite was used to produce aluminium, which was essential to the aircraft industry. Interestingly enough, the signing of the bilateral agreement on the bauxite companies roughly coincided with a report in late April 1946 that Junkers began to produce jet aircraft for the Soviet Union on a large scale, and that for this reason the Soviet authorities had banned the use of aluminium in other forms of manufacturing in the eastern zone of Germany.¹⁰⁴

Only four days after the Iranian government agreed to set up a joint Soviet-Iranian oil company to exploit crude oil in Northern Iran,¹⁰⁵ a similar agreement was concluded with the Hungarian oil industry as well. Signed on 8 April (just like the bauxite treaty), it created two companies: MASZOVOL (Hungarian-Soviet Oil Company) and MOLAJ (Hungarian Oil), which was acquired by the Soviets. It was stipulated that MASZOVOL inherited the concessions that had previously belonged to the Hungarian-German Oil Company (MANAT) to explore, drill and exploit crude oil and gas, and to process and sell oil and gas products. MASZOVOL acquired the Hungarian government's 15 percent share of all the crude oil produced in Hungary, which it had the right to export to those countries with which Hungary had a commercial treaty.¹⁰⁶ As for MOLAJ, the Soviet Union was given more than 50 percent of the Hungarian government's shares of the state-owned company (Magyar Olajmûvek) and was compensated for them by the Soviets. MOLAJ's, which largely refined oil, was allocated 15 percent of all crude oil refined in Hungary, plus a share of the remaining 85 percent of crude oil refinery business. All the rights and assets of the former German-Hungarian Oil Company (MANAT) were vested on MASZOVOL, thus all the concessions and obligations included in MANAT's 26 August 1940 Concession Treaty. It also received all the assets of Orenstein és Koppel Ltd.¹⁰⁷

¹⁰⁴ See Eduard Mark, *The War Scare of 1946 and its Consequences*, op. cit. 395.

¹⁰⁵ See Natalia Yegorova, "The 'Iran Crisis' of 1945-1946: A View from the Russian Archives," CWHIP *Working Paper 5* (Woodrow Wilson International Center for Scholars: May 1996), p. 20.

¹⁰⁶ *Ibid.*

¹⁰⁷ *Ibid.*

On 9 December 1947, a protocol was signed on the operation of Hungarian-Soviet companies. The protocol provided that Hungary give an advance payment of 33.5 million forints (3 million dollars) on profits and dividends to the Soviet Union in the form of commodities, out of which 3 million forints had to be invested by the latter in Hungary. The advance payment on profit and dividends was established even *before* the annual financial balance was known. That is, the profit had to be advanced by the Hungarian treasury to the Soviets, while other Hungarian or foreign companies in Hungary were not allowed to pay dividends to their shareholders or dispose of their profits. Such privileges, extended to Soviet companies from 1946 violated Article 33/C of the Hungarian Peace Treaty, according to which United Nations nationals “shall be granted national and most favored nations treatment” in “commerce, industry and shipping.”

The agreement also provided for the joint bauxite companies' right to explore bauxite. According to the agreement, if an applicant sought a concession for a territory also requested by a Hungarian-Soviet bauxite company, the latter automatically enjoyed priority, but it was obliged to fulfil the same conditions promised by the other applicant.¹⁰⁸

In 1947, the Hungarian Communist Party spelled out its economic policy objectives. Banking was to be centralized, banks were to be nationalized. Loans were to be controlled and supervised by the state, the nationalized banks were to become specialized so as to deal with the sphere of economy allocated to them. In the field of industry, nationalization was also the declared objective, and was to begin by directly nationalizing those firms which were financed by banks now under state control. Other firms were to be driven to bankruptcy in such a way so that they would have to sell most, or all of their shares to the state in return for loans—which could only be granted by the state, thereby making those companies completely financially dependent upon the state.¹⁰⁹ Domestic trade, allocation and procurement of important

¹⁰⁸ MOL KÜM Szu tük, XIX-J-1-j IV-548 34, doboz ikt. sz. n. 1947. The same agreement also provided that claims against the Hungarian-Soviet companies and the liabilities of Soviet companies in Hungary dated before 20 January 1945 were waived.

¹⁰⁹ Actually the Soviets acquired a formerly Austrian institute, Merkur Bank. It was renamed Kereskedelmi és Iparbank Rt, its capital was raised and was put in charge of the financial affairs of all companies with a

foodstuffs, other goods, and raw materials were to be brought gradually under state control; foreign trade was to become a state monopoly. The regime also made efforts to conduct 75 percent of Hungary's foreign trade with the Soviet Union and the "people's democracies." Fuels and raw materials were to be allocated, wages were to be regulated centrally.¹¹⁰

The program was fully implemented in 1948; the private sector and foreign investments (except Soviet ones) were eliminated, production, the regulation of prices and wages were the prerogative of state organs. Although the Soviet companies and the joint Soviet-Hungarian ones were in an exceptional position, the centralized economic system was in many cases detrimental to them as well.

In 1949, Soviet-Hungarian economic talks took place in Moscow. The negotiations focused on the fusion of joint companies operating in the oil and bauxite industry and the problem of fitting these companies into the new economic system. The serious Soviet-Hungarian conflicts, which had resulted from the operation of the joint companies, now surfaced. The Hungarians endeavoured to protect their country's economic sovereignty within the limits set by previous agreements and the political relations. On the other hand, Moscow wished to preserve its privileges and to put even more favorable conditions into the new treaty. The head of the Soviet delegation, Vladimir Dekanozov, remarked: "...the victorious country demands to assert its rights for the reason that the defeated nation started war against her."¹¹¹ The Hungarian delegation, headed by István Vörös, argued that "the Soviet companies in Hungary and the

Soviet interest in Hungary. Moscow got hold of 80 percent of the Budapest branch of Creditanstalt Bankverein and an 18 percent interest in Általános Magyar Hitelbank (General Hungarian Credit Bank). As provided by the Italian peace treaty, the Hungarian-Italian bank became Soviet-owned, which had been one of the five most important financial institutes in Hungary prior to World War II. See Pető Iván-Szakács Sándor, *A Nazai Gazdasági JvitizedJnde t`rtJnete*, op. cit. 24-26.

¹¹⁰ RTsHIDNI, fond 17 opis 128 No. 309. The documents produced by the leading organs of the Hungarian Communist Party can be found in the files of the International Department of the CPSU in Moscow.

¹¹¹ MOL KÜM XIX-J-1-j Szűk, IV-510/b 26, doboz ikt. sz. n. The second Moscow session of the Soviet-Hungarian economic talks. The meetings of the permanent Committee, 11 April 1949. Dekanozov was a subordinate of Merkulov's in the agency for Soviet Property Abroad (Gusimz). He had previously been Deputy Minister of Foreign Affairs and had worked for the NKVD as Beria's confidant.

Hungarian-Soviet joint venture companies should be fitted into the country's external and domestic trade relations.” Dekanozov retorted that it was “unjust that in those companies, in which the [Soviet Union] is an owner, and which produce *strategically and economically* strategic materials, like bauxite and oil, the Soviet Union should have no say.”¹¹² The Deputy Foreign Minister was twisting the truth: it was Hungary which was trying to gain influence in controlling and directing the companies. The Hungarians stated that

the institution of the managing director lends the companies a Soviet character and certain Soviet organs in Hungary instruct those companies as if they were Soviet ones. The managing directors should be a part of the uniform system of control, and the Hungarian side would like to secure a full influence on the functioning of the companies ... the institution of the managing director means that the companies are looked upon as Soviet ones.¹¹³

Thus, e.g., the managing directors did not comply with a decree stipulating that the insurance contract had to be made with a native insurance company, nor with the law that all companies operating in Hungary were supposed to use a Hungarian bank for their financial transactions.¹¹⁴

With regard to the question of prices, an ambiguous situation existed. As co-owner, the Soviet Union had a legitimate claim in formulating bauxite and oil prices, but in the recently established economic system, only the Hungarian Office of Prices theoretically had such a right. Moscow was also able to refer to the fact that it was the number one purchaser of the above commodities and wished to involve the Soviet *state* authorities in fixing the prices. The Hungarians thought that this demand was tantamount to an infringement of Hungarian sovereignty and made a counter-proposal to the effect that the Office of Prices would *consult* with the Soviet head of the companies, but the Hungarian authorities would have the final word.¹¹⁵

¹¹²MOL KÜM XIX-J-1-j Szu tük, IV-510/b 26, doboz ikt. sz. n. The second Moscow session of the Soviet-Hungarian economic talks. The second meeting of the permanent Committee, 11 April 1949.

¹¹³ *Ibid.*

¹¹⁴ *Ibid.*

¹¹⁵ *Ibid.*

One of the biggest disputes was that concerning the profits and dividends of the oil companies. These had to be renegotiated, since the two joint oil companies had been fused into one. Both sides agreed on the absurd provision that the profit should be determined in advance for several years in a fixed sum, including the rate of growth: what they could not agree upon was the sum. The Soviets demanded an unrealistically high figure, one which did not follow from earlier results. While the Hungarians desired to calculate the profit by taking into account earlier profits—which were themselves arrived at fictitiously, the Soviets wanted profits calculated according to a fictive multiplier, in proportion to the capital of the two companies added together. Hungary was reluctant to do this, since MASZOVOL, one of the other companies was actually fact showing a deficit.¹¹⁶ Additionally, the Soviets demanded that the 15 percent royalty going to the Hungarian government under the earlier concession treaty be reduced to 5 percent. Moreover, the Soviet Union wanted to change the mining law in effect since 1911 in order to abolish the institution of mining concessions. The aim of this was to vest exploration, drilling and production rights directly in the joint companies.¹¹⁷

According to the 1946 agreement, the companies were allowed to dispose of their own products, but the nationalization of domestic and foreign trade required that they renounce this right in the new 1949 agreement. State foreign trading companies would henceforth take over. The Hungarians, however, insisted that they be obliged to take the amount fixed by the Planning Office (a state organ responsible for formulating plans for the national economy's production). This, of course, violated the Soviet owners' right to have a say in the production of their own companies. The Soviet delegation wished to set this right and demanded that the production plans of the two countries be harmonized with those of the joint companies. This issue raised the same problems of state sovereignty as that of prices.¹¹⁸ In their finances, the joint companies

¹¹⁶*Ibid.*

¹¹⁷*Ibid.*

¹¹⁸*Ibid.*

did not participate in the single-account system of the Hungarian National Bank, but had their accounts kept by the Soviet-owned Kereskedelmi és Iparbank¹¹⁹

The talks ended in a compromise, in part due to skillful negotiation by the Hungarians, and in part because Moscow decided to make concessions on the less significant questions. At Hungarian request, Moscow thus dropped its proposal to acquire 50 percent of Ajkai Ermés Trust (Ajka Power Station) and thereby acquire a significant portion of the Hungarian electricity industry. The negotiators came close to concluding an agreement on making the Soviet-owned Urkut Zichy manganese mine a joint company (Maszovmangán). The idea was not realized because the Soviets wanted a share in the full Hungarian production of manganese, which the Budapest government found unacceptable.

The Hungarians also wanted a revision of the properties it believed had been erroneously seized by the Soviet Union under the Potsdam Declaration, but Moscow adamantly refused to give in on this point. All the Soviet government was willing to agree to was a deal, whereby the Potsdam issue was pronounced closed, and in return, the Soviet authorities terminated their search for further German properties in Hungary. The Soviet Union assumed responsibility for dealing with foreign governments that filed requests against Hungary as a result of the Potsdam Declaration's implementation. This was a significant development since several governments, including the British and the French, had put forward claims against Hungary. Furthermore, the Soviet Union renounced its claims to German landed property which had been assigned to new holders in the course of the 1945 land reform.¹²⁰

The Hungarian-Soviet airline was instructed to take into account the Hungarian government's financial wishes "as far as possible," but the Hungarian treasury continued to finance its losses. The Hungarians were only able to gain influence on the company's schedule for foreign flights. As a compromise, however, the three joint companies' accounts were transferred to the Hungarian National Bank, although the rest of the joint firms accounts continued to be held by the Soviet financial institution in Budapest.

¹¹⁹Translation: "Commercial and Industrial Bank".

¹²⁰ *Ibid.*

The several Hungarian-Soviet bauxite companies were restructured into one such firm (Maszobal), just as had happened in the oil industry (Maszolaj).¹²¹ Compromise was reached concerning the price question of bauxite-aluminium commodities. According to the agreement signed in Moscow on 31 December 1949, when fixing the prices, the Hungarian authorities were to instruct the price authorities “to make preliminary consultations with the Soviet representative in the company, and to take into account his observations as far as possible.”¹²²

Hungarian state organs were to sell the products of the joint companies, and the Hungarian government obliged itself to purchase the amount of products fixed by the state economic plan. This meant that the joint companies were forced to produce the amount envisioned by the Hungarian authorities. The Soviet Union also withdrew its claim to participate in the formulation of the Hungarian plan. The question of oil profits was left unresolved by the treaty—the only reference to the issue was a sentence providing that profit would be paid only in case production exceeded an annual 50,000 tons. Hungary reserved the right of concession, and the 15 percent royalty was payable only if production exceeded the 50,000 ton annual minimal limit.¹²³

The leadership of the joint companies was left to the Soviets with slight modifications. A member of the Hungarian delegation, László Bauer, who was an expert from the Hungarian Workers’ Party, declared that “as far as the role of the deputy managing-director is concerned, we do not want them to be limited to secondary roles, for them to become puppets, which in certain cases did in fact occur.”¹²⁴ As a compromise, Moscow agreed to instruct its representatives in the companies to adhere strictly to Hungarian laws and decrees, but reserved

¹²¹The founders of the new Hungarian-Soviet Bauxite-Aluminium Joint Stock Company were the Hungarian Ministry of Heavy Industry and the Glavnoe Upravlenie Sovetskim Imuchestvo za Granitsei (Gusimz - High Commission of Soviet Property Abroad) operating beside the Soviet Council of Ministers. The shares of Hungarian-Soviet Oil Joint Stock Company were held by the same organs.

¹²²“The 31 December 1949 Hungarian-Soviet agreements,” 31 December 1949, MOL KÜM Szu tük, XIX-j-1-J iv 548.1 35, doboz ikt. sz. n.

¹²³*Ibid.*

the right to turn to the Hungarian government if certain legislation was seen to violate the companies' contractual rights. Hungarian legislation had to maintain the rights granted to the joint companies in the agreement.¹²⁵

Finally, the 1949 agreement provided for an exchange of shares. The Soviet Union handed over to Hungary those properties, which it acquired as German assets, but in which its share was less than 50 percent, and Hungary turned over to the Soviets those joint companies in which the Soviet share was *more than* 50 percent. The balance proved to be—not surprisingly—\$14 million in favor of the Soviet Union. Hungary settled this claim by paying half the amount in forints, which the Soviets were obligated to spend in Hungary, the other half by payment in kind over a period of four years.¹²⁶ In practice this meant that what the Soviets gave with one hand (a reduction in reparations) they took away with the other (the \$14 million payment). Further payments to Moscow included \$15 million under the 1947 settlement on German claims payable to the Soviet Union, and a four-year payment of 1 billion forints (1945: ca. \$90 million) starting in 1953 on payments for former “German” companies resold to Hungary.

An additional agreement on joint companies was signed in 1952, which extended the operation of Hungarian-Soviet units. MASZOBAL and MASZOLAJ devoured new companies. Fifty percent of the value of the companies which had been taken over was to be paid to the Hungarian government by the Soviets. The new treaty now secured the right to explore oil and bauxite on all Hungarian territory, including the concession previously enjoyed by the Hungarian-American Oil Company (MAORT), which was fused into MASZOVOL in

¹²⁴The 17th session of the first sub-committee of Hungarian-Soviet economic cooperation. Moscow,” 13 July 1949, MOL KÜM Szu tük, XI-J-1-j IV-510/b 26, doboz ikt. sz. n.

¹²⁵“Annex to the 13 December 1949 agreement,” 13 July 1949, MOL KgM Szu thk, XI-J-1-j IV-510/b 26, doboz ikt. sz. n. “The 17th session of the first sub-committee of Hungarian-Soviet economic cooperation. Moscow,” 13 July 1949, MOL KgM Szu thk, XI-J-1-j IV-510/b 26, doboz ikt. sz. n.

¹²⁶ “Protocol to the 31 December 1949 Agreement,” 31 December 1949, MOL KÜM Szu tük, XIX-J-1-j IV-548/1 35, doboz ikt. sz. n.

June 1952. As a result MASZOVOL came to control 99 percent of Hungarian oil production.¹²⁷

The 1952 agreement was the final one by which the Soviet Union acquired a direct influence over strategic branches of the Hungarian economy. As a result of the shift in foreign policy after Stalin's death in March 1953, in late 1954 the Soviet Union offered to resell the joint companies to Hungary. A similar step was taken in other countries with partially Soviet owned enterprises.

The Soviet economic offensive in the early post-war years reoriented Hungarian foreign trade. In 1946, the Soviet Union was already Hungary's most important trading partner, which was quite an achievement considering that before the war commercial relations between the two nations had been almost non-existent. Out of a commercial turnover of \$70 million, Moscow's share was \$30 million.

Furthermore, the cost of Soviet-Hungarian trade burdened the Hungarian treasury, which was forced to finance a part of the payments for the exports. In one case, this meant almost half the total cost. Until 31 December 1946, Hungary took 55.7 tons of fruit pulp to the Soviet Union, at a price of 6,935 forints per ton, which included a profit of 832 forints. Of the 6,935 forints owed, the Soviets paid only 3,100 forints. Thus, the fruit pulp exported to the Soviet Union cost the Hungarian treasury 3,815 forints per ton. In the first eight months of the 1946-1947 budget year, similar "hidden" costs reached 142 million forints, slightly more than the monthly foreign trade turnover. Another such example was coke. Hungary bought coal from the Soviet Union. The coke actually came from Poland, and the Poles received raw cotton in exchange from the Soviets. The coke was supplied to Hungary for steel products. In 1948 the world market price of coke was \$14, which the Poles gave up for \$12/ton cotton. Hungary paid \$17/ton steel products for the \$14 coke. Thus Moscow made a profit of \$5 on each ton of cotton sold in the deal.¹²⁸

¹²⁷MOL KÜM Szu tük, XIX-J-1-j IV-548/3 35, doboz 1717 sz. and NAWDC, RG 864. 053/7-1052; 764.00/10-2152.

The Elimination of American Investments

As in Romania and Bulgaria, Soviet economic penetration meant the elimination of foreign investments. This was the fate of American companies as well, most significantly in the oil industry. The largest Hungarian oil company, Magyar-Amerikai Olaj Rt.—Hungarian-American Oil Ltd. (MAORT)—was founded in July 1938 as the subsidiary of Standard Oil of New Jersey, with 94 percent of the shares being held by Standard Oil.¹²⁹ In 1941, it was sequestered by the Ministry of Industry without a change in ownership. Leadership was handed over by the American Paul Ruedemann to his Hungarian subordinate, Simon Papp, on 12 July 1945. Between April and August 1945, the Soviets took over the operation of all oil fields and oil refineries in Hungary, including those of MAORT. MAORT's sequester was terminated. In November Ruedemann resumed his leadership of the company.¹³⁰ A government plenipotentiary was assigned to MAORT to supervise production, since the company was involved in production for reparations. The plenipotentiary, Zoltán Gombos, instructed MAORT to maintain high levels of production. According to experts, such high production levels led to the loss of a significant amount of gas, and consequently, of oil. In 1945, 54.5 percent of production, 148 million cubic metres of gas was lost, oil production diminished from 810,000 tons to 655,000 tons as a result of an excessive exploitation of the oil fields.¹³¹

The question of American interests became one of the chief issues of conflict between the United States on the one hand, and the Soviet Union and Hungary on the other. Washington

¹²⁸Nicholas Nyaradi, *op. cit.* p. 254.

¹²⁹Department of State Research and Analysis Branch microfilm no. 3467. See also: Szurovy Géza, *A kőolaj regénye* [The Novel of Oil] (Budapest: 1993).

¹³⁰ In 1944, MAORT oil fields had yielded 809,969 tons of oil, and produced 3.1 million tons during eight years of operation. The company's war damages were estimated at 5.8 million pengős. The provision of the Hungarian armistice according to which Allied (including American) property had to be returned in good condition after the military administration was lifted, was not met.

¹³¹Szurovy Géza, *op.cit.* In 1946 oil production increased, but 60 percent of the natural gas was lost. The natural gas content of the oil fields drove the oil up. If oil is extracted too quickly, too much gas is lost. Eventually, not enough gas remains to enable oil extraction.

had the following aims concerning the protection of U.S. investments. First, that American companies, or those with significant American investment be able to operate free of discrimination under equal conditions; and second, that the shareholders receive dividends and compensation for war damages, or nationalization. Finally, Washington wanted to avoid the Soviet Union receiving American property as reparations. In order to secure these objectives, the U.S. ACC representative was empowered to act in the defense of U.S. interests with Voroshilov.¹³²

U.S. officials charged that oil fields were wastefully exploited with no regard for the correct method of utilizing an oil field; that Americans were kept away from production; and that the equipment and products of MAORT were taken away. Moreover, the Americans were afraid that the Soviet-dictated unbridled pace of oil production would cause serious, irreparable damage to the oil fields. For this reason, the U.S. government insisted that Soviet personnel be withdrawn from MAORT and that the company regain full control over its own activities. Yet, in spite of the State Department's protests, the Soviets retained control of the oil fields. The Hungarian-American Oil Company was unable to pay dividends, since state prices for its products were too low.¹³³ In 1945, MAORT produced 655,567 tons of oil, which experts considered too much and recommended that the following year's rate be fixed at 568 thousand tons until new wells could be brought into production. In response to the situation, the American shareholders' representative gave instructions for a 10 percent reduction in production in January 1946. This was not done.

The Russians, in fact, insisted on increasing production still further to 674,539 tons in 1946. In February 1947, communist cadres took control of the company. At their instruction, oil production was raised to a dangerous level and the price of crude oil was fixed so low that not even production costs were covered.¹³⁴

¹³²FRUS 1945 vol. IV, p. 815.

¹³³MOL KÜM, USA admin. XIX.-J-1-k 4/a 9, doboz ikt. sz. n.

¹³⁴*Ibid.*

In the same year, the Supreme Economic Council recommended a 10 percent reduction of the company's oil production. The Ministry of Industry proposed a more significant, 16 percent cut and was of the opinion that unless this was done, the following consequences could occur: half of the country's 7 million ton known oil deposit would be lost which would mean that the budget would lose 1.7 billion forints in the forthcoming 10-15 years. Furthermore, 3.5 million tons of oil represented six years' production and covered twelve years of internal consumption; MAORT would be able to demand \$50 million for compensation and finally, without the 16 percent cut, the rate of decline in production could reach 25-30 percent.¹³⁵

In early 1946, ACC representative General Key was instructed by the Pentagon to demand the withdrawal of Soviet troops from MAORT's oil fields. In February, a Soviet officer showed up at the oil fields and claimed that he had the ACC's instruction to manage MAORT property, including drilling, production and transportation. Voroshilov denied that MAORT property was under Soviet control and refused to allow the production cut demanded by the Americans. Deputy foreign minister Andrei Vishinskii explained that Soviet intervention was justified by Soviet expenditures on MAORT, German investment, and the importance of a high rate of production.¹³⁶

Washington found it especially painful that American companies received no payment for reparation deliveries. The Hungarian Office of Reparations was of the opinion that Hungary's reparation obligations could be fulfilled only if "we increase our exports ... in these exports companies with foreign relations will be in the vanguard ... the American foreign service must be made to understand that American firms operating in Hungary cannot receive special treatment..."¹³⁷ Special treatment was in fact reserved for the Soviet companies. Since the U.S. companies were not paid for their shipments, no dividends could be paid nor new equipment bought. MAORT, after the victory of the Smallholder Party in the 1945 elections ordered \$340

¹³⁵*Ibid.*

¹³⁶MOL KÜM, USA admin. XIX-J-1-k 55, doboz 3955 40739/4-1946.

¹³⁷MOL KÜM, USA admin. XIX-J-1-k 25/6 55, doboz 41132/4-6.

thousand worth of equipment, out of which only \$70 thousand worth is known to have arrived in Hungary.¹³⁸

On 2 April 1946, the U.S. Legation turned to the Hungarian Foreign Ministry to complain that reparation orders to Standard Electric Co. Ltd. were taking up the American firm's total production and in several areas even exceeded its productive capacity. Since the firm received payment in Hungarian currency and had no access to foreign currency, it was unable to purchase raw materials and equipment required for efficient operation and was unable to pay dividends to its shareholders. American shareholders were in effect bearing reparation burdens. Therefore, it was requested that American firms involved in reparations be remunerated either in foreign exchange or in goods that could be sold for foreign currency.¹³⁹ Prime Minister Ferenc Nagy responded that although the Hungarian government would "take into consideration the financial interests of the United States in the case of Standard Electric, as in all other cases,"¹⁴⁰ all ministries and government organs involved agreed that no foreign currency should be placed at the company's disposal for the purpose of paying dividends. The Hungarian National Bank thought it desirable to increase Standard Electric's export possibilities, so that its South-East-European markets could be preserved for Hungary. Thus, it was recommended that "no more than 30 percent" of the payments for her deliveries should be allocated to cover the company's imports. It was added that "at present time there is no possibility to transfer dividends owed to her shareholders." The Ministry of Industry expressed that "as far as the investment of foreign capital in Hungary is concerned, the government did not and will not take responsibility for the profitability of that capital, capital will always have to count with certain risks."¹⁴¹

In contrast, Soviet and Soviet-Hungarian companies enjoyed important advantages. They were guaranteed exemption from taxes and duties under the 1945-1946 agreements. They were allowed to transfer their profits, which were guaranteed in advance, to the Soviet Union

¹³⁸Szurovy Géza, op. cit.

¹³⁹MOL KÜM, USA admin. XIX-J-1-k 55, doboz 3955 40739/4-1946.

¹⁴⁰*Ibid.*

without limitations, as foreign currency restrictions did not apply to them. The Foreign Ministry did promise to attempt to reschedule reparation shipments and thus reduce export obligations, which was a precondition of increasing “free” exports. An increase of “free” exports in turn allowed for an income in foreign currency, a part of which was to be used to acquire new equipment. In response to Standard Electric's complaint, it was promised that the company would be allowed to have 30 percent of its foreign currency earnings in foreign exchange—hitherto all earnings had been available only in Hungarian currency. Foreign currency could be used to purchase necessary equipment and raw materials. Reparation shipments continued to go uncompensated, allegedly in order to curb rampant inflation. Nonetheless, it was promised that blocked accounts would be unfrozen after the stabilization of Hungarian currency. Finally, Standard Electric was informed that no currency was available for the payment of dividends.¹⁴²

Yet, even after the “stabilization” of the Hungarian currency, the government decided that, in protection of the new currency and stabilization, no claims of a financial nature could be asserted against the Hungarian state. According to historians Iván Pető and Sándor Szakács, “with stabilization, a tendency that had prevailed since 1945 was institutionalized and finalized, which, as a result of a now conscious economic policy made it impossible to accumulate private capital.”¹⁴³ This policy was a prelude to the final elimination of foreign (and Hungarian private) investments. In 1948, MAORT was sued for procrastinating the acquisition of new equipment, for trial boring where there was no hope of finding oil, for consciously deploying oil drills in such a way that would decrease potential production and for reducing production in order to sabotage the governments three-year economic plan.¹⁴⁴ As we shall see, this motion prepared the company's nationalization and merger into the Soviet-Hungarian oil interests.

The U.S. government outlined its position on nationalization on 29 May 1947. Nationalization was regarded as a *domestic affair of the given government*. On the other

¹⁴¹MOL KÜM, USA admin. XIX-J-1-k 25/c 55, doboz 40.736/4-1946. In 1943, it was valued at \$58,266,599

¹⁴² “The Foreign Ministry to the American Legation,” 27 June 1946, MOL KÜM, XIX-J-1-k 25/c 55, doboz 41.133/4.1946.

¹⁴³Pető Iván-Szakács Sándor, op. cit. p. 74.

¹⁴⁴MOL KÜM, USA admin. XIX-J-1-k 43 af. 9, doboz ikt. sz. n.

hand, Washington insisted on prompt, adequate and efficient compensation of the owners, stating that nationalization did not change obligations of foreign governments or their citizens towards the U.S. government and its citizens. Finally, it was requested that all companies be treated on the same terms.¹⁴⁵

In May 1948, Zoltán Vas, the head of the Supreme Economic Council, declared that American interests would not be nationalized and the state managers would be recalled. He said that a Communist supervisor had been appointed to MAORT because of overemployment and lack of discipline, and that 1,000 of the company's 4,000 workers would be laid off.¹⁴⁶

The U.S. Legation repeated that Hungarian prices did not cover production costs. Additionally, they argued that the government's insistence on overproduction which was harming both the company and the oil fields, was being done partly to reduce the profitability of the investment in the long run so that the *Hungarian government could then accuse them of sabotage*. If proper prices were given for shipments and the company was to be granted an export-quota, revenues could be used for new drilling and construction of pipelines thereby increasing investment.

In regard to Ford Motor Co., the Legation complained that it had not obtained an import license, while the Hungarian state owned company specializing in motor vehicles (MOGÜRT) was free to import cars. The Hungarian government was held responsible for American property that had been transferred to the USSR under the Potsdam Declaration. The Hungarian argument that the Soviet officials on the ACC, Marshall Voroshilov and Gen. Sviridov, gave orders for the transfer of these properties, was refuted with the statement that the United States had repeatedly informed Hungary that until the signature of a Peace Treaty it did not regard the implementation of the Potsdam Declaration either legal or necessary.¹⁴⁷

¹⁴⁵ "The Secretary of State (Marshall) to the Legation in Budapest," 29 May 1947, NAWDC, RG 59 864.5034/5-2947.

¹⁴⁶ "Discussion between Zoltán Vas and Harrison Lewis of the U.S. Legation," NAWDC, RG 59 864.50/5-2148.

¹⁴⁷ "The U.S. minister in Hungary (Selden Chapin) to the State Department," May 14, 1948, NAWD, RG 59 711.64/5-1448.

In order to solve outstanding problems between Hungary and the United States, several rounds of negotiations were held in Budapest during July 1947 in which Foreign Minister János Gyöngyösi participated. Gyöngyösi, however, was not empowered to make a statement on his government's political position. He was enabled only to sound out American complaints and investigate them.¹⁴⁸ Gyöngyösi emphasized his willingness for compromise. Among the questions to be resolved was the compensation of U.S. citizens, the restitution of Hungarian goods from the American zones of Germany and Austria, and compensation for the Ajka power station which had been a subsidiary of the partially American-owned, but nationalized Tungram Rt.

Hungary unilaterally declared that it would recognize as U.S. citizens Hungarians who had been naturalized prior to 1931 only, meaning that the properties of Hungarians naturalized after that date would be taken as Hungarian. Washington refused to accept this, even though the Hungarians promised compensation for nationalized property. The Truman administration clearly felt that it was in its competence to decide who was a U.S. citizen and who was not. Eventually, the Hungarians also acknowledged that the Soviet-owned companies were being given special treatment. Such as being allowed to purchase raw materials abroad and freely transfer their profits and dividends to the Soviet Union.¹⁴⁹

By late August 1948, the Hungarian-American talks broke down. One U.S. negotiator remarked that if things went on as they had been, the Hungarian government would get everything without having to give anything. Twelve sessions later, every issue remained unresolved; there was no agreement on war claims, the Hungarians paid no compensation, and the Americans froze the restitution of property from their zones. No meeting of minds occurred about American claims deriving from the land reform either. As far as nationalized property was concerned, an agreement was revealed on compensation, but neither the time nor the means were defined. Since the question of compensation remained unsettled the United States

¹⁴⁸ "Negotiations between the Hungarian and the U.S. governments," 16 July 1948, NAWDC, RSG 59 711. 64/7-1448.

¹⁴⁹NAWDC, RG 59 711.64/8-1248.

suspended the execution of Article 26 of the Peace Treaty, while Budapest did the same with Article 30.¹⁵⁰

The Nationalization Act of 1948 theoretically did not apply to property which was more than 50 percent owned, but this provision was ignored if the proprietor gained U.S. citizenship after 1931. In spring 1948, as part of the nationalization program, a state supervisor, Pál Székely, was appointed to MAORT. Hungarian authorities also accused all MOART experts of being “Hungarian agents of imperialism who intentionally installed 25 exploratory wells in the wrong place.” On 25 September, the government took over MAORT's management, and confiscated its assets and rights. The measure was based on a decree according to which the step was necessary in order to “prevent wilful sabotage of the production of crude oil ... and ... to secure undisturbed production.”¹⁵¹ In September 1949, the American-owned Union Textilmvek Rt. (Unio Textile Works Ltd.) was liquidated, its machines and equipment were taken away.¹⁵² A similar fate awaited Ford Motor Co. as the Hungarian state-owned company, MOGÜRT, took possession of its buildings and immovables. Borsodvidéki Bányaiipari Rt. (Borsodvidéki Mining Ltd.) was also nationalized, its owners were promised compensation—it never received any, and in return they were willing to renounce their ownership.¹⁵³ Since U.S. citizens were unable to protect their interests under the prevailing legal system in Hungary, the United States sought to intervene diplomatically so that her citizens might obtain compensation for their lost properties. Negotiations were initiated by Washington to that effect, but no response was forthcoming; Budapest resented that restitution of Hungarian property was halted from the U.S. zone.¹⁵⁴

¹⁵⁰Article 30 provided that those Hungarian goods which had been forcefully taken away by the German army or authorities after 20 January 1945 had to be restored to Hungary. Article 26 obliged Hungary to restore property belonging to the United Nations on its territory "as it now "exists.

¹⁵¹“The Deputy Director of the European Department (Hickerson) to the 1948 Deputy Secretary of State (Lovett),” 22 November 1948, FRUS 1998 vol. IV, p. 391.

¹⁵²MOL KÜM,USA admin. XIX-J-1-k 23/d 51, doboz 6151.

¹⁵³*Ibid.* 12619.

¹⁵⁴*Ibid.* 12619.

Nationalization sometimes even violated existing decrees, and certain enterprises were taken under state control, which in theory might have remained in private ownership. This further aggravated bilateral relations. Singer Sewing Machine Co. was just such a case. The Ministry of Domestic Trade justified nationalization by referring to a decree which in this instance was not applicable. The Foreign Ministry drew attention to the mistake, and later proper justification was used.¹⁵⁵ The case of a certain Autóipari Kft. (Motorcar Ltd.) is more intriguing. In this case, no proper legal justification was found and the Ministry of Foreign Affairs, which was more interested in maintaining Hungarian-American relations, came into conflict with the overzealous Ministry of Domestic Trade. This company belonged to a U.S. citizen by the name of Szunyogh, who had left Hungary in 1938. His enterprise was nationalized under decree 1310/1949(33), which, however, was applicable only to those who left the country illegally. The U.S. Legation made an appeal on Szunyogh's behalf and the Ministry of Domestic Trade accepted its validity, but maintained the decision to privatize the company under another decree, which applied to industrial enterprises with more than 10 employees and service shops larger than 100 square metres, but not to commercial ventures.¹⁵⁶

The Ministry of Foreign Affairs pointed out that the Domestic Trade Ministry was referring to an erroneous decision, which could be represented towards the United States, “since a previous incorrect measure cannot be the legal basis for this decision.” “It is strange,” said the Foreign Ministry memorandum, “that the Ministry of Domestic Trade should act so superficially, especially after we called their attention that another mistake might be made.” The Ministry of Domestic Trade was called upon “either to cancel the resolution or, if possible, find a different reason so that a proper answer could be given to the Legation of the United States.” The head of the Legal Division of the Ministry of Domestic Trade acknowledged that no legal basis could be found to justify the nationalization of Szunyogh's company. Assistant Minister Vajda was unable to comprehend though “why the Foreign Ministry was being so obnoxious, since they too are aware what economic policy was behind nationalization.” The Foreign

¹⁵⁵*Ibid.* 62.323.

¹⁵⁶*Ibid.* 12.846

Ministry complained on the other hand that this was not the first time it had to face such a situation and the affair was all the more unpleasant, since it might give the Americans an opportunity “to make a mountain out of a molehill concerning the affair.” Finally, no appropriate legal justification was found, the matter was closed and no further measures were taken.¹⁵⁷

In late 1948, the so-called sabotage trials were launched, which involved U.S. citizens as well. In September 1948, the two American directors of MAORT, Paul Ruedemann and George Bannantine, were taken into custody by the secret police (ÁVH). The actual arrest was made by the head of the secret police, Gábor Péter himself, but not without difficulty. According to the official account, an American of “huge size” appeared on the scene, who “threw a detective to a distance of 3 meters.” The American version of the same story recounted that a pistol was aimed on a Legation employee and the two individuals were taken away in handcuffs.¹⁵⁸ Minister of Foreign Affairs László Rajk informed the American Legation that the two had been taken into custody because several Hungarians had confessed against them to the effect that at Ruedemann and Bannantine's instructions, and with their active participation, "MAORT's oil production was sabotaged, so that the Hungarian state obtain less oil." Rajk pointed out that the two Americans confessed that they had acted on the orders of Standard Oil New Jersey. He refused to give information on where they were held and violating diplomatic norms he did not permit the U.S. consul to get in touch with the two Americans.¹⁵⁹

The former president and director of MAORT, Simon Papp had been arrested on 18 August. During interrogation Papp “confessed” that he set out to minimize MAORT's oil production, partly because of technical reasons and partly because he did not want to produce oil for the Russians. He then stated that Ruedemann was of the opinion that “oil production had to be reduced in Hungary because this is the United States' political and economic interest.”¹⁶⁰ In his own confession, Bannantine stated that he received instructions from the Standard Oil management “to reduce Hungarian oil production because of political reasons,” since “in the

¹⁵⁷*Ibid.* 12.846

¹⁵⁹*Ibid.*

¹⁶⁰MOL 276f. 67 cs. 155. őe.

future, Hungary might participate in a new war.” He also admitted to having caused “greater harm to Hungarian economy than what natural occurrences in oil production would have caused.” Ruedeman, in turn, confessed to his intention to influence production negatively, but not to giving specific instructions to this effect. He also denied an allegation in Papp's confession that they purposefully designated test drilling spots in places where no oil deposits could be expected.¹⁶¹ As a response to the arrests, the U.S. threatened to close the Hungarian consulates in Cleveland and New York, suspend the restitution talks and considered banning U.S. citizens from Hungary. These measures proved unnecessary, as the Americans were soon expelled from the country. The Hungarian participants were sentenced in a political show trial—Simon Papp was sentenced to death, which was then changed to life imprisonment. He was let free in 1955 with an amnesty.¹⁶²

The proceedings lacked any element of truth or legality. As was already mentioned, it was the Communist-led Supreme Economic Council which recommended a 16 percent cut in production in 1947 as “an unavoidable necessity”—otherwise the “drop in production would reach 25-30 percent.” The Council also thought that domestic and international needs could be met even if the 16 percent cut were implemented. This recommendations were sent to the Communist Party leadership.¹⁶³ Furthermore, not even MAORT's Communist Party members noticed that any sabotage was going on. Rákosi admitted this much at a meeting of the HWP Political Committee: “... the party organs not only did not signal to the party headquarters the machinations of the American leaders and their accomplices, not only did they not draw the attention of the party headquarters to the possibility of sabotage, but on the contrary, party members working at MAORT kept on saying to leading comrades ... from 1946 that there was no sabotage and that the constant decrease of production was justified from the national

¹⁶¹*Ibid.*

¹⁶² Gzurovy GJza, *A k`olÍ resPnye*, op. cit.

¹⁶³MOL 276f. 68. cs. 93 ÷e.

economy's perspective..."¹⁶⁴ An arrested geologist, György Kertay, who was MAORT's Communist Party secretary, admitted that he had "denied the possibility of sabotage."¹⁶⁵

The point is that production was being maintained. Sabotage did not have to be proven—it was taken for granted from the very beginning, as was American participation in it. On 26 August 1948, that is, even before Ruedemann and Bannantine were arrested, Papp's interrogating officer (!) reported to Rákosi "...I am already of the opinion that after sabotage will have been proven there will be no legal obstacle to annul the [MAORT] treaty which would mean that all of MAORT's properties can be immediately sequestered by the Hungarian Treasury."¹⁶⁶ The officer knew what result the interrogation had to produce. Beside MAORT's nationalization, the objective was to extract information on where to find oil, which the Hungarian-Soviet oil companies were unable to do. Colonel Timár reported: "...Since this afternoon we are urging occupying Simon Papp to give us positive information on how to increase production on known oil fields and how we can find new fields with fruitful research."¹⁶⁷ The HWP Political Committee also resolved also that "judicial proceedings in the MAORT affairs must be conducted within a month, and as a result of these proceedings the confiscation of all MAORT's assets and the termination of the MAORT concession must be ruled to cover the Hungarian state's losses which it suffered as a result of the sabotage."¹⁶⁸ True to the Stalinist practice, the verdict was ready even before the trial could begin.

Similar practices prevailed in the case of the arrest of Robert Vogeler, the deputy director of Standard Electric and IT&T on 18 November 1949.¹⁶⁹

The Soviet Union's economic stranglehold on Hungary had tremendous *political* consequences. First of all it severely curtailed Hungarian sovereignty and worked toward the

¹⁶⁴"Record of the September 23 meeting of the HWP Political Committee," MOL 276 f. 53. cs. 10. őe.

¹⁶⁵"Record of the interrogation of György Kertay, August 29, 1948," MOL 276 f. 67. cs. 155. őe.

¹⁶⁶"Colonel Timár's report to Rákosi," MOL 276 f. 67. cs. 155. őe.

¹⁶⁷*Ibid.*

¹⁶⁸MOL 276 f. 53. cs. 10. őe.

¹⁶⁹MOL KÜM, USA admin. XIX-J-1-k 11, doboz 4/bd. As part of the same affair a British citizen, IT&T representative in Hungary, Sanders, and the director of Standard Electric, Imre Geiger was arrested as well.

country's transformation along communist lines. Secondly, the Soviet economic dictates put a severe strain on Hungary's relationship with the Western world, which ultimately led to the breakdown of Hungarian-U. S. relations.

Washington held the Hungarian government responsible for the abusive implementation of the Potsdam Declaration, and it was not until the very end of 1949 that Moscow took it upon itself to handle protests against Soviet seizure of Western companies.

Hungarian intransigence on compensation for nationalized property led to the breakdown of bilateral US–Hungarian talks in 1948. Finally, in 1948 the “sabotage” trials which involved American citizens led to outright hostility between Washington and Budapest. Again, these trials had a lot to do with economy, namely the Soviet–Communist imperative that no capitalist investment should be allowed to survive. The motive of profit was not absent either; lucrative enterprises could be seized free of charge. The merchants of the Kremlin had every reason to be satisfied. Economic expansionism provided a continuous flow of wealth from Hungary to the Soviet Union, contributed to the Soviets’ unchallenged control and sovietization of Hungary, and last but not least provided a relatively safe way to decouple that nation from its Western links, to destroy the only kind of presence the Americans had hoped to maintain.

About the Author

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