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Financial Nationalism in the EU's East

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Following the 2007-08 global financial crisis and its aftershocks, financial nationalism experienced a resurgence in Central and Eastern Europe, particularly in Hungary and Poland. Financial nationalists seek to employ financial levers to promote national unity, autonomy, and identity, favoring national insiders over outsiders both as an engine for growth and as a bulwark against foreign influence. All of this is done in the name of the nation, as state financial activism and national patriotism become conflated. This financial nationalism has deeply challenged the European Union even as EU policies have bolstered the political power and material resources of financial nationalist governments. The EU now has the opportunity and responsibility to draw the line and finally reject these efforts to undermine and exploit the European integration project.

Financial Nationalism in Practice

Nationalists draw contrasts between national insiders as opposed to "foreign" outsiders, and identify both groups through collective rather than individual characteristics. Although nationalists typically identify with a particular state, they usually do not consider all citizens or residents of that state to be members of the nation, while individuals outside state borders may be included as national compatriots. Nationalists, like populists, often view "elite" transnational expert communities and standards with suspicion.

Financial nationalism involves directing these nationalist sentiments towards the financial sector. Financial nationalists will attempt to steer financial resources to national insiders for avowedly nationalist purposes, employing insider-controlled commercial banks, state-owned banks, or the central bank to do so. This may involve forcing existing foreign-owned banks out of the country or to transition from majority foreign to majority insider control, applying new discriminatory financial and access policies, the mandatory conversion of existing foreign-currency instruments to domestic currency, and the reduction of central bank independence. Financial nationalists will typically also promote the use of the state's currency in domestic consumer pricing, savings, and private and commercial loans, and to the extent possible will support its spending through public debt denominated in domestic currency. They will promote the physical currency as a national symbol and emphasize its use in daily transactions and savings as a patriotic act.

Financial nationalists came to power in Hungary in 2010 and in Poland in 2015. In Hungary, Viktor Orbán and the coalition led by his center-right Fidesz party won constitution-busting parliamentary supermajorities in the April 2010, 2014, and 2018 elections running on a nationalist-populist platform of economic self-rule. As early as 2012 Orbán began using the term "economic patriotism" to describe his government's policies.[i] The government heavily concentrated its rhetoric on the financial sector, and worked quickly to domesticate the private financial sector and to balance its budget on the backs of foreign financial institutions. In 2010 over 85% of the Hungarian banking sector was foreign owned. The government's first “crisis tax” was aimed at these banks, seeking to raise Ft200 billion through a progressive tax on bank assets. Bank taxes were increased twice more, in 2012 and 2013, contributing to record losses in the sector. These measures served their dual purpose of reducing the federal deficit and significantly re-nationalizing the Hungarian financial sector. The government had achieved the 50 percent target by 2014 through foreign exit and domestic acquisition of major institutions. The government moved at the same time to establish control over the National Bank of Hungary (MNB). The MNB subsequently took several measures to support the financial nationalist agenda, including a push to re-domesticate Hungarian debt, financing insiders through low-interest forint loans, and converting foreign-currency loans to forint at below-market interest rates. Furthermore, the MNB and government have established a series of well-funded foundations that have increasingly taken over the higher-education sector, with the intention both of reinforcing nationalist, conservative doctrines and channeling financial resources to Fidesz supporters.

In Poland, even before its electoral victory in 2015 the Law and Justice (PiS) party adopted a nationalist outlook and made policy pledges consistent with financial nationalism. Such views helped PiS win the presidency in May 2015 and a parliamentary majority in October 2015.

Indeed, Ahlquist et al. argue that PiS would not have won its parliamentary majority without support from voters who had borrowed in Swiss francs and responded to PiS's campaign promises to bail them out.[ii] Like Fidesz, the PiS government declared its intention to remain outside the euro zone indefinitely despite the lack of a derogation and to conduct a nationalist monetary policy. PiS quickly gained control over the National Bank of Poland and the Financial Supervision Authority. Taking another page from the Fidesz playbook, PiS introduced a tax on banking assets in January 2016, while exempting state-owned banks. PiS also followed through on its promise to “re-Polonise” the banking sector by reducing foreign ownership, and through a series of mergers and state acquisitions, the Polish state came to control over 50% of banking assets in the country. In addition, the PiS government actively promoted the shift of government bond ownership from foreign to domestic in order to reduce its vulnerability to external shocks. A more active political opposition has kept PiS in relative check as compared to Fidesz, however, and forced it to water down many of its preferred policies.

How the EU Enables Financial Nationalism

It is no accident that the post-communist region’s strongest financial nationalist governments have arisen in new EU member states; the political legitimacy and financial resources that come with EU membership have been critical to their success. Turning rhetoric into policy requires gaining significant control over the political system, since implementing financial nationalist policies means a re-centralization of financial power into the hands of national insiders and state bodies. EU officials have long remarked on increasing political authoritarianism in Hungary and Poland with dismay, but until recently have taken few concrete steps to challenge it.

In turn, having financial nationalist policies yield economic fruit rather than fiscal disaster requires external material resources. The EU has steadily provided these resources both indirectly and directly via the international bond market, trade relationships, and fiscal transfers.

A first, and critical, reserve of capital has been the international bond market. Bond traders have a single-minded commitment to returns relative to risk, without much regard for considerations such as political openness, nationalist policy goals, or even negative treatment of foreign-owned financial institutions. For bond markets, EU membership combined with low budget deficits and inflation have made Hungary and Poland relatively good bets. The Orbán government has held dozens of successful bond auctions since coming to power, is regularly able to raise money through bond offerings, and has been able to do so at reasonable yields. Similarly, bond markets have put little meaningful pressure on the Polish government to change course. Although financial publications are replete with negative comments from fund managers, the actual traders continue to focus on the government's ability to make its payments on time.

Second, trade bloc memberships can provide a steady source of funds. For Hungary and Poland, belonging to the EU has been invaluable in this regard, as membership keeps the European market fully open to their goods. In fact, Hungarian exports reached record highs under the Orbán government. European countries accounted for 88% of Hungary's exports and 89% of Poland's exports in 2020, providing a key source of revenue.

Finally, and most importantly, the European Union has directly transferred extensive resources to Hungary and Poland's financial nationalist governments. Hungary has been one of the largest net recipients of EU funds relative to gross national income throughout Orbán's time in power. One European Commission report estimated that EU funds in the 2007-2013 budget cycle boosted Hungary's GDP by 5%, while the 2014-2020 budget cycle allocated more funding to Hungary on a per-capita basis than any other country besides Lithuania.[iii] On an absolute basis, Poland is one of the largest fiscal beneficiaries of these arrangements in the entire EU. The Multiannual Financial Framework for 2021-27 continues this pattern, with Poland scheduled to receive the largest absolute amount of EU cohesion funds and Hungary the sixth largest.[iv] The EU has occasionally delayed tranches of money as it investigated alleged corruption in bidding processes but has not - yet - been willing to impose meaningful financial penalties. These constant injections of EU funds allow both governments to reward national insiders, to appear more fiscally responsible on paper than they are in practice, and to use EU financial resources to consolidate their political and institutional power.

The EU at a Crossroads

Thus far the EU has not fully acknowledged its role in enabling financial nationalism to gain a foothold in the new-member states. Fidesz and PiS could not have successfully implemented these policies without relying on the political legitimacy and external resources that have come with EU membership. Financial nationalism's apparent success in Hungary and then in Poland, combined with rising conservative populist sentiment in the region, has encouraged parties and politicians in other states – most notably the Czech Republic, Slovakia, Romania, and Serbia - to flirt with financial nationalist rhetoric and policies as well. Meanwhile, the parallel rise of financial nationalism and financial statecraft in Russia, particularly in response to US and EU sanctions, further encourages would-be financial nationalists in the EU's east and threatens European integration.

Concerted EU pressure could change financial nationalist governments' behavior in Hungary and Poland, which would then likely take the momentum away from the movement across the EU's east. The EU has little direct leverage over financial nationalist policies themselves as long as government macroeconomic indicators remain stable and within accepted limits. However, if EU officials can put meaningful financial pressure on the Hungarian and Polish governments for their rule of law violations, it could ultimately have the same effect. After years of inaction, EU officials appear to be willing to consider applying such pressure. On April 29 the Orbán government abruptly reversed course and declared that it would not take out much-needed loans under the EU's Recovery and Resilience Facility after talks with Commission president Ursula von der Leyen made it clear that the loans would come with requirements to make the Hungarian procurement process more transparent.

The EU's big stick, however, could be December 2020's Regulation "on a general regime of conditionality for the protection of the Union budget".[v] This Regulation would allow the Commission to impose penalties on countries whose rule of law violations imperil the "financial interests of the Union." Fidesz and PiS have asked the European Court of Justice to consider an annulment of the Regulation, temporarily delaying its implementation. EU officials should press for a fast-track ruling that could allow it to come into force this year. The Covid recession has already put the Fidesz and PiS governments under unaccustomed financial pressure, and parliamentary elections are scheduled for spring 2022 in Hungary and fall 2023 in Poland. It is time for EU officials to draw the line and refuse to pay for their own member-state governments to undermine European integration and the legitimacy of the European project.

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[i] Viktor Orbán's speech at the 25th Bálványos Summer Free University and Student Camp, 26 July 2014, Tusnádfürdő (Băile Tuşnad), Romania.

[ii] Ahlquist, J., Copelovitch, M., & Walter, S. (2020). The political consequences of external economic shocks: evidence from Poland. *American Journal of Political Science*, *64*(4), 904-920.

[iii] European Commission, *WP1: Synthesis report: Ex post evaluation of Cohesion Policy programmes 2007-2013, focusing on the European Regional Development Fund (ERDF) and the Cohesion Fund (CF)*, *Task 3 Country Report, Hungary*, September 2016; http://ec.europa.eu/regional_policy/sources/docgener/evaluation/pdf/expost2013/wp1_hu_report_en.pdf.

[iv] See https://ec.europa.eu/info/strategy/recovery-plan-europe_en#figures

[v] See https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32020R2092&from=EN